SOMETHING CAN BE DONE*

In the calendar year 1944 the Dominion of Canada collected from a population of approximately 12,000,000 people the sum of $1,620,474,875.00[1] in income tax and excess profits tax equivalent to approximately $135.00 per capita. Included in the above figures is the sum of $809,570,762.00[1] from individual income taxpayers under the Income War Tax Act (exclusive of any excess profits tax paid by such individuals in respect of businesses carried on by them) equivalent to approximately $68.00 per capita. This vast sum paid by individuals is not taken solely from the so-called rich. Persons earning less than $5,000.00 per annum were called upon to pay $470,700,000.00 in the tax out of their 1944 earnings. The taxable income of all persons in Canada having a taxable income in excess of $5,000.00 a year amounted in the aggregate to $657,000,000.00[1] in 1944. The aggregate of income taxes payable by those persons for the year 1944 was $285,300,000.00.[1] Therefore if all taxable incomes in excess of $5,000.00 a year were taxed 100% in respect of the excess, the government could only obtain an additional $371,700,000.00 a year. After payment of existing income taxes, the taxpayer with a taxable income of $5,000.00 has left approximately $2,700.00 a year on the average Therefore if no person in Canada could keep more than $2,700.00 of taxable income each year, the government could only collect another $371,700,000.00 assuming that our national income remained at the war level of 1944 during the years of peace. In many incidents of the income and excess profits taxes the Canadian rates are the highest of any country in the world.

Two very informative and interesting papers were delivered at the last meeting of the Canadian Bar Association by J. A. MacAulay, K.C., and Leon J. Ladner, K.C. outlining the history of income tax laws in the United Kingdom and Canada, and demonstrating the impact and effect of income tax legislation on the national economy. They have shown that wise and well-considered income tax laws promote national prosperity, while tax statutes which cause uncertainty and fear in the psychology of the investor stifle business and industrial development and contribute substantially to national depression which we are all so anxious to avoid, particularly in the post-war period. My

*A paper prepared for the Annual Meeting of the Canadian Bar Association scheduled for last August but cancelled owing to governmental travel restrictions.

[1] Dominion I.T., E.P.T. and S.D. Statistics, 1944.

purpose is to illustrate some gross inequities in our tax laws, to support many of their conclusions, and to suggest some remedies not heretofore advocated, so far as I know, before this Association. I shall endeavor to avoid repetition.

In the above circumstances it would seem that income tax and excess profits tax should be fairly and equitably distributed, but, in fact, not only is the present tax severe, but in many instances unjust, unfair, discriminatory, and uncertain.

It may be said by some—why all this furore about the inequity, injustice, and discrimination of our income tax laws at the present time, when, with the exception of excess profits taxes, these alleged inequities, injustices and discriminations have existed in the main since 1917? The answer is—Firstly, when the rates were low and the exemptions comparatively high and the number of income taxpayers was small, a small protesting minority would be as the ripple of a rivulet against the thunderous cataract of the demagogic cry "soak the rich". The inclusion of a million new taxpayers and the severity of the tax by reason of the exigencies of war, and the plan of the supreme economic planning group of Canada, have made the majority of the people of Canada more tax conscious than heretofore. The tax is now hurting a lot of people. Secondly, the rigidity of administrative interpretation of many obscrue and confused sections of the tax Acts during the past four years as contrasted with the liberal interpretations based on the merit of the taxpayer's case which prevailed prior thereto, has caused taxpayers to resent administrative law, and lawyers and accountants to ponder the wisdom of allowing the continuance of parliamentary enactments which do not clearly define the quantum of tax payable, and the continuance of a system which makes the accuser, the judge,—and in many cases the final judge,—of the taxpayer's liability for payment. Thirdly, the enactment of retroactive provisions which impose taxes where none existed at the time of the determination of the business man to enter upon the venture and to risk his capital for the return of a calculated profit, aggravated by the recent endeavor to impose taxes by Order-in-Council retroactively for the years 1940 to 1943 when Parliament legislated that the tax should be applicable only for the year 1944.[2] To summarize, the severity of the tax during recent years and the necessity of its continuance to provide social services have focused

[2] Sec. 5, ss. 4 of E.P.T. Act, and Order-in-Council P.C. 148–5311 (August 1st, 1945.)

attention upon the long existing defects of the income tax laws and they, which were latent except to the few, have become patent to the many.

The existing tax is severe.

The severity of the income tax is apparent when one realizes that an unmarried taxpayer without dependents receiving an income from investments of $100,000.00 per annum is only allowed to keep $18,463.00. If the same taxpayer had an income from the same sources of $200,000.00 he would only be allowed to keep $20,496.00; or that a married man, with a wife and three children to maintain, in receipt of an income of $1,300.00 per year, pays $3.00 income tax; or that an unmarried person earning $15.00 a week pays $38.00 in tax each year.

Something should be done.

The existing tax is unjust.

Farming is our basic industry. According to the last census there were 1,085,781 rural families in Canada. Probably more than one-quarter of the population are dependent upon this industry. The farmer's income tax is calculated on something claimed to be his *annual* income, which is usually nothing of the kind. A farmer reaps his grain in the fall. Prices are low and he holds it to the following spring. He then sells, in the following fall, his grain crop of both years. The profits realized from the two crops have to be returned for income tax in one year and the farmer will have to pay a much higher rate than if the crop had been sold in each year. The farmer raises a colt and has to feed it for four years before the colt can be sold, but the profit from the raising and feeding of the colt is received and taxed in one year. The farmer's wife, in addition to her household duties, does a great deal of manual work on the farm. If the farmer pays his wife for the work done, he cannot deduct it from his income. On the other hand, the wife of the city man can take employment outside the home and can earn up to $660.00 without payment of any tax thereon and without increasing the taxes payable by her husband.

We need not limit our illustrations to the rural community. Let us take an urban resident who operates two separate businesses. Section 10 of the Income War Tax Act provides that "the income of a taxpayer shall be deemed to be not less than the income derived from his chief. . . . business. . . ." Which business is his chief business? In many cases, your guess would be as good as mine. If one business made profits and the other losses,

I would have no difficulty in answering for the National Revenue Department. Seriously, however, if both have profits, the taxpayer pays on the graduated scale on the aggregate of the profits, but if one has profits and the other losses, the losses of the one cannot be deducted from the profits of the other despite the definition of section 3 of the Income War Tax Act that "income" means the *net* profit. . . . being profits from. . . . business received by a person from *any* . . . .business.

Something should be done.

The present tax is unfair.

Under the present schedules of income taxes a married taxpayer earning $1,200.00 per annum pays no tax, but if he earns an additional $100.00 per annum, namely $1,300.00, and has the additional burden of three children to maintain, he has to pay a tax of $3.00. To permit such a discrepancy is very short-sighted policy in the national interest. No such married man can give his children an opportunity for adequate education. The income earning power of the succeeding generation is fixed by the degree of education possessed by such generation. According to a recent survey, published by the Sun Life Assurance Company of Canada, the life earnings of a boy are determined by his schooling. Here is the schedule:

	Boy starts work at age	Average Yearly Earning	Lifetime Earnings
Elementary School Only	14	$1,400.00	$ 64,000.00
High School Graduate	18	$2,100.00	$ 88,000.00
College Graduate	22	$4,600.00	$175,000.00

Every married man with children should have a minimum exemption of $2,400.00 a year.

If you take out War Risk Insurance on the assets of your business you can only deduct, as an expense of earning the income, 18% of the premium from income taxes and 22% from excess profits tax, notwithstanding the fact that you can deduct the full premiums on every other kind of insurance.

No deduction for obsolesence is permitted, probably due to the fact that, at the time of the origin of the English Act Act after which our Act is patterned, modern inventions were unknown. We copied our Act from the English Act of 1917 but in 1918 deduction for obsolesence was introduced into the English Act. Many manufacturers struggle on with obsolete machinery until it is 100% depreciated under depreciation schedules, thus

increasing the cost of production. Yet we hope to maintain our national income and full employment by vast exports of goods which can only be sold in world markets on a price basis in competition with mass production goods from modern machinery.

Something should be done.

The existing Tax Acts are discriminatory.

Mr. X was in business for a number of years in Ontario. Mr. Y had three similar businesses in Alberta. They decided that each could be of assistance to the other in operating more profitably the existing businesses in Alberta and acquiring other similar businesses. To equally share in the operation, control, and profits of the combined ventures they caused to be incorporated in 1941 the "A" Company (each holding one-half the issued shares thereof). On the acquisition of each of five businesses—all of which had been in operation for some years—they incorporated the B, C, D, E and F companies successively as wholly-owned subsidiaries of the "A" Company, each to operate each business acquired, and the "A" Company advanced by way of loan to each subsidiary company such capital as it required for its successful operation. Each company filed its own returns for income and excess profits tax and, as new companies (incorporated since 1940), applied to the Board of Referees under the Excess Profits Tax Act to fix for each a standard profit. In 1943 section 15A of the Excess Profits Tax Act was enacted whereby all the subsidiary companies B, C, D, E and F are purportedly prohibited from going to the Board of Referees and their standard profits are fixed at $5,000.00 in the aggregate for all, to be apportioned among them at the Minister's discretion. In effect the first $5,000.00 of their joint profits are taxed at 30% and all their profits in excess of 116 and ⅔% of $5,000.00 must be paid to the Crown. But if these companies had had the good fortune to file during their existence a consolidated return for tax purposes, the amount of taxes payable would have been very much less. In such event, under section 4A(1) of the Excess Profits Tax Act, the standard profit of the subsidiary companies would have been $25,000.00 in the aggregate. Had X and Y, upon incorporation of the B, C, D, E, and F companies, each held half of the controlling shares personally, instead of vesting them in the holding company "A", you would have had a different result from either of the above set out. In this event each company could have gone to the Board of Referees to have a standard profit fixed for it and would only have been taxable for excess profits for the amount in excess of the standard profits so fixed. On January 2nd 1945

the shares of the subsidiary companies were sold by the "A" company to the individuals Mr. X. and Mr. Y. The result is, I submit, that each company is entitled to go to the Board of Referees to fix for each company a standard profit for the year 1941, and each pays as excess profits tax on the amount in excess of its standard profit so fixed (section 15A is only operative for 1942 and subsequent years); for the years 1942, 1943 and 1944 each pays excess profits on any amount in excess of $1,000.00; for the year 1945 and subsequent years each pays excess profits as in 1941; provided Treasury Board does not declare itself to be of opinion that the main purpose, for which the sales and transfers of shares from the "A" Company to the individuals in 1945 were effected, was to avoid or reduce liability for tax, in which event Treasury Board will determine what the respective companies are to pay. Such is the chaotic condition of our tax laws under which private enterprise is to function to maintain the national income and provide full employment, It may be said by some that the companies should have chosen in the beginning the form of return and the corporate structure to avoid additional tax. Their management would have had to be prescient indeed to have foreseen the situation, as section 15A was enacted May 20th 1943 retroactive to 1942, and section 4A was enacted August 15th 1944 retroactive to 1940.

Something should be done.

In his paper "Postwar Tax Impact" delivered by Mr. Ladner last year, the absurd extent to which Parliament has gone in abdicating its precious and exclusive function of imposing taxes by vesting discretionary powers in the Minister of National Revenue was clearly demonstrated. Yet I would not advocate divesting the Minister of all discretionary power. The discretionary powers may be divided into three broad classes. (1) Those which give power to find as a fact. No person whose duty it is to collect a tax, if one is payable, should have power to determine as a fact that which makes the taxpayer liable or not liable for payment. (2) Those which give power to find as a fact that which is determined by existing factors irrespective of the Minister's judgment—e.g. whether a debt is a "bad debt" can only be determined by the inability of the creditor to collect by due process of law. No Ministerial discretion can make a good debt, bad, or a bad debt, good. If a "bad debt" is to be artificially determined for the purposes of the Act, then enact a code of rules by which it is determined. (3) Those which give power to determine which previously settled principles of law or account-

ing are applicable to particular circumstances. The intricacies and varieties of business organizations and transactions necessitate the retention of this type of discretionary power. But I suggest that never under any conditions should such discretionary power be absolute as this leads inevitably to autocracy. Specific provision should be made that the Minister should exercise a judicial discretion so that the same may be subject to review by the law courts of the land.

Something should be done.

The existing Tax Acts are uncertain.

Not only are the taxes severe, unjust, unfair, and discriminatory, but the interpretation of the statutes defies the wit of man. No good purpose can be achieved by stating that the Canadian Act is worse than the English Act or better than the Australian or approximately the same as the South African. They all spring from the same root—the English Acts, and are carelessly drawn. His Honour Judge Konstam, who sat on two Royal Commissions and is the author of the well-known text-book now in its ninth edition states:

> The Income Tax Acts . . . do not provide a code of law on the subject. They consist of a number of more or less disconnected enactments which leave undealt with many matters of first importance; while they frequently cover the same ground more than once in such manner that the reader is puzzled to know whether the second enactment is intended to limit or expand the first or is merely superfluous.[3]

Lord Macmillan, who is well-known in Canada for his work some few years ago in connection with our railway situation, was Chairman of an English Commission "to prepare a draft of a Bill or Bills to codify the law relating to income tax with the special aim of making the law as intelligible to the taxpayer as the nature of the legislation demands. . . .", and reported on behalf of the Commission, excerpts of which are as follows:

> Unhappily the actual language in which many of the statutory provisions are framed is so intricate and obscure as to be frankly unintelligible. Probably no chapter of our legislation has incurred more condemnation from the judiciary for its drafting imperfections.
>
> The fact that this branch of legislation cannot avoid being technical and complicated is no excuse for perpetuating its present confused and illogical shape.
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> The present state of affairs is intolerable and should not be allowed to continue.[4]

[3] The Law of Income Tax by Konstam, 9th ed., p. 5.

[4] 1927 Comm. (Eng.) Report 1932 "Income Tax Codification Comm. Report".

Our own Rowell-Sirois Commission stated with reference to our own Acts:

> The present complexity is beyond belief . . . they have grown up in a completely unplanned and uncoordinated way and violate every cannon of sound taxation.

Such was the comment prior to the war. During the past few years amendment has been piled upon amendment to meet the exigency of one or more particular cases without due consideration or regard to the resulting effect, far different than anticipated. They were probably drafted by the Legal Committee of the Department of National Revenue, reviesed in the Finance Department, changed in the Justice Department, resulting in an enactment very different from the original draft and creating a result which was never anticipated. Had it not been for the good sense and reasonableness shown by the senior officials of the Department of National Revenue in the practical application of our legislation and the interpretive rulings issued by the National Revenue Department devising expedients for making good their deficiencies and omissions, the amendments in many respects would have proved unworkable. But the aforementioned common sense and reasonableness is frequently frustrated by government policy. Any section of the Act which requires interpretive rulings to tell us what it means should be repealed and re-enacted.

Accountants have a more intimate knowledge of the inequities produced by the Canadian Acts than any other group. In an editorial of The Canadian Chartered Accountant it was stated:

> **One of the postwar 'musts' is a revision of the income tax itself. It stands today as a horrible example of piling amendment on amendment.[5]**

It is difficult to understand how a nation whose forebears produced Coke and Blackstone can longer keep on its statute books Acts so severe to all, discouraging to investors, unjust and unfair to rich and poor alike, and which cause so much irritation and confusion to taxpayers as to propagate evasion.

Something should be done.

Time moves on with winged heels. V–E Day and V–J Day have passed into history. The Postwar Period is upon us.

Something can be done.

[5] The Canadian Chartered Accountant, October, 1944 Issue, p. 195.

1. The severity of the tax upon present taxpayers can be ameliorated without material loss of needed revenue. Income tax in principle is a fair and equitable tax, but all the actual annual profits of all persons and corporations should be taxed, not what is declared to be annual income to some persons when in fact it is not, while other persons have actual income which is tax-free. I mention but two of many sources of additional revenue :

(a) Income of Co-operatives actively carrying on business in competition with taxable persons or corporations.

(b) Income from Provincial and Municipal Public Utilities. Recently the Province of Quebec expropriated the Montreal Light, Heat and Power Company to operate the same as a public utility. As a result, the gross revenue from income and excess profits taxes is reduced by $8,515,341.00 per annum, the taxes previously payable while operated as a private enterprise.[6]

2. To obliterate the injustice, unfairness, and discrimination, create a separate Department of Income Tax with its own Minister and Deputy Minister specially qualified by knowledge, experience and vision — there is no better than the present Deputy Minister (Taxation) — and a special branch of such Department to study the clarification of the existing Acts, the necessary amendments thereto, and the available additional sources of true income and profits to be taxed. I do not suggest that the Act should be re-drafted but it should be overhauled and where the language is obscure or ambiguous it should be made plain. To do this the branch should first prepare a legal dictionary showing what interpretation has been placed by the judiciary on words or phrases actually used in the Acts. Such is frequently different from the ordinary meaning, and in drafting it is useless to use a word thinking it has one meaning, if, when a dispute arises, the courts hold it has another. This would involve the collection and briefing of thousands of cases. They should examine the legislation in force in other parts of the British Empire in particular and all democratic countries in general. They should examine and digest the various reports of Royal and Departmental Commissions who have considered tax matters, problems and Acts and the evidence given thereat. Then the branch should study and clarify each section in turn or first deal with the most important sections and then with

[6] *Montreal Gazette* Article (1943 taxes of M. L. H. & P.).

the lesser. Concurrently with the above proceedings, studies could proceed with a view to accomplishing the desired purpose. The Department of Finance could still settle the income tax policy, and I believe still maintain that secrecy surrounding fiscal policy which seems to be so highly prized in this country. But, having determined such policy, it should be communicated to the new Income Tax Deputy Minister and then have the necessary amendments to the Act drafted by that Department, enacted as drafted, and the tax collected by that Department without interference.

3. Create a Board of Tax Commissioners and take much of the existing discretionary power from a Minister of the Crown. The right of appeal of the taxpayer to the Minister from any assessment should be transferred to the Board and an appeal should be from the Board to the Exchequer Court of Canada. The present provision requiring a deposit of $400.00 to appeal to the Exchequer Court should be repealed. The small taxpayer should have the opportunity of having his case decided by a court of the country. Where can he accumulate $400.00? This appeal should be facilitated, instead of being the privilege of the few. The Board should consist of nine to twelve members including a Chairman and teams consisting of two should travel throughout the country on circuit, the Chairman remaining in Ottawa, similar in organization and function to the former Board of Pension Commissioners. Each team should be assigned to different Provinces on each circuit tour, thus meeting the objection that Provincial influences and prejudices would produce disparity in administration. In any case involving rulings, or interpretations of any Acts, the judgment of a team should not be pronounced until reviewed by the Chairman of the Board or, if deemed advisable by him, by a majority of the whole Board. The decisions should be published and thus a jurisprudence established available to all who would read and know. Every taxpayer is entitled to know — not years after the income is earned when he receives his assessment, but now—the tax for which he may be liable. A taxpayer would be able to have a matter involving discretion determined by a judicial tribunal before which he could appear without the expense involved of travelling hundreds of miles to submit his case to the head of the Department. Though Parliament vests a discretion in the Minister, everyone knows that such discretion is seldom exercised by him but by numerous officials of the Department. It has been stated before the Committees of this

Association that, if the taxpayer bears the cost of going to or sending a representative to Ottawa, the errors in the exercise of discretion by officials in the divisions will be rectified by Headquarters. This is not so always. I cite an instance: An Inspector of a Division in the exercise of the Minister's discretion, pursuant to sec. 6, sub-sec. 2 of the Income War Tax Act, decided that part of the rental paid by a taxpayer for the premises in which the company carried on business should be disallowed as an expense incurred to earn the income, on the ground that such amount was not "reasonable and normal". The matter was submitted by counsel for the taxpayer to the designated official of Headquarters at Ottawa. The material filed showed, *inter alia*, that another Department of Government was paying a higher rental for similar space in similar premises in the same city. The Headquarters' official was convinced, I believe, that the Inspector was in error. The Inspector finally conceded that the rental paid was "reasonable" but adhered to his position that it was not "normal". The Headquarters official could not or would not overrule the Inspector. This is not a criticism of any official of the Department. The Deputy Minister and his officials are intelligent, conscientious, and hard-working, much understaffed by reason of a shortage of qualified manpower and the additional burden of a million new taxpayers in the last few years. It is a criticism of the legislation and the system. A taxpayer is entitled to have such questions determined by a judicial tribunal and not by those charged with the responsibility of collecting taxes and susceptible to carrying out the policy of the government of the day.

4. Increase the salaries of the Deputy Minister and many of the officials, including Assessors, of the Department. Security of tenure of office plus a pension or superannuation for which the employee pays a premium, deducted from his modest salary, is not compensation for the services rendered. The present Deputy Minister is a profound lawyer, with superior knowledge of accounting, and a judicial mind, and a student of tax problems, qualifications not readily found to be combined. Most of the departmental officials are intelligent, industrious, courteous and honest, qualifications much desired by private enterprise. It would be easy to profit by dishonesty when all one has to do is fail to see an obscurity in a taxpayer's return. Some of these officials to my personal knowledge have been offered more remunerative positions to leave the Departmental service. Their salaries have not been increased, except possible small statutory increases, since 1935. The cost of living has increased at least

18% since the outbreak of war. Income taxation is a difficult and technical subject. If the research branch is established, which I have suggested, it will require specially qualified personnel which cannot be entirely recruited from within or from without the service, with present Civil Service classifications and salary ranges. No Deputy Ministership will be more important or should be more remunerative. If a real job is to be done, the reward for faithful service must be adequate and attractive.

I omit deliberately any advocacy of the abandonment of the practise of retroactive legislation in tax matters, because, if it is not now, it will be a subject of political controversy.

The lawyer, pictured in canvas and in story, seated in his dishevelled office surrounded by musty and dusty law books, removed from the current problems of business, shunning controversial public questions and confining his efforts to the interpretation of existing laws, is part of antiquity. Modern business is never static. It is new, involved and intricate. The most important factor to the creator of new business, resulting in new sources of income, more employment, and more prosperity, is not how much can he make, but how much can he keep after he has paid his toll in tax for the privilege of functioning in a democratic country with a free, but responsible, enterprise economic system. The modern lawyer must not be content with guiding that business-man on the present tortuous and uncertain path through the pitfalls of income or profits tax, but, in the public interest, must actively participate, through the Canadian Bar Association and any other channels available, in securing a path, straight, firm and clear so that all who venture may know with reasonable certainty, the reward of him who attains the goal.

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