Literal or Liberal?

Trends in the Interpretation of Income Tax Law

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A few years ago there appears to have been a feeling in some quarters that the interpretation of taxing acts was tending to veer away from its traditional strictness towards a liberality hitherto unknown. John Willis, writing in the Canadian Bar Review in 1938 on "Statutory Interpretation in a Nutshell", commented upon the fact that there were then traces of the use of the *Heydon*'s case rule in interpreting taxing statutes: and W. Friedmann, writing in the same journal ten years later on "Statute Law and Its Interpretation in the Modern State", said that taxation acts were now regarded as social purpose acts of a special type and that "the courts apply the principles of *Heydon*'s case". It may therefore be interesting to see just what has happened in the courts during the last fifteen years or so in the interpretation of taxing acts, and more especially of income tax acts.

Methods of Interpretation

The *Heydon*'s case rule, or "mischief" rule, is one of the three well-known methods adopted by the courts in interpreting statutes, the other two being the "literal" rule and the "golden" rule. The literal rule—a term which is self-descriptive—is used if the meaning of the words is "plain"; but one of its drawbacks is that judges cannot always decide what the plain meaning is, even though they may agree that it is plain.[1] The golden rule provides that the ordinary meanings of words shall be accepted unless such an interpretation results in an absurdity or contradiction. The main pitfall here is the necessity for deciding what constitutes an absurdity—a matter on which judges do not necessarily agree. The mischief rule, or *Heydon*'s case rule—so called from the case of

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[1] *Ellerman Lines* v. *Murray*, [1931] A.C. 126.

the year 1587 in which it is laid down—necessitates consideration of the purpose behind the act and its interpretation according to that purpose. Lord Coke in the case itself explains it admirably:

> . . . for the sure and true interpretation of all statutes in general . . . four things are to be discerned and considered: (1) What was the common law before the making of the Act, (2) What was the mischief and defect for which the common law did not provide, (3) What remedy the Parliament had resolved and appointed to cure the disease of the Commonwealth, (4) The true reason of the remedy. And then the office of all judges is always to make such construction as shall supress the Mischief and advance the remedy . . according to the true intent of the makers of the Act. .

In the past, the literal rule was considered to be the one suited for the interpretation of taxing statutes, and to be sufficient for that purpose. Rowlatt J., in *Cape Brandy Syndicate* v. *C.I.R.*,[2] said that there was "no room for any intendment" in a taxing act, and went on to say that "there is no equity about a tax; there is no presumption about a tax; you read nothing in; you imply nothing, but you look fairly at what is said and at what is said clearly, and that is the tax". And Lord Atkinson in *Ormond Investment Co.* v. *Betts*[3] said that "so called equitable constructions" of a taxing statute were "not permissible".

The Function of Taxing Statutes

This attitude developed because in those days taxing statutes were felt to be in a rather different category from other statutes. In the early days of taxation they were purely financial enactments, or revenue-collecting media, having no social or economic purpose. They were not designed to put right any inadequacy or wrong in the social or economic structure, as were so many other statutes, or to act as instruments of governmental policy. Moreover, taxes were, by comparison with modern taxes, so small that they were not of paramount importance in individual, communal or business life, and the correct interpretation of the statutes imposing them was therefore not a matter of consuming importance. Taxing statutes then were reasonably straight-forward and consisted of few provisions—as witness the first Income War Tax Act of 1917 in Canada, which comprised a mere twenty-four sections.

This casual attitude—compared, that is, with the purposeful atmosphere that surrounds tax collection today—gave rise to the tradition of always giving the benefit of any doubt to the tax-

[2] (1921), 37 T.L.R 402. [3] (1928), 13 T.C. 400.

payer, and to the sanctioning, even in high judicial places, of the practice of legal tax-avoidance. One of the best known dicta on this last point is that of Lord Sumner in *Levene* v. *C.I.R.*[4] to the effect that taxpayers incur "no moral censure if, having considered the lines drawn by the legislature for the imposition of taxes, they make it their business to walk outside them". Lord President Clyde, in *Ayrshire Pullman Motor Services & D. M. Ritchie* v. *C.I.R.*,[5] expressed the same idea with more colloquial vigour when he said that no man is "under the smallest obligation, moral or other, so to arrange his legal relations to his business or his property as to enable the Inland Revenue to put the largest possible shovel into his stores". The same attitude prevailed in the United States, where the condoning words of the Supreme Court in *U.S.* v. *Isham*,[6] that "If a desire to avoid taxes were carried out by legal forms, it could not be the subject of legal censure", were long quoted in defence of such practices.

In recent years, however, a change has been taking place in the function and application of taxing statutes. They are no longer mere tax collecting agencies, for they are used also as economic and social weapons—to combat inflation, to discourage some types of business activities and consumer purchases and to encourage others, to promote the development of natural resources, to advance scientific research and social welfare schemes, and so on. Rowlatt J.'s statement that "there is no room for any intendment" in a taxing statute reads oddly today against the background of such devices in taxing acts as deferred and accelerated depreciation, concessions for such undertakings as mines and oil fields, allowances of contributions to pension funds and the like. Taxation has become a fiscal weapon of considerable power, and is used to direct the economy of the country in war and in peace.

Ideas on tax avoidance have changed too, for the extent of modern taxation and its high rates have led to a growing feeling that every citizen should pay his full share and that no one should be permitted to avoid any part of his liability even by means that are technically within the law. Avoidance—even legal avoidance—of taxation is now considered to be anti-social, since the burden of the tax avoided by one taxpayer inevitably adds to the burden on the rest of the community. The changed attitude is reflected in such judicial comments as those of Lord Greene M.R., who in 1942 commented upon the battle "between the Legislature and those who are minded to throw the burden of taxation off their

[4] (1928), 13 T.C. 486. [5] (1929), 14 T C. 754. [6] 17 Wall. 296.

own shoulders and on to those of their fellow-subjects", and approved the legislature's intention to impose "the severest penalties" upon such people.[7] In the next year Lord Simon, in *Latilla* v. *C.I.R.*,[8] said that whereas judicial dicta could be cited in support of the fact that taxpayers are "entitled" to adopt tax avoidance methods within the law, "there is no reason why their efforts . . . should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship". In the United States the reaction had also set in, and the case of *Gregory* v. *Helvering* gave both rise and effect to the "business purpose doctrine", which said that if any transactions served no business purpose, but had been undertaken purely to avoid taxation, they would be held to be without substance.

Strict Interpretation

The tenet that taxing statutes must be "strictly construed" has been part of interpretation concepts for as long as taxing statutes have existed, and has now become axiomatic. Some of the main dicta date back to the middle of the 19th century, as for example the words of Lord Cairns in 1869, in *Partington* v. *A.G.*:

> If a person sought to be taxed comes within the letter of the law he must be taxed however great the hardship may appear to be. On the other hand if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be . . . . if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute. where you can simply adhere to the words of the statute.

The same judge in 1878, in *Cox* v. *Rabbits*,[11] said that

> a taxing Act must be construed strictly; you must find words to impose the tax, and if words are not found which impose the tax, it is not to be imposed

The principle expressed in these early judgments has been reiterated time and time again in tax cases, and is unquestionably accepted in legal and judicial circles as the basis for interpreting taxing acts. But the expression "strictly construed" has become so much a part of ordinary legal language that there is sometimes a danger that its meaning will not be sufficiently considered. This is a fate that overtakes all familiar things: they are taken for granted, rarely analyzed and, finally, often misunderstood.

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[7] *Howard de Walden* v. *C.I.R.* (1942), 25 T.C. 121.
[8] (1943), 25 T.C. 108.
[9] (1935), 293 U.S. 465.
[10] (1869), L.R. 4 H.L. 100.
[11] (1878), 3 App. Cas 473.

What, exactly, does "strict interpretation" mean? Gerald Sanagan, in an article in the Canadian Bar Review of January 1940 on "The Construction of Taxing Statutes", gives a useful analysis of the principle. He points out that it has been expressed from time to time in different ways: first, that the tax must be imposed in "clear and unambiguous language"; secondly, that there must be no equitable construction; and, thirdly, that the onus is on the Crown to show that the subject is within the operation of the tax. But he also shows that the second and third ways are really the same as the first. His summary is as follows:

> To impose a tax, the words of the Act, including the context, must be clear and unambiguous, but if they are so, no considerations of hardship or the like may be entertained; that is, the wording only (including the context) of the taxing Act may be regarded, and not the general purpose of the Legislature to impose taxation on income or whatever it may be, and if the subject falls within the wording (including the context) then a tax is imposed. In a word, taxes are imposed by the letter of the law and not the spirit.

It is now proposed to inquire what effects, if any, the change in the concept of the function of taxing acts has had on this principle of strict interpretation.

The Period of Transition

For income tax in Canada, the decade preceding the passing of the Income Tax Act of 1948 was a time of transition from the reign of ministerial discretion to the rule of law. During these years — roughly 1938 to 1948 — the feeling was growing that the rule of law was preferable to the looser system of ministerial discretion. Moreover, with the increasing number and complexity of taxing provisions, it was becoming obvious that taxing statutes were often far from "clear and unambiguous"; and at this point a subtle change becomes visible in the concept of what "strict interpretation" means. Up to this time, the word "strict" had been felt to be almost synonymous with "literal"; but now it begins to be felt that it is not necessarily so in the matter of interpretation. Strictness, in the sense of ensuring that the provisions of the act are exactly applied, is the essence of good interpretation; but literalness may be the reverse of good interpretation if it goes counter to the real intention of those provisions. Previously, where the words of the statute had given room for doubt over their meaning, the benefit of the doubt had been given to the taxpayer; now it began to be felt that even in a taxing statute there might be circumstances where the application of *Heydon*'s rule would actually

result in a more exact interpretation than would the principle of literal interpretation. Settled convictions die hard, however, and until very recently it appears that *Heydon*'s rule was invoked only to justify the giving of judgment to the taxpayer.

A taxpayer may win an appeal for one of two reasons: first, that he has not been carefully enough charged; and, secondly, that he is definitely within the scope of an exemption section. In either of these cases there are three situations which may face a court. First, an alternative interpretation of the statute is presented which is plausible and reasonable and which raises doubt over the precise meaning of the statute. In such a case the benefit of the doubt goes to the taxpayer. Secondly, an alternative interpretation is presented which is plausible and which, it is asserted, conforms with the intention of the legislature. The only way in which this claim can be tested is by the use of *Heydon*'s rule, and it is in this type of case that it now begins to be used. Thirdly, an alternative interpretation is presented, which it is asserted is the equitable one—in other words, it is asserted that "this is what the rule ought to be in this situation". This interpretation will not stand up under any kind of construction—since "equitable construction" is not permissible in taxing acts—and it cannot therefore be considered.

The Courts during the Period of Transition

The decisions of the courts during the period of transition stand fast upon the use of a strict interpretation "against the Crown". Some decisions were still arrived at by the literal method, and its use in cases like the *Trapp* case showed the need for amendments in the law which would more clearly indicate what the judge felt to be the intention of the legislature. Even when the "mischief" rule was invoked in favour of the taxpayer, no interpretation was given which was not justified by the words of the statute, interpreted in the light of the known intent behind them; and however often reference might be made in the courts to the intention of the statute, it is emphasized over and over again that no tax can be levied, and no concession given, which does not fall within the words of the statute, properly interpreted.

A survey, within the space of an article, of the cases of ten years is necessarily sketchy; but an attempt will be made to touch upon all the cases in which the question of interpretation was a major issue. At the beginning of the period a couple of cases illustrate, respectively, the way in which strict interpretation gave

the taxpayer the benefit of the doubt, and the attitude of the courts towards tax avoidance. In *Hatch* v. *M.N.R.*[12] Angers J. decided that a personal corporation was not a taxpayer under section 2 of the Income War Tax Act, and added a definite statement on the necessity for not taxing a subject except by the exact words of the statutes:

> The subject is not taxed by inference or analogy; the tax must be imposed in categorical and unambiguous terms; in case of doubt the construction of the Act must be resolved in favour of the taxpayer.

The two cases of *Malkin* v. *M.N.R.*[13] are of particular interest on the subject of tax avoidance, for they show that neither the intention of the subject to avoid tax nor the intention of the legislature to frustrate it will have any effect on the judgment of the court unless the one is forbidden and the other effected by the actual words of the statute. The question at issue in both the cases was whether the income of a trust, set up by the appellant and consisting of property left by his wife to him and their children, together with some shares and insurance policies of his own, was taxable on him. He occupied the estate rent free, and disbursements made by the trust during the year of assessment of the first case exceeded its income by over $2,000. The president in that case found that the appellant was not liable under section 3(e) and section 11. His occupancy of the estate was not due to his being a salaried employee, nor was it incidental to any "salary, wages, emoluments", and so on; and the expenses in connection with it were not "personal and living expenses" within the section. He was therefore not chargeable. The judge added that:

> . . . even if the purpose and effect of the trust settlement were to avoid some of the burdens of taxation . . that would not sustain the assessment in question if it were not clearly authorized by the taxing statute. A statute levying a tax cannot be extended by implication beyond the clear import of its terms, and the terms . . . cannot be extended to frustrate the efforts of a taxpayer to avoid taxation. . . .

Between the two cases the law was amended by adding the following words to the charging section:

> or the payment of such constitutes part of the gain, benefit, or advantage accruing to the taxpayer under any estate, trust, contract, arrangement, or power of appointment, irrespective of when created.

In the second case, the same judge said that it was "quite manifest that it was one of the purposes of the amending statute to capture the tax assessed in this case", but that he did not think the drafts-

[12] 1 D.T.C. 447.

[13] 1 D.T.C. 456; 2 D.T.C. 587.

man had succeeded in doing so and that the appellant must therefore succeed. It thus becomes obvious that even when the intention of the legislature is *known* to be that of frustrating tax avoidance in a particular set of circumstances, it does not achieve its object unless it has expressed its intention in unmistakably clear words. *Heydon*'s rule is not invoked against the taxpayer.

A few years later, in 1943, the case of *O'Connor* v. *M.N.R.*[14] was avowedly decided in the Exchequer Court by the rule of *Heydon*'s case, and in favour of the taxpayer. The issue was whether legacies payable in instalments out of the capital of an estate were income—that is, "annuities" under section 3(g). Thorson P., after citing dicta from British and Canadian cases to the effect that tax must not be imposed except by the exact words of the act, went on to try to find a meaning for the words "annuities or other annual payments received under the provisions of any will". He quoted from the judgment of Lindley M.R. in *In re Mayfair Property Co.*:[15]

> In order properly to interpret any statute it is as necessary now as it was when Lord Coke reported *Heydon's* case to consider how the law stood when the statute to be construed was passed, what the mischief was for which the old law did not provide, and the remedy provided by the statute to cure the mischief.

He then decided that "applying the rules in *Heydon*'s case to the interpretation of Section 3(g), the term 'annuities or other payments received under any will' does include annuities that are chargeable against the whole estate of the testator", but that the legacies in this case were not included in the class of cases brought into charge. He rejected the "ordinary" meaning of the word "annuities", and decided that the payments, whatever they were called, were actually "a distribution of the capital of the estate among the legatees". He went on:

> By the application of the rule in *Heydon's* case the term 'annuity' . . . has been given a particular meaning in order 'to cure the mischief for which the old law did not provide'. It should not receive any wider meaning than is necessary for the purpose sought to be accomplished, nor be made to apply to cases that are quite different from those which it is designed to cover.

This case, like the later one of *Wilder* v. *M.N.R.*, to which I shall refer in its place, indicates that the courts were showing resistance to the literal meaning of a statute where it altered the earlier law.

A case in 1945, *The King* v. *British Columbia Electric Railway Co.*,[16] which was concerned with the meaning of the words "Cana-

[14] 2 D.T.C. 637.
[15] [1898] 2 Ch. 28.
[16] 2 D.T.C. 692 (Ex. Ct.); 2 D.T.C. 824 (S.C.C.).

dian debtor" in section 9B(2), caused considerable interest because of the different interpretations given by the Exchequer Court and the Supreme Court to the word "residence"; and from the point of view of this study is also interesting because at first glance it appears to be an exception to the rule that "the intention of the legislature" is at this time invoked in favour of the taxpayer. But this case was not brought under a charging section, and was more a matter of administration than of taxing. The Exchequer Court held that a company incorporated in England but carrying on operations in Canada was not a "Canadian debtor", and introduced into the concept of residence the questions of nationality and domicile. The Supreme Court reversed the decision, Kerwin J. saying:

> "One purpose of Section 9B as first enacted and as amended from time to time was to ease the foreign exchange situation, and the expression in question should receive the same meaning throughout the section. It could hardly be contended that in subsection 1 or in paragraph (e) of subsection 2 the expression meant anything except an individual who resided in Canada or an incorporated company which — in the sense in which that word is explained in well-known tax decisions — resided in Canada.

The decision of the Supreme Court was confirmed by the Privy Council, which held in dismissing the appeal that the test of residence is not nationality and "the appellant is within the language of the Act".

The use of the mischief rule again benefited the taxpayer in the case of *Might* v. *M.N.R.*,[17] where the social purpose of the act was invoked. The question was whether a married woman who was engaged in the practice of medicine was "employed" (rule (2), s. 1, and rule (6), s. 2, of the first schedule to the act) for the purpose of allowing the husband to claim the married allowance; or whether "employed" meant only employed in a master-servant relationship. O'Connor J. pointed out that:

> The purpose or object of the proviso is clear. It was enacted by Parliament to induce married women to go to work, in order to relieve the manpower shortage [after three years of war].

He held, therefore, that there would be no object in limiting the proviso to those employed as servants — "the intention must have been to get the largest number possible" — and he cited the *Heydon*'s case rule in support of the judgment.

The intention of Parliament was again referred to in *M.N.R.*

[17] 3 D.T.C. 1166.

v. *The Great Western Garment Co. Ltd.*[18] The rates of salaries had been "frozen" by the Wartime Salaries Order of 1941, and the question was whether, where salaries were paid tax-free, a company was allowed to deduct from its profits the higher *gross* salaries which it had had to pay as a result of higher taxes, or whether these higher gross salaries represented an increase in the "rate of salary". Locke J., allowing the deduction, said:

> Had it been intended to prohibit an increase in the amount of salary rather than to prohibit a change in the salary arrangement, Paragraph (a) would have been so worded.

Rand J. remarked that he could not imagine why the words "rate of" should have been added to the word "salary" if they were not intended to be significant.

It has not, of course, always been necessary to invoke the mischief rule in order to achieve strict interpretation, and a number of cases were decided by a literal interpretation—the word "literal" being here used in its narrowest sense and not, as it often is, as a synonym of "strict". Two cases illustrate the literal interpretation of clear and unambiguous language resulting in decisions in favour of the taxpayer. In *Connell* v. *M.N.R.*[19] it was held that a husband was not liable under section 32(2) to a tax on income from securities transferred to his wife before their marriage, because when the transfer was made he was not a husband. Thorson P pointed out that:

> It is well established that a tax liability cannot be fastened on a person unless his case clearly comes within the express terms of the enactment by which it is imposed. It is the letter of the law that governs in a taxing Act. . . . The Court has no right to assume that a transaction is within the intention or purpose of a taxing Act if it falls outside its words. . . These are the basic principles of income tax law.

In *Anderson* v. *M.N.R.*[20] a woman was held to be entitled to the deduction for children adopted informally but not legally. The court held that the word adoption was used in its ordinary sense, and Angers J. said:

> I am satisfied that the legislators, who are usually accurate and precise, wanted, at a time when the exchequer was not so heavily burdened, to put on the same footing as the natural parents any individual who . . . actually supports . . . one or more persons connected with him by . . . adoption.

A third case shows how literal interpretation can work against the taxpayer. Reference has already been made to the case of

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[18] 3 D.T.C. 1055; 4 D.T.C. 526. [19] 2 D.T.C. 903. [20] 3 D.T.C. 1030.

Trapp v. *M.N.R.*[21] as an illustration of the fact that the attitude of the courts during the transition years was a contributory factor in establishing the rule of law in 1948. Judgment in the case was given on a literal interpretation of the statute, thereby exposing the need for a change in the law.

The case turned upon the question of the deductibility of interest accrued and owing but not paid, the taxpayer stating that he had always made his returns on an accrual basis and wished to continue to do so. Mr. Justice Thorson, after analyzing the wording of section 5(1)(b) and section 6(1)(b), pointed out that the former was an exception to the latter, which would otherwise be the governing provision, and that to construe 5(1)(b) as allowing the deduction of unpaid interest would be to extend its meaning. The taxpayer, he said, was not entitled as a matter of right to be taxed on an accrual basis. The court was concerned not with "what is truly net profit or gain from an accountant's point of view" but only with taxable income; and the question to be determined here was "not whether the deduction of the unpaid interest was in accord with the principles of good business and accountancy practice but rather whether the appellant was entitled to it under the Act. If he was not, that is the end of the matter and the appeal must be dismissed." Later he said:

> The administrative practice of permitting certain classes of taxpayers to file their income tax returns on an accrual basis . . . has, no doubt, in many cases resulted in taxation on a more equitable and sounder basis than would otherwise be the case. It was, in effect, a needed income tax law reform by administrative action in the cases where such action was taken. But income tax law reform is not a matter for administrative action; it is a function that belongs exclusively to the appropriate legislative authority. It is, perhaps, not beyond the scope of the judicial function to suggest, under the circumstances, that the Act be amended with a view to coming nearer the objective of taxing what is truly the net profit or gain than the Act as it stands now does. . . In this connection it might be again pointed out . . . that in the *Capital Trust Corporation* case, both Angers J. in this Court and Davis J. in the Supreme Court of Canada commented upon the harshness and injustice of the result of the decision from which there was no escape in view of 'the liability plainly imposed by the statute'.

It is of interest that the Income Tax Act deals with this particular problem, for section 11(1)(c) provides that in these circumstances interest may be deducted when paid or when payable, depending upon the method regularly followed by the taxpayer in computing his income.

[21] 2 D.T.C. 784.

Today's Trends

With the passing of the 1948 act and the formation of the Tax Appeal Board, the period of transition drew to a close and the principle of the rule of law was established. The existence of the board — and the almost complete disappearance of ministerial discretion — naturally led to a great increase in the number of cases, a fact forcibly illustrated by Mr. R. S. W. Fordham of the board in his book *Income Tax Appeal Board Practice.*[22] He says that during the thirty years from 1917 to 1947 the Exchequer Court heard only 150 income tax appeals, or an average of five a year; whereas the board heard 289 appeals in 1951 and 211 in 1952. The task of interpreting the new act has fallen most heavily on the board, and since only a small percentage of the cases heard by it have been appealed to the higher courts, its views on interpretation are of interest.

The Tax Appeal Board

At one time there was a feeling that the judgments of the board were too liberal, and some lawyers expressed misgivings that sometimes the board had substituted a kind of judicial discretion for the old ministerial variety. Stuart Thom, speaking at the Sixth Annual Conference of the Canadian Tax Foundation in 1952,[23] said:

> . . . there have been several cases in which it seems to me that the Board undertook to ameliorate what it considered to be harsh or unreasonable legislation. . . If I am correct in discerning in the Board a trend towards what is sometimes called the equitable determination of difficult cases, I express the personal opinion that it is not to be encouraged.
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> There are two examples that I might make. In the *Harrison* case the prospect of having to tax a premium paid on the redemption of a preferred share in the particular circumstances of the case was so oppressive in the mind of the Board that it left liability to be determined by the intention of the taxpayer. It is an attractive possibility, but I question its validity. In the *Storrar Dunbrik* case it was thought necessary to regard a partnership as being a person in order to avoid a result which the Board considered would be preposterous.

In spite of the odd case like those which disturbed Mr. Thom, most of the board's decisions seem to have tended quite the other way — in the direction, in fact, of uncompromising literalness.

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[22] C.C.H. (Canadian) Ltd., Toronto, 1953.

[23] Proceedings of the Sixth Tax Conference, Canadian Tax Foundation, Toronto, 1952, pp. 15-16.

The first case heard by the board under the new act was *Johnson* v. *M.N.R.*,[24] and here the literal interpretation given by Mr. Justice Graham (the then chairman) resulted in a judgment against the appellant, even though Mr. Justice Graham obviously felt that there was some hardship involved. The case concerned the allowance for children who did not qualify for family allowance until September 1949, and the appellant claimed that he was entitled for that year to three-quarters of the deduction for dependent children who do not qualify. It was, in fact, one of those cases where the claim was based on what, in the opinion of the taxpayer, the law ought to be. The judge said that there was "a measure of truth" in the contention, but that the interpretation of section 25(1)(c) did not allow it. "If there be any unfairness", he went on, "then it is a matter for appropriate legislation. This Board has no authority to take this into account if the language of the statute is clear and unambiguous as is the case here."

Mr. Fisher, in another case later in this same year, *Hendershot Paper Products Ltd.* v. *M.N.R.*,[25] upheld this attitude. He said:

> It has long been established that, whatever construction may be put on a taxing statute, it is not open to an equitable construction but must be strictly construed. . . . If there is any inequity caused by a strict interpretation of the law, it will be for Parliament to remedy the situation if it thinks it desirable, but it is not for this Board to attempt to give the legislation a liberal interpretation . . .

A number of cases, in fact, show that the board's members have frequently given a strict interpretation against their own sympathies, with no attempt to "ameliorate" the legislation. For example, in *Walter* v. *M.N.R.*[26] and *Cohen* v. *M.N.R.*,[27] both cases where the appellant was compelled by physical disability to use a car to get to work, the board expressed sympathy with the appellants but disallowed the appeals for the deduction of car expenses. In *Hon. H. W. Newlands* v. *M.N.R.*,[28] the board also expressed some sympathy for the appellant but confirmed the assessment in one year, 1950, of the whole amount of a pension mistakenly withheld for ten years and paid in a lump sum of some $61,000. The board felt unable to allow the appeal because the act taxes income in the year in which it is received, and no hardship can change the rule.

The large number of cases under the arms length concept, which was introduced by the new act, have all been decided strictly,

[24] 50 D.T.C. 470.
[25] 51 D.T.C. 191.
[26] 52 D.T.C. 3.
[27] 52 D.T.C. 356.
[28] 53 D.T.C. 196.

though Mr Fisher in an early case, *No. 25* v. *M.N.R.*,[29] dissented vigorously from the judgment of his colleagues that the word "deemed" in the expression "shall be deemed not to be dealing with each other at arms length" in section 127(5)—now 139(5)—permits no elasticity in the application of the section. In that case Mr. Fordham, his judgment being concurred in by Mr. Monet, said that the purport of the section was "clear and free of ambiguity", and added that "The Board has, of course, to take income tax legislation as it finds it and not as it might have been, or should be" Mr. Fisher, however, opposed the rigid construction of the phrase on the ground that it would lead to injustices which he was sure the legislature had not intended. Nevertheless, his judgments in the recent cases of *Benedet* v. *M.N.R.*[30] and *Sibbitt* v. *M.N.R.*[31] show that he has accepted the principle of rigid interpretation on this point, though clearly he would have liked to consider evidence to rebut the presumption of non-arms length dealing if the law allowed him to do so, and he still felt that an injustice existed in the law. In the *Benedet* case a son had paid his father $15,000 for a half share in a fishing vessel whose market value was said to be around $30,000, though its undepreciated capital cost was only $12,330. Mr. Fisher said that "in accordance with jurisprudence" the transaction must be considered to be not at arms length, and that he could only dismiss the appeal, "even though the transaction may have been entered into in good faith and there may have been good value in the property". The second case was concerned with a transaction between a separated husband and wife, and must, said Mr. Fisher, also be considered to be not at arms length,

> in spite of the fact that, at the time the purchase took place, they were in fact on most unfriendly terms and each of the parties was looking after his or her own interest without any consideration for the interests of the opposing party. This is one of those situations in which the legislation leaves no option to this Board, or to the Courts, to deal with the matter in the light of the true facts, namely, that the parties *were* dealing at arms length.

On the other hand, Mr. Fisher's insistence on the letter of the law in another arms length case, *Sheldon's Engineering Ltd.* v. *M.N.R.*,[32] produced a judgment which some people have felt nullifies the arms length concept in the act. The case was a complicated one involving the winding-up of one company and the formation of another; and because, Mr. Fisher thought that at some time between 3 and 4.30 p.m. on the day when these operations

[29] 51 D.T.C. 331
[30] 54 D.T.C. 51.
[31] 54 D.T.C. 65.
[32] 53 D.T.C. 11.

took place the companies were not related within the meaning of section 127(5), therefore they were dealing at arms length. This judgment seems to be contrary to the admitted purpose of the arms length provisions as a whole, but it certainly applied the very last letter of the law. In yet another arms length case, the same member's insistence on a literal interpretation produced the result that the expression "one person" meant one person and one only, in spite of an earlier decision by the majority of the board in *Storrar Dunbrik* v. *M.N.R.*[33] (mentioned by Stuart Thom) that it could be interpreted as two or more persons.

One of the pitfalls inherent in the use of the literal method of interpreting the ordinary meanings of words—that of deciding what those meanings are—is illustrated by the varying interpretations given by the several members of the board to the seemingly simple expression "chief source of income" in section 13(1). It has been held, as in *No. 76* v. *M.N.R.*,[34] that a farm which has never produced anything but heavy losses is a source of income, and in other cases, like *Pemberton* v. *M.N.R.*[35] and *No. 140* v. *M.N.R.*,[36] that it is not.

There have been times when the board's adherence to the rule of literal interpretation has led to some odd situations, which have nevertheless demonstrated, what Mr. Justice Thorson felt in the *Trapp* case to be desirable, the need for a change in the law.

The case of *No. 19* v. *M.N.R.*[37] shows how far the board and the courts are prepared to go in insisting on a clear expression of legislative intention. The board held here that the transfer of property between spouses was not affected by section 32(2) of the Income War Tax Act if there had been more than one substitution. Mr. Fisher said that, "if Parliament had intended that the subsection should be applicable when a series of substitutions has taken place, it could very easily have said so". This decision was recently confirmed by the Exchequer Court, in *M.N.R.* v. *MacInnes*,[38] where Thorson P. gave the reasons for his decision in much the same words as Mr. Fisher. He stated that the question was a "technical" one, but adhered to the principle that unless the taxpayer was brought expressly within the words of the section he could not be taxed, and "if Parliament had intended that a husband should be liable to tax in respect of income derived not

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[33] 52 D.T.C. 154.
[34] 53 D.T.C. 1. This judgment was reversed by the Exchequer Court in *M.N.R.* v. *Robertson*, 54 D.T.C. 1062.
[35] 53 D.T.C. 212.
[36] 54 D.T.C. 40.
[37] 51 D.T.C. 281.
[38] 54 D.T.C. 1031.

only from property transferred by him to his wife and property substituted therefor but also from property substituted for such substituted property it should have expressed its intention in clear terms". He gave the analogy of the proviso to section 6(1)(n) of the Income War Tax Act, which expressly stated that the term "owner" included a series of owners, and pointed out that the same sort of phrase could have been used here.

This case is one of those where a doubt, deemed "reasonable" by the courts, having been raised over the meaning of the statute, the benefit goes to the taxpayer. It could be—and indeed has been —argued that here no doubt really existed at all, for it would seem to be perfectly clear that the wording, "or property substituted therefor", is sufficiently wide to cover any number of substitutions, and that to require the act to state explicitly that more than one substitution is included is not only unnecessary but amounts to a refusal to give the existing language its plain meaning. But the insistence of the board and the court that the charge must be spelled out to the last letter is a measure of the importance attached by them to a crystal-clear expression of the intention to charge. Since section 21(2) of the Interpretation Act negatives any inference that amendments to an act indicate a change in the meaning, it may be said that the intention to charge was there, for section 22(3) of the Income Tax Act, enacted by the Statutes of Canada 1952, chapter 29, section 6, provides that where two or more substitutions of property have been made, the property finally held shall be deemed to have been substituted for the property originally held. A 1954 decision of the board, *No. 141* v. *M.N.R.*,[39] which was given under the old act, followed the precedent set by *No. 19*.

In two cases on compensation for loss of office, *Bury* v. *M.N.R.*[40] and *Steinmann* v. *M.N.R.*,[41] the board adhered to the rule of literal interpretation and held that if a taxpayer had not spent a complete taxation year in the same employment before receiving, in 1949 or 1950, a payment to which section 34 was applicable, he could not be taxed on it. In *Bury*, Mr. Monet said that "The right of option, given to a taxpayer under Section 34 of the Act, is absolute, and, when exercised, the taxpayer is entitled in law to pay *the tax as determined under the provisions of Section 34* and no other tax". And in *Steinmann*, Mr. Fisher said that all taxpayers "are entitled to expect that their taxes will be computed . . . in strict accordance with the express provisions of the law as enacted by Parliament

[39] 54 D.T.C. 44. [40] 52 D.T.C. 390. [41] 52 D.T.C. 415.

and in no other way". In these two cases it might well be argued, against the background of the recommendation of the Ives Commission, that payments for loss of office should be averaged for tax purposes over several years in the same way as lump sum payments on retirement or cessation of employment, and also, since "retiring allowances" were already specifically charged in section 6(a), Parliament intended section 34 to be a relief and not a charging provision. The determination of which it is makes a considerable difference to the results of strict interpretation, for although, if a taxpayer does not come within the express wording of a charging section, he cannot be charged, similarly if he does not come within the wording of a relief provision he cannot be granted relief. But, since the board felt, apparently, that section 34 was a charging section whose express language did not include the circumstances of the taxpayers in the two cases, the taxpayers were able to escape without paying tax at all. The words which allowed this —"last complete taxation year in the employment"— no longer appear in the amended section, and the act now provides that, for payments received in 1953 and subsequent years, the special tax is at the effective rate applicable to the income of the employee for the three years immediately preceding the year in which the payment was received. Election under what is now section 36 will therefore always result in tax if the taxpayer had income in any of the three preceding years.

Mr. Fisher felt himself bound by a decision of the Exchequer Court to give a broad interpretation in the case of *No. 112* v. *M.N.R.*,[42] where a transaction between a corporation and a minority shareholder was held not to be at arms length. Six brothers owned all but three of the shares of a company, and one brother — who was the president of the company and held twenty per cent of the shares—sold some property to the company. The company claimed capital cost allowances on the full purchase price, on the ground that the transaction was at arms length because the vendor was a minority shareholder. Mr. Fisher said:

> In the recent decision of Cameron J. in *M.N.R.* v. *79 Wellington West Ltd.* . . . the question of the intention of Parliament was dealt with in connection with certain provisions of the income tax law which, in my opinion, were much more ambiguous than is the section involved in this appeal, and the Exchequer Court decision proceeded to give a broad interpretation to the language used in the statute in order to carry out what the Court felt was the intention of Parliament. I feel

[42] 53 D.T.C. 302.

> bound by this decision to adopt the same kind of reasoning in the interpretation of the provision under review in this appeal.

This judgment was confirmed by the Exchequer Court—*Miron & Frères Limitée* v. *M.N.R.*[43]—where Mr. Justice Fournier pointed out that, in the absence of any evidence to the contrary, it must be assumed that the vendor was one of a group by whom the company was controlled, and the transaction therefore came within the wording of section 20(2)—now 20(4).

The Higher Courts

The decisions of the Exchequer and Supreme Courts in recent years seem on the whole to continue to follow the traditional principles of strict interpretation: that is, they hold that the wording, in context, is the only basis for taxation and unless the taxpayer comes within that wording he cannot be taxed. There are however one or two intriguing judicial situations, to be discussed later, which may or may not be indicative of a changing trend.

Some of the courts' decisions have already been mentioned, where it appeared necessary to round off the story of the case as heard by the board, and these will not appear again here. An example of the more conventional type of strict interpretation against the Crown is the case of *Wilder* v. *M.N.R.*,[44] where the Supreme Court decided that a so-called annuity, which was really a payment of a certain sum each month for his life to the vendor for a business, was not taxable. The Chief Justice here said:

> In my view the true construction to be given to section 3(1)(b) is that the annual profit or gain derived from the source of annuities or other annual payments is taxable income, but that the annuity, or other annual payment, received under the provisions of a contract, if the Minister has not expressed the opinion that some interest was blended with principal money, is not taxable under section 3(1)(b).
>
> I have no doubt that Parliament could declare to be income an annuity or annual payment which represents capital money, but in my opinion, Parliament has not done so.

This case, like the earlier one of *O'Connor* v. *M.N.R.*, illustrates the resistance of the courts to a literal interpretation which alters the earlier law. It is interesting to note that under section 11(1)(k) of the Income Tax Act the capital element of the payments would be determined and the interest element would be taxable.

A warning against "assuming a legislative intent that involves a departure from or a restriction of" ordinary meanings was given

[43] 54 D.T.C 1022. [44] 52 D.T.C 1014.

by Mr. Justice Thorson in *Mountain Park Coals Ltd.* v. *M.N.R.*[45] The dispute was over the question whether the appellant was entitled to exclude from the computation of deductible losses dividends received from other Canadian corporations. In a discussion of the meaning of the word "losses" the court declined to accept the appellant's contention that it meant only business operation losses, and the learned judge said that:

> It is not permissible to interpret words that have a well-known ordinary meaning such as the word 'losses' by assuming legislative intent that involves a departure from or a restriction of such meaning. . . . The legislative intent of an Act must be gathered from the words by which it is expressed and it is the meaning of the words as used that is ascertained.

The case of *Shaeffer Pen Co.* v. *M.N.R.*[46] is an illustration of the application of the strict-interpretation rule in the context of the act. The company had in 1946 changed its fiscal year to end on February 28th instead of December 31st, and sought to deduct its loss in the year ending on February 28th, 1947, from the gains in 1945 under section 5(1)(p), which allows deductions for losses sustained in the year immediately following the taxation year. The minister disallowed the deduction, contending that the two-month period January-February 1947 was the taxation year immediately following 1945. The Exchequer Court dismissed the taxpayer's appeal and upheld the minister's contention. Thorson P. held that the word "year" in the section meant "taxation year", his opinion being based on the grounds that the words of an act must be interpreted in context and "the whole scheme of deductibility of losses applies only in the case of losses sustained in taxation years". He felt that the draftsmanship of the section left something to be desired: and the section was amended by section 139(2) of the Income Tax Act, where a company's fiscal year is stated to be a taxation year.

A particularly interesting case is *Robson* v. *M.N.R.*,[47] which went from the Exchequer Court to the Supreme Court. The appellant was the managing director of company *A*, which had a substantial undistributed surplus. In 1938 it had acquired the shares of company *B* for $100, and in 1944 it sold these shares at cost to the appellant. In the next year the appellant sold them for $750. The Exchequer Court held that the sale of the shares at $100, instead of being genuine, was a device for distributing part of the company's surplus. The court valued the shares in 1944 at $600,

[45] 52 D.T.C. 1221. [46] 53 D.T.C. 1223.
[47] 51 D.T.C. 500 (Ex. Ct.); 52 D T.C. 1088 (S C.C.)

and found that the difference between $600 and the $100 paid by the appellant was a dividend and taxable under the Income War Tax Act. The Supreme Court confirmed both the judgment and the share valuation, and held that the profit of $500 a share was income of the year 1944, when the shares were acquired, and not of 1945, when they were sold. The Exchequer Court judge, Sidney Smith D. J., contrived to bring the transaction within the scope of section 3, though only by relying on the unproved assumption that company *A* intended to distribute its undistributed income:

> If shareholders, because they are shareholders, are given the chance to buy shares in another company at less than their value, and the selling company then has undistributed profits on hand, then I think Section 3 is applicable, at least on the assumption that the company intended to distribute the profits. So I have no serious doubt about the taxability of the transaction. . . .

Rand J. in the Supreme Court pointed out that the investment made by company *A* in company *B* was made from funds representing accumulated profits:

> and if the shares so obtained had been distributed among the shareholders . . . there can be no doubt that they would have been income within the meaning of Section 3 of the Income War Tax Act as 'dividends or profits directly or indirectly received . . . from stocks.'
>
> But such a distribution can be made under the guise of a sale, and here Smith J. has found that to have taken place. . . . I agree with Smith J that the form adopted was simply what was thought to be a means of avoiding the taxation consequences of declaring a dividend.

Both courts here looked through the form to the substance of the transaction and, in view of their decision that the "sale" was actually a distribution of income made in money's worth, were able to tax the profits.

The intention of the legislature to tax all such receipts has since been clearly indicated in section 8(1) of the Income Tax Act; and, although this section was not of course applicable to the case, the general intention of the legislature to discourage tax avoidance had already been made known in an increasing number of measures. It might almost be felt, therefore, that this case was an application of *Heydon*'s rule, were it not for the fact that that intention is not specifically shown in the section relevant to the case and could not therefore be used to interpret its words. In order to bring the transaction within the taxing law, the courts found it necessary to go beyond the form of the transaction and to decide what the actual meaning and purpose was. Having found, though with a suggestion of hesitancy, that the transaction was a distri-

bution of income, they had no difficulty in bringing it within the scope of the words of the act by strict interpretation. The chief interest of the case from the point of view of this study lies in the readiness of the courts to look closely and questioningly at transactions which may be devices to avoid taxation, to regard them with none of the leniency once shown in such matters, and to bring them within the scope of the language of the statute if that is at all possible. The judges did not of course say "this is a tax-dodging device and, since the legislature disapproves of such devices, we will declare the profits taxable". But they did say, in effect, "this seems to be a tax-dodging device and we must therefore search deeply into its real character in order to see whether it cannot legitimately be brought within a strict interpretation of the taxing act".

If the *Robson* case is compared with *M.N.R.* v. *MacInnes* (*No. 19*), which we have already considered, it is difficult to avoid speculating how great a part the sympathy or otherwise of the judges plays, not of course in their dispensing of justice, but in their attitude towards what justice is. In the *Robson* case the inevitable lack of sympathy with tax avoidance, legal though the avoidance might be, caused them to apply the law not to the transaction as it appeared to be but *to what they considered it to have been in reality*. In the *MacInnes* case there was definitely a feeling that, since the tax imposed by the section was unusual in the sense that it applied to a person in respect of income not strictly his own — or, as the judge put it, the section "is a special provision imposing upon a taxpayer a tax liability under certain specified circumstances which, apart from the section, would not have rested on him"— therefore the terms in which the tax was to be imposed must be superlatively clear. So strong was this feeling that one may be forgiven for wondering whether the court admitted an ambiguity where there was none, and gave to the taxpayer the benefit of a non-existent doubt.

The last case to be considered here is one the significance of which readers must judge for themselves. *M.N.R.* v. *79 Wellington West Ltd.*[48] was the Tax Appeal Board case *No. 59*, and Mr. Fisher's decision was reversed by the Exchequer Court. The appeal of the Crown was against the board's decision that property bought from two brothers was not bought from "a person" within the terms of section 8(3), Statutes of Canada, 1949, chapter 25, and that the capital cost allowances disallowed by the minister, on

[48] 53 D.T.C. 1149.

the ground that the transaction was not at arms length, be allowed. Cameron J. felt himself "unable to agree that the word 'one' is so clear and unambiguous that it must necessarily be interpreted as a numeral", and compared its use with that of "une personne" in the French version—which of course could be translated as "one person" or "a person". Following the principle that "when an ambiguous word is used in the statute it is to be interpreted in accordance with the context and object of the statute", the learned judge sought the intention of the legislature—not only in enacting the arms length provisions generally but in enacting that particular subsection:

> In this subsection the primary object was to place in a special category those cases in which the depreciable property had changed hands and in which the parties were not dealing at arms length in order that the capital cost should be based on a fair market value, such as would be the case in a transaction between persons dealing at arms length.

The judgment concluded with the words:

> For these reasons I have reached the conclusion that the intention of Parliament, as I conceive it to be, is better effectuated by giving to the words 'une personne' in the French version, the meaning 'a person' rather than by construing the words 'one person' in the English version as one person only. Such a construction disposes of all cases involving non-arms-length transactions and places all taxpayers whose property has been at the same time transferred in other than an arms length transaction in precisely the same position in determining their capital costs That I believe to have been the intention of Parliament as disclosed in the legislation itself.

This case clearly goes beyond the interpretation of a phrase in the context of the act, since the court avowedly used its knowledge of the intention of the legislature to enable it to come to its conclusion on the meaning of the section. As we have seen, this has been a not uncommon occurrence in recent years; but what makes this case unusual is that the judgment went *against* the taxpayer, and it is in fact the one clear case I have been able to find in which this has happened.

Conclusion

From this survey, then, it would appear that during the last fifteen years or so there have been some changes in the attitude of the courts to the interpretation of income tax acts. While the basic principle that no tax must be charged unless it is imposed clearly by the words of the statute remains unchanged, there is a difference in the manner in which the meaning of those words is decided.

Strict interpretation has come to cover, not only literal interpretation and interpretation in context, but interpretation of the words in the light of *Heydon*'s rule, as is shown by a number of cases during the decade before 1948. Until recently, however, *Heydon*'s rule was always used to give the benefit of the doubt to the taxpayer, but there have recently been some indications that its use may be extended to cover all instances where the doubt may be resolved by its application, regardless of who gets the benefit. The part played by the Tax Appeal Board in this development is negligible, since most of its judgments have been not only strict but literal and, with a few exceptions, have taken little account of the intention of Parliament.

The steps in the progression of the courts may be broadly summarized as: strict interpretation against the Crown—*Heydon*'s rule against the Crown—*Heydon*'s rule against the taxpayer. Is this last an accident and an exception, or is it the thin end of a new wedge and an indication of a future change in ideas on interpretation?

Reporters and Reporteds

One criticism that I desire to voice is against the excessive number of cases that are reported, illustrative of every conceivable shade of difference in the facts, and too often uselessly duplicating and reduplicating each other so far as the basic principles are concerned. When it is remembered that every reported decision is capable of adding at least fifteen minutes to the length of the debate in the next case, the time has surely come for the exercise by the law reporters of a little self-denial and for a reduction in the number of different series of reports. Another criticism, directed against the judges, including myself, is against the practice of three or more full-dress opinions being delivered by different judges, too often with little apparent effort at co-ordination, with the result that much time and thought have to be expended by the reader in the effort to discover the common *ratio decidendi*, if there is one, and not seldom such a common *ratio decidendi* is incapable of discovery. I cannot understand, for instance, why the House of Lords, a final court of appeal, does not issue a single judgment as the Judicial Committee does, instead of compelling us to pore over 40 or 50 pages of print, embodying much repetition and often one or two dissenting opinions. Once again, if you compare 1870 with 1953, you will find that the average length of the judicial opinions has more than doubled. These may seem trifling suggestions, but their adoption would at least help to check the steady growth of the snowball. (The Rt. Hon. Lord Cooper, Defects in the British Judicial Machine (1953), 2 J. Soc. Public Teachers of Law (N.S.) 91, at p. 95)