TAXATION LAW: 1923-1947

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I. *General Considerations*

To the lawyer practising in the sphere of business law, the term "Taxation Law" has attained a well-accepted meaning. To him it usually means income tax law and rarely includes the law governing customs duties or the many manifestations of excise taxation, perhaps because these subjects, unlike income tax problems, are not often met in a legal practice. Quite apart from this, however, income tax law is by far the most important subject in taxation law to the lawyer and the taxpaying public. While excursions into other parts of the broad field might be interesting in an academic sense, their relative importance and the limited space available have led me to limit this review of the development of taxation law in Canada during the last twenty-five years to a consideration of income tax only.

The year 1947 is a turning point in the development of Canadian tax law. In 1947 the old order disappeared from the Canadian scene to be replaced by new administrative direction and new legislation. If for nothing else, 1947 is memorable for the coincidence of two events of major importance. In that year the administration of the Taxation Division of the Department of National Revenue at Ottawa suffered two changes of Deputy Minister, with the result that many policies and practices of a generation of tax officials were altered or terminated. In 1947, also, by the introduction of the new Income Tax Bill, No. 454, the government indicated its intention to confirm the Income Tax Appeal Board as a permanent feature of the law. By this same Bill, not yet passed by Parliament, the whole structure of Dominion income taxation is to be altered and new concepts of administration and tax incidence are to be introduced.

The development of income tax law in Canada is but another chapter in the history of the struggle for the rule of law. This struggle is reflected not only in the decisions of the courts and the enactments of Parliament, but in the career of the one man who, perhaps more than all others, has left his mark upon the Dominion taxing law during the last twenty-five years. Another aspect of the struggle is seen in the tension within the Taxation Division itself, between the assessing branch with its practical approach and the legal officers with their respect for principle and their refusal to be influenced by the amount of money involved in any problem presented to them.

"The rule of law" has been defined on many occasions, but perhaps seldom as clearly as by Dicey in the following passage:

> Rule of law means, in the first place, the absolute supremacy or predominance of regular law as opposed to the influence of arbitrary power and excludes the existence of arbitrariness, of prerogative, or even of wide discretionary authority on the part of the government. Englishmen are ruled by the law, and by the law alone; a man may with us be punished for a breach of law, but he can be punished for nothing else.[1]

In the income tax field the rule of law may be said to be the supremacy of the strict language of the statute over any administrative or arbitrary determination of liability.

Part of the struggle for the rule of law in this field has been the attempt to make legal rather than ethical standards the fundamental basis of the determination of taxable income. In the early days of income tax, the courts and the administration followed the rule of law and consistently maintained that the machinations of the taxpayer were to be judged solely by the governing statute. Although he was speaking of conditions in another country, Lord President Clyde aptly expressed their point of view when in a case before the Scottish Court of Sessions he said:

> No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow — and quite rightly — to take every advantage which is open to it under the taxing statutes for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.[2]

Gradually this objective view gave way to one that measured a taxpayer's liability more by his intentions and the morality of his actions than by the strict letter of the taxing act. The change was first apparent in the administrative attitude to the various attempts of taxpayers, beginning in the middle 1930's, to secure tax-free distribution of corporate surpluses. In 1938 the ethical test was imported into the statute itself by the enactment of section 32A.[3]

Under this section the Treasury Board may find that any transaction was entered into by a taxpayer for the purpose of avoiding taxation and, notwithstanding that he may not be taxable under any other section of the Act, it may assess him what it determines to be the proper tax. This section has added

[1] A. V. Dicey, The Law of the Constitution (1908).
[2] *Ayrshire Pullman Motor Services* v. *C. I. R.* (1928-9), 14 T.C. 754.
[3] 2 Geo. VI., 1938, c. 48.

to the technical construction of the various charging sections of the Income War Tax Act a new test of tax liability — the subjective and ethical reasons that prompt a taxpayer to enter into any transaction. Section 32A provides for an appeal to the Exchequer Court, which is given jurisdiction to determine whether the main purpose of any transaction brought into question by the Treasury Board was the reduction or avoidance of liability.

II. *Sources of the Law*

The sources of income tax law in Canada are the taxing statutes of the provinces, to the extent that they are unaffected by the Dominion-Provincial Agreements of 1946, the Dominion taxing acts and orders in council, and the decisions of the courts.

The Dominion acts comprise: the Income War Tax Act,[4] which, it is expected, will be superseded shortly by a new statute, The Income Tax Act; and The Excess Profits Tax Act, 1940,[5] which expired on December 31st, 1947.

The provincial statutes dealing with income tax are, with the exception of those of the provinces of Quebec and Ontario, modelled on the Nova Scotia Income Tax Act. This latter statute bears a marked resemblance to the Income War Tax Act and indeed, being administered by the Dominion Taxation Division, will probably receive the same official interpretation. In Quebec and Ontario the chief taxing acts are the Corporation Tax Act of Quebec[6] and the Corporation Tax Act of Ontario.[7] Provincial tax legislation, while important from a technical point of view, has not a sufficiently prominent position in the national picture to warrant attention here.

In addition to the legislation itself there are other quasi-statutory sources, such as the Reciprocal Agreements for the avoidance of double taxation in the fields of shipping and aircraft entered into between Canada and a number of countries.[8] In 1935 Canada made an agreement with the United Kingdom for the reciprocal exemption of certain agency profits and ten years later a similar agreement was entered into with New Zealand.[9] There are also two Conventions for the avoidance of

[4] R.S.C., 1927, c. 97, as amended.
[5] 4 Geo. VI, 1940, c. 32.
[6] Statutes of Quebec, 1947, c 33.
[7] Statutes of Ontario, 1939, c. 10.
[8] Great Britain, United States, Italy, Norway, Denmark, Japan, Greece, Sweden, Netherlands, Germany, France, Barbadoes.
[9] Agreement between Canada and the United Kingdom for Reciprocal Exemption of Certain Agency Profits from Income Tax, signed October 3rd, 1935, and Agreement between Canada and New Zealand for Reciprocal

fiscal evasion and double taxation, between Canada and the United States and Canada and the United Kingdom, and similar Conventions between Canada and these same countries for the avoidance of double succession and death duties.[10]

The third source of the law in income tax matters is the decisions of the Canadian courts, supplemented for their persuasive value by judgments of English and American tribunals, in so far as these latter relate to statutory provisions which are *pari materia* with Canadian legislation. There now exist more than 150 Canadian decisions on Dominion income and excess profits taxes alone.

The Dominion and provincial income tax systems tend, in their broad outlines and philosophic concepts, to follow United Kingdom models rather than those of the United States. In both the English and Canadian legislation there are gaps between the enactments of Parliament and the statements of the courts. These have been largely filled by orders in council, administrative rulings, and exercises of ministerial or administrative powers of a purely discretionary nature by administrative tribunals or departmental officers. In so far as the orders in council are concerned, they have been held, upon occasion, to have the force of enacted legislation. Administrative rulings and decisions are, however, merely expressions of the departmental view of the law and are not binding upon the taxpayer.

The history of administrative discretion in Canada has been enlivened by a continuing conflict between the administration and the taxpayer to secure flexibility of application for the former without impairing the rights of the latter. Many disputes have

Exemption of Certain Agency Profits from Income Tax, effective from November 3rd, 1945: Dominion of Canada Taxation Service (DeBoo), pp. 27-52 and 27-54, respectively.

[10] Convention and Protocol between Canada and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion in the case of Income Taxes, signed March 4th, 1942, and made applicable as and from January 1st, 1941: C. C. H. Canadian Tax Service, paras. 10-099 *et seq.*; Dominion of Canada Taxation Service (DeBoo), pp. 5001 *et seq.* Agreement between Canada and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, signed June 5th, 1946: C. C. H. Canadian Tax Service, paras. 10-870 *et seq*; Dominion of Canada Taxation Service (DeBoo), pp. 5501 *et seq.*

Convention between Canada and the United States of America for the Avoidance of Double Inheritance Taxation, signed June 8th, 1944, and made applicable as and from June 14th, 1941: Dominion of Canada Taxation Service (DeBoo), pp. 5461 *et seq.* Convention between Canada and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Inheritance Taxation, signed June 5th, 1946, and made applicable to estates of persons dying after December 31st, 1944: Dominion of Canada Taxation Service (DeBoo), pp. 5601 *et seq.*

been taken to the Canadian courts and from them to the Judicial Committee of the Privy Council. Many more have been settled amicably; in a few cases decisions have been enforced in a rather arbitrary manner without an opportunity being given the courts to grant redress.

For a field of law that has become important to so large a section of the public, surprisingly little in the way of authoritative legal writing has been produced in Canada compared to the United States or the United Kingdom. This is perhaps to be explained by the economic difficulties of publishing in this country. The following list includes almost every publication that has made its appearance on the Canadian tax scene:

R. I. Frears, Frears on Income Tax. 1947. Toronto: Canadian Law List Publishing Company.

A. W. Gilmour, Income Tax Handbook. First published in 1945 and reissued annually. The Dominion Association of Chartered Accountants.

M. L. Gordon, Digest of Income Tax Cases. First published in 1939 and brought up to date periodically. Ottawa: The King's Printer.

M. L. Gordon, Digest of Excess Profits Tax Cases. 1942. Ottawa: The King's Printer.

C. P. Plaxton and F. P. Varcoe, Dominion Income Tax. 1921. Toronto: The Carswell Company Limited.

C. P. Plaxton and F. P. Varcoe, Dominion Income Tax. 1929. Toronto: The Carswell Company Limited.

H. A. W. Plaxton, Canadian Income Tax Law. 1947. Toronto: The Carswell Company Limited.

H. H. Stikeman, Canada Tax Acts Consolidated. First published in 1944 and reissued annually. Toronto: Richard DeBoo Limited.

H. H. Stikeman, Canada Tax Cases (Annotated). Published periodically. Toronto: Richard DeBoo Limited.

H. H. Stikeman and A. W. Gilmour, Canada Tax Manual. First published in 1947 and brought up to date periodically. Toronto: Richard DeBoo Limited.

H. H. Stikeman, Dominion of Canada Taxation Service. First published in 1942 and brought up to date monthly. Toronto: Richard DeBoo Limited.

H. H. Stikeman and G. D. Sanagan, Provincial Taxation Service. First published in 1948 and brought up to date periodically. Toronto: Richard DeBoo Limited.

J. R. Tolmie, Canadian Tax Service. First published in 1939 and brought up to date periodically. Toronto: C. C. H. Canadian Limited.

H. H. Stikeman, M. L. Gordon and A. L. Richard, Special Lectures on Taxation. 1944. Toronto: Richard DeBoo Limited.

J. Willis, Law Society of Upper Canada: Refresher Course. Vol. I, Part II. Income Tax. 1945. Toronto: Richard DeBoo Limited.

III. *Historical Developments*

Unlike most other fields of law, taxation law is directly affected, as already suggested, by more than the decisions of the courts and the enactments of Parliament. It is influenced, quite independently of the jurisprudence or the statute books, by the day-to-day interpretations of the officials of the Taxation Division. The general tone of this administrative interpretation of the law is set by the chief officer of the Division, the Deputy Minister. By his directives to his officials, and by their rulings in the disposition of the cases of individual taxpayers, his personal interpretation both of government policy and of the statute law becomes important to every tax practitioner and taxpayer. A tax practice thus involves, not only a knowledge of the law, but an understanding of the personalities and what might be called "tax philosophies" of the senior administrative officials.

The Taxation Division of the Department of National Revenue has had four administrative heads since the first enactment of the Income War Tax Act in 1917:

R. W. Breadner.....1917, to March 30th, 1927.
Dr. C. S. Walters.....April 1st, 1927, to July 15th, 1932.
C. F. Elliott, K.C., C.M.G...July 15th, 1932, to Nov. 30th, 1946.
F. H. Brown, C.B.E.....Nov. 30th, 1946, to Oct. 15th, 1947.[11]

Each of these four men has left his mark not only upon the Taxation Division itself, but upon the legislation passed and the jurisprudence made during his regime.

Although the development of Dominion income tax law has been conditioned by historical events quite outside the control of any of these men, the terminal dates of three of the four principal periods into which the development may be most readily divided coincide with the end of three of these administrations: those of Mr. Breadner, Dr. Walters and Mr. Brown. The fourth division point is the outbreak of war, which divides the period between Mr. Elliott's appointment and the resignation of Mr. Brown into two.

1. *1917-1927*

When the Canadian Bar Review was founded, in 1923, the Dominion Income War Tax Act was five years old and Mr. Breadner's administration was already more than half over. The years between 1917 and 1927 were almost entirely concerned with

[11] By Order in Council P.C. 267, dated January 2nd, 1948, Mr. V. W. T. Scully was appointed Deputy Minister, effective February 1st, 1948.

laying out and improving the general framework of the administrative techniques and legislative provisions. Perhaps the best indications of the concern in this period with broad principles are the rather simple questions which were thought sufficiently important to be brought before the courts. To-day few of them would be matters of dispute. For example, in the case of *Caron* v. *The King*,[12] the question of the Dominion's power to tax the salary of a provincial cabinet minister required a judgment of the Judicial Committee before it was resolved in favour of the Crown. Again, in *Smith* v. *Minister of Finance*,[13] the taxpayer claimed that profits earned by him from illicit trading in liquor were not income subject to taxation under the Income War Tax Act. In this case the now familiar principle was first expressed that the Income War Tax Act imposed a tax upon the person and not upon his trade, business or calling and that, accordingly, the source of the income need not be regarded.

One reason why the issues of the early years were simple, arising principally over questions of jurisdiction and the nature of taxable profits, was that the rate of taxation at the time, measured by today's standards, was extraordinarily low. It was not until the rates began to climb and the incidence of tax became more important to the businessman and the tax gatherer that the administration and Parliament made the Act proof against the assaults of all but the most wily and the most daring. While no sustained attempt was made to tighten the statute until the early 1930's, Mr. Breadner's administration saw the introduction of two measures of some importance in this connection. In 1923 what is now section 10 was enacted, under which a taxpayer's income is deemed to be not less than that received from his chief business or calling. In 1924 what are now sections 23 and 23B were passed to ensure that taxpayers with non-resident affiliations should not shift taxable profits from Canada to the non-resident by selling abroad at an abnormally low price.

During the rising prosperity of the last years of Mr. Breadner's regime the magical term "Cyclical Financing" was unknown. Instead of increasing with the average income of the nation, the tax rates were reduced and the exemptions were increased. These reductions were most notable in the years 1926 and 1927. Toward the end of this period the jurisprudence began to deal with questions turning upon more technical interpretations of the law. One of the important cases was *The King* v.

[12] [1924] A.C. 999.
[13] [1927] A.C. 193.

The Anderson Logging Company Limited,[14] in which the Judicial Committee held that the fact that profits were reflected as an estimate on the balance sheet did not render them assessable to income tax, since, to be assessable, they must have been actually earned.

In the case of *Gagné* v. *the Minister of Finance*[15] the question of the imposition of a tax on undistributed income was effectively settled. In this case, Mr. Gagné purchased for $43,500 the shares of the capital stock of a company with a large accumulated earned surplus. Soon after acquiring these shares, Mr. Gagné caused the company to declare a dividend to him of $40,020. He disputed an assessment raised against him in respect of this money on the ground that it was a return of capital to him. The court, however, could not agree with this "extraordinary contention", and affirmed the assessment.

Although it occurred after 1927, a refinement of this rule was made in *George Hope* v. *the Minister of National Revenue.*[16] Here a corporation set aside certain accumulated undistributed profits as a reserve fund for the benefit of a certain class of shareholder. Upon the sale of the company's assets and the discontinuance of the business, the shareholders were taxed to the extent that the company had undistributed profits on hand. The court held that the company could not, merely by changing the description of a fund on its books of account, alter the nature of the moneys from undistributed income to capital in the hands of the shareholders.

Another interesting decision was that in *North Pacific Lumber Company* v. *the Minister of National Revenue,*[17] in which it was held that a liquidator appointed under a winding-up act is the agent of the company and that any profit he may make in the course of his dealings with the company's affairs is taxable income to the corporation.

2. *1927-1932.*

Upon Mr. Breadner's resignation in 1927, the position of Commissioner of Income Tax was filled by Dr. C. S. Walters, who is now the Deputy Minister and Controller of Finances of the Treasury Department of the Province of Ontario. Dr. Walters had been the Inspector of Income Tax for the Hamilton District from 1920 to 1927 and had acquired a broad experience

[14] [1925] S.C.R. 45; [1926] A.C. 140 and [1926] 1 D.L.R. 785.
[15] [1925] Ex. C. R. 19.
[16] [1929] Ex. C.R. 158.
[17] [1928] Ex. C.R. 68.

in the early stages of the administration of the Act. His appointment as Commissioner was the first occasion upon which an individual already experienced in income tax became head of the Department. During Dr. Walters' regime, the chief legal counsel for the department was Mr. C. F. Elliott, who was later to become Commissioner of Income Tax. Dr. Walters and Mr. Elliott exerted considerable influence upon the departmental viewpoint and the nature of the legislation introduced. Although broad questions relating to basic tax concepts continued to be subjects of dispute before the courts in the years immediately following 1927, the problems became increasingly more technical as the years passed. An example of this development is seen in the cases relating to deductible expenses in the determination of taxable income.

In 1931, in the case of *Roenisch* v. *the Minister of National Revenue,*[18] the Exchequer Court held that provincial income tax paid to the Province of British Columbia could not be deducted from income subject to Dominion taxation, as being an expense wholly, exclusively and necessarily laid out to earn the income. Another case on this subject was *In Re Salary of Lieutenant-Governors,*[19] in which it was held that certain expenses incurred by the Lieutenant-Governor of a province were not properly deductible from his taxable income under the Act. It was indicated that the only deductions that could be allowed were those chargeable against income other than salary, which was fixed and irreducible. This case was later varied by the obiter dicta of the President of the Exchequer Court in his judgment in *Samson* v. *the Minister of National Revenue.*[20] The *Lieutenant-Governors* case, however, still reflects the thinking of the Division with respect to deductions from salary and the principle enunciated in the case has been incorporated in a provision of the proposed new Income Tax Act.

The legislation in the period of Dr. Walters' administration from 1927 to 1932 saw few changes of marked importance. In 1930 certain primary producer co-operatives were exempted from income tax.[21] In the same year government annuities up to $5,000 were exempted[22] and charitable donations up to 10% were allowed as deductions from income.[23] During this period corporate tax rates were increased from 8% to 11%.

[18] [1931] Ex. C.R. 1.
[19] [1931] Ex. C.R. 232.
[20] [1943] Ex. C.R. 17; [1943] Canada Tax Cases 47.
[21] 20-21 Geo. V, c. 24, s. 2.
[22] 20-21 Geo. V, c. 24, s. 3.
[23] 20-21 Geo. V, c. 24, s. 3.

3. *1932-1939*

Upon the resignation of Dr. Walters on July 15th, 1932, Mr. Elliott was appointed Commissioner of Income Tax. This title was not changed until July 24th, 1943, when the position of Commissioner of Income Tax was abolished by statute[24] and Mr. Elliott was made Deputy Minister of National Revenue for Taxation, a position he held until his resignation in October 1946.

Mr. Elliott took office in a period when the effects of the depression were beginning to be most seriously felt throughout the country. Fortunately, rates of tax were still so low that they could be increased in order to provide funds for the various programmes designed to counteract the economic stagnation of the period. The pressure upon the government to obtain funds increased and it became the task of the Taxation Division to assist in raising money by every means available to it. In order to do this with fairness and still preserve the principle of ability to pay, changes took place in the nature of the amendments to the law as well as in the problems that came before the courts. There was a steady increase in rates of tax on corporate and personal income and a widening of the sources of income which were made taxable, together with the introduction of specific legislation to close all possible loopholes for tax avoidance.

In 1933 a 5% withholding tax was imposed on dividends and interest paid to non-residents and a 12½% tax was imposed upon royalties going to non-residents who paid no other taxes in Canada.[25] In 1935 a surtax was imposed upon investment income,[26] and in the same year the gift tax was enacted, as section 88 of the Income War Tax Act,[27] to prevent the circumvention of the surtax by the giving away of capital property.

By 1936 the trough of the depression had been passed and the government began to consider means of encouraging the investment of foreign capital in Canada. To this end, in 1936, a new class of corporation was created — the Non-Resident-Owned Investment Corporation.[28] The Non-Resident-Owned Investment Corporation, or the N.R.O. Company as it has come to be known, is a company which derives its income solely from investments or from trading or dealing in securities, mortgages and similar property, and of which 95% of the aggregate value of its issued shares is owned by or held for the benefit of non-

[24] 7 Geo. VI, c. 24.
[25] 23-24 Geo. V, c. 41.
[26] 25-26 Geo. V, c. 40, s. 1.
[27] 25-26 Geo. V, c. 40, s. 14.
[28] 1 Edw. VIII, c. 38, s. 3.

residents of Canada. Certain beneficial rates of tax, which have varied over the years, apply to these companies and place them in a preferred position vis-à-vis the ordinary corporation.

In addition to legislation to induce foreign capital to come to Canada, incentive legislation was passed to promote new activities within Canada. Legislation was introduced[29] which exempted from taxation the income of any company derived from the operation of a metalliferous mine (coming into production between May 1st, 1936, and January 1st, 1940) for its first three years of operation.

In 1939 incentive legislation, of a type never before seen in Canada, was introduced to induce taxpayers to enter upon new capital expenditures. Under this a taxpayer could deduct from his Dominion income taxes, over the following three years, an amount up to 10% of the capital costs incurred and paid in the year beginning May 1st, 1939.[30]

In 1936, also, an agreement was entered into by the Dominion government with certain of the provinces, by which the latter relinquished the work of administering and collecting income taxes under their provincial tax acts to the Dominion. Although it was not realized at the time, this was to be the first step in the centralizing and unifying of the various tax laws of the country and I might digress for a moment from the chronological record of events to complete the story of the development. The agreement of 1936 was to be followed by the signing of the Dominion-Provincial Tax Agreements in 1942, by which all the provinces imposing an income tax or certain corporation profits taxes agreed to vacate these fields during the war. The Dominion Government was thus able to raise its income tax rates and pay the provinces a subsidy, calculated upon a per capita basis, to compensate them for the surrendered revenue. The latest phase was reached when the Dominion Finance Minister made his historic offer to the provinces in 1946. This offer was accepted in principle by all the taxing provinces save Ontario and Quebec, and separate five-year agreements were entered into by each agreeing province. The prime objectives of these agreements are:

(1) to reduce duplication of direct taxation;

(2) to give greater stability to the revenues of the provinces agreeing;

[29] 1 Edw. VIII, c. 38, s. 20.
[30] 3 Geo. VI, c. 46, s. 17.

(3) to enable the governments concerned to carry out fiscal and other policies with greater facility and mutual co-operation.

Although the signatory provinces have agreed not to impose personal income taxes, they may enact legislation to provide for the levying of a 5% corporation tax, which will be assessed and collected by the Dominion government acting as an agent for the taxing province. This levy may be made applicable to all classes of corporations that are liable under the Income War Tax Act, with the exception of Non-Resident-Owned Investment Corporations. The agreements also provide that the provinces may impose taxes on income derived from mining and logging operations carried on in the provinces and that they may tax royalties and rentals on or in respect of natural resources within the provinces.

When the non-agreeing provinces of Ontario and Quebec brought down their fiscal legislation for 1947, they left the personal income tax fields to the Dominion government. To make up for the losses in revenue from this field, however, they reimposed a corporation profits tax of 7% and maintained the same succession duties as under the wartime agreements. These provinces have also reimposed taxes on the paid-up capital and the places of business of corporations within their jurisdiction; such taxes being collected by the provincial governments themselves.

To return to the chronological survey, during the period from 1932 until the outbreak of war the tax rates rose slowly but surely and, as a result, there was an ever-increasing incentive to the taxpayer to seek loopholes in the legislation. Amendments were introduced with increasing frequency to block these gaps. The most notable of these amendments was the addition of section 32A to which reference has already been made.[31] This section as first enacted permitted the imposition of a tax for the purpose of dissuading a resident Canadian taxpayer from entering into any transaction or arrangement with a non-resident that would have the effect of reducing liability to tax in Canada. In 1940 this section was repealed and re-enacted in a more stringent form to cover a wider field of tax evasion.[32]

At the same time, as an adjunct and aid to these legislative changes, the discretionary powers of the Minister were widened and those already in the statute books were resorted to with increasing frequency by the administration. Since the govern-

[31] 2 Geo. VI, c. 48, s. 7.
[32] 4 Geo. VI, c. 34, s. 24.

ment found that it had a determined and courageous Commissioner of Income Tax whose administration could usually be counted on to make the unworkable work, it tended to legislate in principle and by inference rather than to deal specifically with given problems. The details were left in the administrative field and discretionary authority was given to the Minister and to his Deputy to enable them to fill in the legislative gaps by administrative action.

The development of the use of discretionary power, and the attempts of taxpayers to have it scrutinized by the courts, became one of the distinguishing features of Mr. Elliott's administration; and the effective solution of the problem of ministerial discretion remains the most pressing item on today's legislative agenda.

At the outset discretionary powers were used for the purposes for which they had been originally intended. They were designed to give the administration a flexibility in dealing with individual cases and in weighing equitable considerations and the special circumstances of different classes of taxpayer. As tax rates rose, however, and as precedent followed precedent in discretionary matters, it became difficult for the Minister to retain his flexibility, since he could do so only at the expense perhaps of some taxpayer with whom he had dealt less leniently in the past or at the expense of a fairly well-determined line of policy. Thus, the administration became as much the prisoner of its own discretionary rulings as it would have been of court decisions, had these questions become matters of litigation. Discretion came to be regarded by the public as a taxing power rather than as a means of alleviating unfair burdens in specific cases.

The important cases during Mr. Elliott's regime in its prewar days reflect the engrossing problems of the time. In *Capital Trust Corporation* v. *the Minister of National Revenue*,[33] it was held that executors' fees, accumulated over a number of years and received by the executors in one lump sum, were taxable income in the year received at the full rates obtaining in that year. This case has been referred to with approval in *K.B.S. Robertson Limited* v. *the Minister of National Revenue*,[34] which went into the question of when a receipt constitutes taxable income at considerable length. The doctrine was developed that once income was received it must be taxable, but that, to be income, money must be received by a person with full power to appropriate it and alienate it irrevocably.

[33] [1937] S.C.R. 192; [1935-37] C.T.C. 258 and 267.
[34] [1944] Ex. C.R. 170; [1944] C.T.C. 75.

Following the *Robertson* case came the notorious decision of *Trapp* v. *the Minister of National Revenue,*[35] which went back to the *Capital Trust* case for its authority that income when received must be taxed at the rates in the year of receipt and, accordingly, that expenses could only be allowed as deductions in the year in which they were actually paid. The learned President held in the *Trapp* case that a cash basis was the only method of keeping accounts permitted under the Act and thus the only legal way of determining income for tax purposes, and that the Minister, even though he wished, had no power to permit a taxpayer to compute his taxable income upon an accrual basis.

Another case of importance in the immediate pre-war years was *Fullerton* v. *the Minister of National Revenue,*[36] which held that a payment received by one of the railway commissioners to compensate him upon the abolition of his office by statute was a capital payment and thus free from tax. This decision followed a well-established line of English jurisprudence and for many years stood unchallenged by Parliament or the courts. In the middle of the war, however, it was realized that there was a loophole that should be closed and all payments for loss of office were made taxable in full by the enactment of section 3(8).[37]

In the middle thirties, section 19 and related sections of the Income War Tax Act, dealing with corporate surpluses, became the subject of litigation, particularly as to what constituted undistributed income on hand and when income could be deemed to be distributed in the form of a dividend to the shareholders. Cases of interest on this point were *McConkey* v. *the Minister of National Revenue,*[38] *Northern Securities* v. *The King,*[39] *MacLaren* v. *the Minister of National Revenue,*[40] and *Bahamas General Trust Company* v. *Provincial Treasurer of Alberta.*[41] It is interesting to note that these Canadian judgments appear to support the principle expressed in a decision of the Privy Council in *Hill* v. *Permanent Trustee Company of New South Wales,*[42] which held that any payment made by a company to its shareholders, when not made in the course of winding-up, must be considered to be a dividend and be taxable as such, even though paid out of capital.

[35] [1946] Ex. C.R. 245; [1946] C.T.C. 30.
[36] [1939] Ex. C.R. 13; [1939] C.T.C. 207.
[37] 9 Geo. VI, c. 23; 10 Geo. VI, c. 55.
[38] [1937] Ex. C.R. 209; [1935-37] C.T.C. 343.
[39] [1935] Ex. C.R. 156; [1935-37] C.T.C. 23.
[40] [1934] Ex. C.R. 13. [1928-34] C.T.C. 135.
[41] [1942] 1 W.W.R. 46; [1940-41] C.T.C. 478.
[42] [1930] A.C. 720.

4. *1939-1947*

The last period of the four mentioned at the outset of this paper embraces the war and its aftermath, that is, the period from the autumn of 1939 until the end of 1947. The fact that it also saw the end of Mr. Elliott's administration and the whole term of office of his successor adds interest, if not causality, to the tax events during it.

With the outbreak of war the first Excess Profits Tax Act was hastily drafted in a matter of a few weeks and introduced in Parliament in the fall of 1939.[43] It soon became apparent that it was ill-equipped to do the work for which it was designed, being contradictory in its terms and unworkable in its approach to the problem. Upon the appearance of the analogous British statute a few months later, a new Act, known as The Excess Profits Tax Act, 1940, was drafted and passed, and its predecessor was repealed.

The purposes of both Excess Profits Tax Acts were twofold. They were primarily designed to raise additional revenue, their function as taxing statutes. The second purpose relates to their place in the national structure of economic planning. In this respect they were designed to drain off profits which it was thought undesirable to leave in the hands of private enterprises in wartime, because of the impetus they might give to inflation.

The Excess Profits Tax Act, 1940, provided for the taxation of the profits of corporations and unincorporated businesses in excess of a standard profit, which was stated to be the average earnings of the taxpayer in the years 1936 to 1939, weighted out by appropriate adjustments for the presence or absence of capital employed, after giving consideration for abnormal years within this period. The initial rate of tax was 75% on profits in excess of the standard profit, although, in 1942, this was raised to 100% with a refundable portion of 20% to be repaid after the war. Provision was also made in the statute for the determination of standard profits in the cases of taxpayers who were either depressed or not in business during the standard period. Specific tests were established whereby certain classes of business could present their cases to a Board of Referees appointed by the Minister by order in council under section 13 of the Act.

By chapter 32, section 4, of the 1947 statutes it was enacted that no tax should be assessed, levied or collected under The Excess Profits Tax Act, 1940, on profits earned on and after January 1st, 1948.

[43] 3 Geo. VI, c. 4.

At the same time as the excess profits tax was imposed, the normal or basic rate of corporate taxation under the Income War Tax Act was greatly increased. When the war commenced this rate stood at 15%. In 1940 it was increased to 18%, plus 20% on profits earned after January 1st, 1940. Added to this basic rate of 38% was a special 12% excess profits tax rate, which meant an effective rate of tax of 40% on corporation profits not exceeding the standard profits. In 1946 the Excess Profits Tax Act was made no longer applicable to unincorporated taxpayers, and in 1947 the rate of tax on corporate profits was reduced to 15% on excess profits only. In 1947 the basic corporate rate under the Income War Tax Act was fixed at 30%, which figure it is hoped will remain a maximum for some years to come.

In 1941 the Excess Profits Tax Act was clarified by permitting the Minister, under certain conditions, to increase or decrease the standard profits of a taxpayer by an amount equal to 7½% of an increase or decrease in capital employed.[44] In the same amendment taxpayers were permitted to make application to have their standard profits fixed by the Board of Referees where their capital employed had increased by more than one-third from one taxation year to another or since the end of the standard period.

With these dramatic increases in tax rates, all anomalies and hitherto little-known inconveniences or mal-adjustments in the tax system became glaring cases of inequity and discrimination. At the same time, the importance of deductions from taxable profits was magnified. Claims for deductions on account of depreciation, salaries, legal and other expenses increased, as did litigation arising from them in the Exchequer and Supreme Courts of Canada.

The question of what constitutes an expense wholly, exclusively and necessarily laid out to earn the income was fought out largely on the issue of what constitutes deductible legal fees. The leading cases on this point were:

Minister of National Revenue v. *Dominion Natural Gas Co.;*[45]
Minister of National Revenue v. *Kellogg Co. of Canada Ltd.;*[46]
Siscoe Gold Mines Ltd. v. *Minister of National Revenue;*[47]
Minister of National Revenue v. *Montreal Coke Co.;*[48]

[44] 4-5 Geo. VI, c. 15, s. 4.
[45] [1941] S.C.R. 19; [1941] C.T.C. 155.
[46] [1942] Ex. C.R. 33; [1942] C.T.C. 51 (Ex.); [1943] C.T.C. 1.
[47] [1945] Ex. C.R. 257; [1945] C.T.C. 397.
[48] [1942] S.C.R. 89; [1944] A.C. 126; [1942] C.T.C. 1; [1944] C.T.C. 94.

Highwood-Sarcee Oils Ltd. v. *Minister of National Revenue;*[49] *Hudson's Bay Company* v. *Minister of National Revenue.*[50]

A recent case of importance relating to deductions, although not to legal fees, which should be referred to as an expression of general principle, is *Imperial Oil Limited* v. *the Minister of National Revenue.*[51]

The gist of these decisions is that legal expenses, like other expenses, are not allowable deductions when incurred in the creation of a capital asset, while legal expenses incurred in the preservation of a capital asset or directly in the earning of income are on the whole allowable. It is interesting to compare the disputes in the courts over the deduction of legal expenses, and deductions under section 6(a) and (b) generally, with the cases that arose when deductions were refused by discretionary, rather than statutory authority, as in the matter of depreciation, depletion, excessive salary charges and the like.

In addition to the delegation of authority to the Minister and his officers already referred to, the legislative requirements of wartime taxation led to the delegation of authority to administrative tribunals. A number of these played an important part during the war. The Board of Referees, for example, early achieved a commanding position in the determination of the amount of excess profits tax to be paid by a new or depressed business. Later, by Order in Council P.C. 209/1647 of March 9th, 1945, a committee of senior civil servants was formed, known as the Business Classification Committee, for the purpose of determining whether a taxpayer's business, after the commencement of the war, was substantially different from that carried on by it before the war. A special depreciation board, the War Contracts Depreciation Board, was also created by Order in Council P.C. 4217 of August 27th, 1940, for the purpose of allowing special depreciation in respect of depreciable assets acquired or constructed for war purposes. Under the administration of the Wartime Salaries Order, limiting salaries to certain levels obtaining prior to November 28th, 1941, a salaries administration was set up which had the same powers and functions as a board.[52] Each of these boards and committees exercised an

[49] [1944] S.C.R. 92; [1942] Ex. C.R. 56; [1942] C.T.C. 101; [1944] C.T.C. 57.

[50] [1947] Ex. C.R. 130; [1947] C.T.C. 86.

[51] [1947] C.T.C.

[52] P.C. 9278, November 27th, 1941; P.C. 946, February 6th, 1942; P.C. 1549, February 27th, 1942; P.C. 4346, May 26th, 1942; P.C. 79/1385, March 3rd, 1944; and P.C. 349, January 31st, 1946.

authority which was discretionary in its essence and was subject to the same rules as governed under other sections of the Act.

In 1942 and 1943, for the first time, a certain proportion of hospital and medical expenses was permitted to be deducted from taxable income in the case of individual taxpayers.[53] In 1942, also, business losses were first permitted as a charge against income of preceding and succeeding years under certain specified conditions.[54] The section permitting this change was later expanded and adapted to take into account certain anomalies that had developed in its administration during the 1943 tax year.[55]

A further amendment of the war years was the introduction of a system of compulsory savings applying to all taxpayers.[56] By this enactment a certain specified proportion of the taxes taken from individuals, and 20% of the taxes on corporate or other taxpayers in the higher excess profits tax bracket, were set aside on the government's books to be repaid after the war. This compulsory savings scheme was a method by which the government sought to merge its wartime need for funds with the anticipated post-war need, should a depression be experienced, to encourage public spending or, if an inflation occurred, to keep money out of circulation.

In 1942, also, the government introduced legislation to effect the deduction of tax at the source from salaries, interest and dividends, more popularly known as "Pay As You Go".[57] In the case of individuals receiving income other than by way of salary, the law required quarterly payments of tax, computed on an estimated income at least equal to that of the preceding year, with the balance payable as an adjustment after the close of the year. The "Pay As You Go" feature of wartime legislation remains in effect to-day and will presumably be permanent. To avoid the inevitable overlapping of current taxes and past taxes which both fell due in the year of enactment, all individual taxpayers were forgiven half the taxes on the earned income of 1942 and half the taxes on their investment income of 1942, if less than $3,000. The payment of the other half of the tax on investment income below $3,000 and of the whole tax on investment income over $3,000, could be postponed until the death of the taxpayer. This represented a major change in the administrative

[53] 6 Geo. VI, c. 28, s. 5.
[54] 6 Geo. VI, c. 28, s. 5.
[55] 7 Geo. VI, c. 14, s. 5.
[56] Section 93 enacted by 6 Geo. VI, c. 28, s. 31, and repealed by 10 Geo. VI, c. 55, s. 18.
[57] 6 Geo. VI, c. 28, s. 31.

technique of collecting taxes in Canada and followed closely the British adoption of P. A. Y. E. ("Pay As You Earn") legislation the year before.

With the end of the war in 1945 the government turned its attention to stimulating the expansion of business throughout Canada. To this end it enacted legislation permitting a business to claim as a deduction from profits, within a period to be specified, one-half of the cost of certain deferred maintenance and repairs which it was unable to effect during the war.[58] In the same enactment, a taxpayer operating a mine was permitted to deduct one-half of the cost of underground development. Prospecting activities were encouraged by the allowance of a tax credit to a taxpayer equal to 40% of the contributions made by him to associations, syndicates or mining partnerships formed for the purpose of prospecting for base metals or strategic minerals.[59] In addition, an organization whose principal business was the production, refining or marketing of petroleum or the exploration or drilling for oil was permitted (upon the recommendation of the Minister of Mines and Resources) to deduct from taxes otherwise payable up to 50% of the expenditures incurred by it, in respect of a well spudded in between June 26th, 1944, and March 31st, 1945, which might prove to be unproductive. It was provided, however, that the well must be a deep-test well and that it must have been deemed desirable in the interest of extending Canada's petroleum resources.[60] A concession was also granted taxpayers desiring to make capital expenditures which would contribute to the post-war conversion of their businesses and provide substantial employment. This was given by the addition of section 18 to the Excess Profits Tax Act, which permitted a taxpayer to assign by way of security the refundable portion repayable under the Act, provided the Governor-in-Council consented to the assignment.[61]

In 1946 the tax position of co-operatives was brought substantially into line with that of other taxpayers. Since the enactment of the first section exempting certain classes of primary producer co-operatives,[62] the governmental attitude toward the taxation of all co-operatives was rendered uncertain by the difficulty of defining a co-operative and determining what portion of its income could be subjected to tax. In 1945 a Royal Commission was appointed under the chairmanship of Mr. Justice E. M.

[58] 8 Geo. VI, c. 43, s. 4.
[59] 6 Geo. VI, c. 28, s. 10 A.
[60] 8 Geo. VI, c. 43, s. 6.
[61] 8 Geo. VI, c. 38, s. 7.
[62] Section 4, *supra*.

W. McDougall to investigate the situation and recommend a solution. As a result of the Commission's report, the government introduced legislation which placed co-operatives and ordinary taxpayers upon an equal footing with respect to the payment of patronage dividends and the payment of taxes upon income.[63] The effect of these provisions was to exempt co-operatives organized after 1946 on the profits of their first three years' operations, provided that they met certain statutory conditions in their incorporation and method of doing business. Patronage dividends paid by co-operatives or ordinary corporations could be paid before tax, provided they did not reduce the earnings in the year of payment below an amount equal to 3% of its employed capital.

Mr. Elliott resigned as Deputy Minister of National Revenue for Taxation on November 30th, 1946, and shortly afterwards was appointed Canadian Ambassador to Chile. His successor was Mr. F. H. Brown, who had had considerable wartime experience as financial advisor to the Department of Munitions and Supply. Before entering the government service at the outbreak of war, he had been Inspector for the Bank of Commerce and he brought, therefore, to his position the combined judgment and skill of a banker and government administrator. The time at which Mr. Elliott left office and Mr. Brown took over substantially coincided with the cessation of wartime planning and a slackening in the governmental need for funds. Many of the pressures to which Mr. Elliott had been subjected disappeared while new ones took their place. For example, the income tax rates on both corporate and individual profits began to decline and certain of the deductions from income, such as advertising expenses and salaries, were once more treated in the lenient fashion of peacetime. At the same time the pressure increased for a revision of the administrative machinery and of the law itself. During his brief tenure of office, Mr. Brown spent his time and energies in bringing the administration up-to-date in such matters as the scale of salaries to departmental officials, methods of making departmental decisions known to the public and speeding up assessments. This implied no criticism of the officers who had served with Mr. Elliott or of Mr. Elliott himself, since it was realized that the war period had afforded no opportunity to increase salaries or properly to revamp the departmental machinery. Mr. Brown addressed himself to both tasks with a will. He was successful in dispersing efficiently the administrative au-

[63] Section 5, sub-sections (8) to (11), added by 10 Geo. VI, c. 55, s. 4.

thority throughout various district offices. He was able, as well, to secure substantial increases in the salaries of almost every class of employee in the Division. By these two major reforms, and many minor ones, the task of the tax practitioner, particularly in districts far removed from Ottawa, was simplified and the efficiency of the Civil Service encouraged. Unfortunately, Mr. Brown's health was not equal to the enthusiasm with which he attacked his problems and he was forced to leave his position on October 15th, 1947. From that time until the recent appointment of Mr. V. W. T. Scully no successor was named and the senior administrative responsibility in the department was divided between Mr. W. S. Fisher, K.C., and Mr. W. F. Wiliams, the Assistant Deputy Ministers of Taxation. Mr. V. W. T. Scully was appointed Deputy Minister to succeed Mr. F. H. Brown and takes up his duties on February 1st, 1948. He brings to the task the professional qualifications of a chartered accountant and considerable administrative experience in wartime government service, his last position being that of Deputy Minister of the Department of Reconstruction and Supply.

During the war years the inexorable pressure of events, including high taxes, rendered the use of discretion unavoidable, but made its fair application in all cases proportionately more difficult. Taxpayers in increasing numbers took their objections against the exercise of discretion to the courts, with the result that a sizeable body of Canadian jurisprudence has been developed. The leading Canadian cases relating to discretionary powers are: *Pioneer Laundry & Dry Cleaners Ltd.* v. *Minister of National Revenue,*[64] *Sterling Royalties Limited* v. *Minister of National Revenue,*[65] *Noxzema Chemical Company of Canada Limited* v. *The King,*[66] *Walkerville Brewery Limited* v. *Minister of National Revenue,*[67] *Nicholson Limited* v. *Minister of National Revenue,*[68] *Burns and Jackson Company* v. *Minister of National Revenue,*[69] *Pure Spring Company* v. *Minister of National Revenue,*[70] *Wrights' Canadian Ropes Limited* v. *Minister of National Revenue.*[71] Of these the two most important are the *Pioneer Laundry* case and the *Wrights' Canadian Ropes* case. In addition,

[64] [1940] A.C. 127; [1938-39] C.T.C. 380, 401 and 411.
[65] [1947] S.C.R. 79; [1942] C.T.C. 133.
[66] [1942] S.C.R. 178; [1942] C.T.C. 21.
[67] [1942] Ex. C.R. 124; [1942] C.T.C. 147.
[68] [1945] Ex. C.R. 191; [1945] C.T.C. 263.
[69] [1945] Ex. C.R. 246; [1945] C.T.C. 343.
[70] [1946] Ex. C.R. 471; [1946] C.T.C. 169.
[71] [1946] S.C.R. 139 and [1947] 1 D.L.R. 721; [1945] C.T.C. 177 and [1946] C.T.C. 73; [1947] C.T.C. 1.

there are a large number of decided cases in the United Kingdom of great persuasive value on the subject.

The Canadian and United Kingdom judgments together have evolved certain rules as to what constitutes a proper exercise of discretionary authority. These rules are strictly limited in scope. The limitation is inherent in the nature of discretionary power, which is well stated in the Australian case of *Moreau* v. *Federal Commissioner of Taxation:*

> His reason is not to be judged of by a Court by the standard of what the ideal reasonable man would think. He is the actual man trusted by the legislature and charged with the duty of forming a belief for the mere purpose of determining whether he should proceed to collect what is strictly due by law; and no other tribunal can substitute its standard of sufficient reason in the circumstances or its opinion or belief for his.[72]

The legal rules which have been laid down by the courts do not attempt to alter this concept of discretion. They merely describe the manner in which discretion must be exercised if it is to be acceptable to the courts. They require that discretion must:

(1) be exercised on proper legal principles;

(2) not be against sound and fundamental principles;

(3) be exercised in a fair and honest manner;

(4) not take into account matters which are not proper for the guidance of the person exercising it; and

(5) not be exercised arbitrarily or fancifully.

Thus while a court may not consider the facts and reasons upon which the Minister has exercised his discretion in order to judge whether it would have come to the same conclusion itself, it is bound to consider the manner in which the discretion is exercised and the circumstances surrounding it in order to determine whether or not the legal rules above-mentioned have been observed. The question, therefore, becomes one of what evidence is required or what facts the court must have before it in order to judge whether the Minister has properly observed the legal rules. It is the introduction of the practical requirements of evidence which a court may need to judge the sufficiency of the Minister's observance of the legal rules, which made the judgment of the Privy Council in the *Wrights' Ropes* case a turning point in the Canadian law on this subject.

In that judgment the law lords came to the opinion that if the Minister will not disclose sufficient of the facts and reasons

[72] 39 Comm. L. R. 65.

which he had before him or which he applied in reaching his discretionary decision, the court will be unable to judge as to whether he has observed the rules of law governing the use of discretionary power. Accordingly, the conclusion is reached that if the Minister gives insufficient reasons he may be presumed to have acted arbitrarily and thereby to have violated one of the fundamental legal criteria. This does not mean, however, that the Minister is necessarily required to produce all the documents he had before him, or that he will be unable to rely upon the privileged nature of inter-departmental correspondence which would otherwise be protected against disclosure to the taxpayer.

The *Wrights' Ropes* judgment also assimilates the right of appeal from an assessment to a right of appeal from the exercise of ministerial discretion. In doing so, their Lordships did not deal with the point raised by the learned President of the Exchequer Court in the case of *Pure Spring Company* v. *the Minister of National Revenue* (*supra*), where it was held that the appeal provided for in section 58 of the Income War Tax Act is limited to an appeal from an assessment and that the exercise of ministerial discretion, being an action taken prior to the assessment, is not a subject of appeal *per se*.

In 1945 the public feeling on this whole question was expressed in a resolution of the Senate that a committee be formed to examine into the provisions and workings of the Income War Tax Act and to formulate recommendations for the improvement, clarification and simplification of assessment methods.[73] A committee of eighteen senators was formed, which sat for the better part of a year and heard representations from professional and industrial groups as well as from officers of the Department. It brought down a report, which will be found in Hansard of May 28th and July 31st, 1946, advocating the creation of a Board of Tax Appeals with power to review the exercise of the Minister's discretion.

The government took note of these recommendations and, in 1946, two new boards were created, the Income Tax Appeal Board and the Income Tax Advisory Board.[74] At the time the legislation was introduced, the Minister stated that the Income Tax Appeal Board was intended as a speedy and cheap tribunal for all questions of a substantive or legal nature relating to income tax assessments and should be in effect a court of first instance before the Exchequer Court of Canada, to which appeals

[73] Minutes of Proceedings of the Senate, October 24th, 1945.
[74] 10 Geo. VI, c. 55. s. 22, Third and Fifth Schedules.

might still be taken. It was explained also that the Income Tax Advisory Board was designed as an advisory committee to assist the Minister of National Revenue in the exercise of his discretionary power, but that he would not be bound in any way by its advice.

The creation of these two boards did not solve the whole problem, however, and a committee of senior civil servants of the Departments of Finance, National Revenue and Justice was formed to study the possibility of large-scale amendments to the statute. The conclusion was reached that the Income War Tax Act should be repealed and a new statute enacted which would, as far as possible, retain the good elements of the old Act but simplify and re-arrange its provisions and introduce some new taxing concepts of a more modern nature. Accordingly, the departmental committee prepared a draft Bill which was to serve as a starting point for the contemplated revision of the law. On July 12th, 1947, the Minister of Finance introduced this draft in the House of Commons as Bill No. 454, The Income Tax Act. During the preparation of the draft and in the period of study and criticism that followed its introduction in Parliament, the public was invited to express its views on the matter to the Minister of Finance. Advantage was taken of the invitation by various organizations, including a new and active body known as the Canadian Tax Foundation, a private organization formed in 1945 to assist the government by making research and other facilities available without pleading any special case.

In form, Bill No. 454 does not resemble the Income War Tax Act either in the order of the sections or the phraseology used. In content, however, it retains substantially all the basic principles which were in the Income War Tax Act. In this Bill the drafters have altered the discretionary powers vested in the Minister or the administrative tribunals. Whereas these powers were granted in the Income War Tax Act as discretions to be exercised in accordance with the Minister's opinion, in Bill No. 454 they appear as discretions to be exercised according to the objective criterion of what is reasonable. This, it is felt, will leave the administrative officials free to use their discretion in substantially the same cases as before, but will also permit the taxpayer to test the Minister's yardstick of what is reasonable before the courts. As a corollary to this change the Income Tax Advisory Board does not appear in the new Bill, although the Board of Tax Appeals is retained.

It remains to be seen whether this attempt to solve the vexing problem of ministerial discretion will succeed as well as

is hoped. There is some danger that, in testing the meaning of "reasonable" as a measure of discretion in Bill No. 454, a body of jurisprudence will be built up by the Income Tax Appeal Board and the Exchequer Court so inflexible as to rob the discretionary powers of most of their value.

IV. *Achievements and Expectations*

The last twenty-five years in Canadian taxation law can only be regarded as a formative or "shakedown" period and, accordingly, the events dealt with in this paper are only of real significance as portents for the future. Can it be said, for example, that a steady improvement has been made in administrative techniques and in the substantive law? Has the law advanced in clarity? Has the struggle for the rule of law been carried to a satisfactory conclusion or been abandoned?

Certainly advances have been made in administrative techniques in the field of income tax. It is difficult to divide the responsibility for the many improvements in this field between the three main influences upon it: Parliament, the administration, and the courts. There have been matters in respect of which each took a leading position and occasions on which each lagged behind.

For example, the administration instigated most of the attempts to plug the statutory loopholes which opened the way to evasion and avoidance, while it left to Parliament and public opinion the initiative in the effort to reduce and simplify the use of ministerial discretion. Parliament itself too often shunned the statement of a harsh tax policy in an open and specific enactment and left to the administrative officers the unwelcome duty of enforcing the legislation, all too often vague and uncertain as to its intention and language. The courts on the other hand have exercised, by and large, their traditional function of interpreting the statute carefully and literally, without regard to the effect of their decisions upon the taxpaying public. This has had the salutary result of dramatizing the effect of the many legislative anomalies and administrative inconsistencies upon various taxpayers, so that situations have been brought to the attention of Parliament for correction of which it might otherwise have been wholly ignorant.

The Canadian taxpayers owe a great debt to the two outstanding figures who have headed the Exchequer Court as president during the last fifteen years: Mr. Justice A. K. Maclean and Mr. Justice J. T. Thorson. Under their guidance the

Exchequer Court has provided the law of income tax in a comparatively short period with a body of precedent which has clearly marked it as a field of its own. With the advent of the Board of Tax Appeals, the jurisprudence will be increased and, consequently, play an even more important role in defining the rights of the tax collector and the citizen.

A further reason for satisfaction is that, in recent years, public opinion has been a real force in bringing about amendments to the law. The public relations of the administration have always been of the best and, on the majority of questions, the moderate attitude of most senior officials has tended to further the rule of law by letting principles rather than dollars be the touchstone of their decisions. Nevertheless, there have been matters, such as the question of ministerial discretion, in respect of which the administration has been inflexible until public opinion has forced a change in the legislation itself.

Another development, which gives promise of progress in this field, is the evident intention of the proposed Income Tax Act to relate income tax concepts more closely to generally accepted business and accounting principles. It also appears that the doctrine of the form under which the observance of the letter of the law would protect a taxpayer, regardless of the spirit, has been largely superseded in administrative thinking by the application of what is known as the rule of substance, which makes intention one of the touchstones of liability. This is reflected beyond doubt in the proposed new Act, in which the intention underlying section 32A of the Income War Tax Act has been substantially expanded in sections 107 and 108.

Perhaps the best reason to believe that taxation law will develop in Canada with full regard for the rule of law is the good relationship that has always existed between the administration and the public. The taxing officers by their objectivity and by their careful consideration of every case have made themselves, with certain minor exceptions, a striking example of a moderate bureaucracy in a democratic system.