

## THE INCOME TAX ACT, THE RULES OF INTERPRETATION AND TAX AVOIDANCE. PURPOSE VS PLAIN MEANING: WHICH, WHEN AND WHY?<sup>1</sup>

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*The Bon-Secours codification confirms that legislative purpose has a role to play in the interpretation of taxing statutes. Plain meaning is a safe and predictable harbour. Dickson C.J.'s exhortations in favour of purpose are not particularly easy to implement (either in the context of interpreting the Charter or in the context of interpreting the Income Tax Act). So the question becomes, when must we forsake plain meaning for purpose?*

*The solution begins with Estey J.'s ruminations in Stubar itself. Estey J. has suggested that the Income Tax Act serves three potential "state interests". These are, 1) the raising of revenue to fund government, 2) the achievement of equity among taxpayers in the raising of that revenue and 3) the achievement of fiscal and social policies unrelated to the raising of revenue. If the provision under scrutiny speaks primarily to state interest one (the normative tax structure), an investigation of legislative purpose may be necessary. If the provision speaks to state interests two or three, a plain meaning interpretation should suffice.*

*If purpose it must be, then the Report of the Royal Commission on Taxation provides an authoritative exposition of both the Canadian tax law evolution prior to 1966 as well as the public policy choices considered by the Department of Finance and the legislators prior to the enactment of the 1971 Act.*

*"Context" is the key to the Supreme Court's purpose-based interpretation of the Charter and context will become the key to a purpose-based interpretation of our normative tax structure.*

*Seemingly contradictory tax avoidance cases make more sense once it is accepted that in state interest one terrain the interpretation exercise should focus on identifying the contextual factor that is determinative. The author proposes several factors to be treated as determinative in the interpretation of certain aspects of our income tax regime.*

*Today our judges are being asked, in certain circumstances, to create law based upon the public policy underpinnings that Parliament has determined*

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<sup>2</sup> The opinions expressed are those of the author and not the Department of Justice. The opinions are as of November 27, 1995. A companion article "Using a Contextual Methodology to Accommodate Equality Protections Along with the Other Objectives of Government (With Particular Reference to the Income Tax Act): 'Not the Right Answer,

*should animate the law. So long as our tax courts identify the contextual factors that are determinative and provide transparent reasons for judgment that enumerate the public policy choices, this should be a rewarding time for tax court judges charged with doing their job based on: "empiricism not dogmatism, imagination rather than literalness".*

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*La codification de Bon Secours confirme le fait que l'interprétation en fonction du but poursuivi a un rôle à jouer dans l'interprétation des lois fiscales. Le sens ordinaire des mots est un terrain sûr et prévisible. Les exhortations du juge en chef Dickson en faveur de l'interprétation selon le but poursuivi ne sont pas particulièrement faciles à mettre en oeuvre (qu'il s'agisse d'interpréter la Charte ou la Loi sur l'impôt sur le revenu). Alors la question est de savoir quand abandonner le sens ordinaire pour le but.*

*La solution commence avec les ruminations du juge Estey dans la décision même de Stupart. Il a suggéré que la Loi sur l'impôt sur le revenu serve trois intérêts potentiels de l'État. Ce sont : 1e lever des fonds pour subvenir aux besoins du gouvernement, 2e réaliser l'équité entre les contribuables dans la levée des fonds, et 3e réaliser des politiques fiscales et sociales sans rapport avec la levée de fonds. Si la disposition considérée s'adresse fondamentalement au premier intérêt de l'État (les normes de structure fiscale), une recherche du but poursuivi par la législature peut être nécessaire. Si la disposition s'adresse aux intérêts deux ou trois, l'interprétation selon le sens ordinaire des mots devrait suffire.*

*S'il doit y avoir une interprétation selon le but poursuivi, alors le Rapport de la Commission royale sur l'impôt offre un exposé qui fait autorité sur l'évolution du droit fiscal canadien avant 1966 de même que sur les choix politiques considérés par le ministère des Finances et le législateur avant l'adoption de la Loi de 1971.*

*La «contexte» est la clé de l'interprétation de la Charte par la Cour suprême selon le but poursuivi par le législateur; le contexte deviendra la clé de l'interprétation des normes de notre structure fiscale selon le but poursuivi par le législateur.*

*Des décisions sur l'évasion fiscale, apparemment contradictoires, prennent du sens quand on a accepté que, dans le premier intérêt de l'État mentionné plus haut, l'exercice d'interprétation devrait mettre l'accent sur l'identification du facteur contextuel qui est déterminant. L'auteur propose plusieurs facteurs à traiter comme déterminants dans l'interprétation de certains aspects de notre régime d'impôt sur le revenu.*

*Aujourd'hui on demande à nos juges, dans certaines circonstances, de créer le droit en se basant sur les fondements politiques qui, selon le Parlement, devraient sous-tendre le droit. En autant que nos tribunaux d'impôt identifient les facteurs contextuels qui sont déterminants et qu'ils donnent à leurs jugements des motifs transparents qui énumèrent les choix politiques, cet exercice devrait être gratifiant pour les juges des cours d'impôt, qui doivent faire leur travail en se fondant sur une approche empirique et non dogmatique, en usant d'imagination plutôt qu'en faisant du mot à mot.*

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### I. Introduction

The Supreme Court of Canada recently codified the rules of statutory interpretation that apply to taxing statutes.<sup>3</sup> In my opinion, the *Bon-Secours* codification goes beyond an exercise in good housekeeping. It is an important part of the puzzle, pulling together elements of a strategy whose overall design had until now been uncertain.

While the reasons for judgment of Gonthier J. in *Bon-Secours* are not seminal (that title goes to the joint work of Estey J. in *Stuart*<sup>4</sup> and Dickson C.J. in *Bronfman Trust*<sup>5</sup>) the *Bon-Secours* methodology provides a key that unlocks the potential of those earlier judgments.

In *Bon-Secours* Gonthier J. provides five rules of interpretation:

Rule 1 - The interpretation of tax legislation should follow the ordinary rules of interpretation;

Rule 2 - A legislative provision should be given a strict or liberal interpretation depending on the purpose underlying it, and that purpose must be identified in light of the context of the statute, its objective and the legislative intent: this is the teleological approach;

<sup>3</sup> *Bon-Secours v. Communauté Urbaine de Québec* (1995), 95 D.T.C. 5017 at 5023. See also the companion case *Buanderie centrale de Montréal Inc. v. Montréal*, [1994] 3 S.C.R. 29, both of which deal with *The Act Respecting Municipal Taxation*, R.S.Q., c. F-2.1.

<sup>4</sup> *Stuart Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, 84 D.T.C. 6305 (all references to D.T.C.).

<sup>5</sup> *Bronfman Trust v. The Queen*, [1987] 1 S.C.R. 32, 87 D.T.C. 5059 (all references to D.T.C.).

- Rule 3 - The teleological approach will favour the taxpayer or the tax department depending solely on the legislative provision in question, and not on the existence of predetermined presumptions;
- Rule 4 - Substance should be given precedence over form to the extent that this is consistent with the wording and objective of the statute;
- Rule 5 - Only a reasonable doubt, not resolved by the ordinary rules of interpretation, will be settled by recourse to the residual presumption in favour of the taxpayer.<sup>6</sup>

The emphasis on a purpose-based analysis of legislation (see rules 2, 3 and 4 above) is ordnance left over from the Dickson watch.<sup>7</sup> If legislative purpose is to be the royal jelly in the “teleological” approach, the question becomes, where do we find a purpose-based analysis of the *Income Tax Act*?<sup>8</sup> The answer, I believe, is found in *Stuart* itself, the *Report of the Royal Commission on Taxation*<sup>9</sup> and the parallel purposive developments in the Supreme Court of Canada’s *Charter*<sup>10</sup> jurisprudence.<sup>11</sup>

Before plunging into an analysis of a purpose-based regime for statutory interpretation, it is important to acknowledge that there is a disting ambivalence about this whole exercise. Plain meaning is a safe and dependable harbour.

<sup>6</sup> *Bon-Secours supra* footnote 3.

<sup>7</sup> See *Bronfman Trust, supra* footnote 5 at 5064. For Dickson C.J. the identification of legislative purpose and object is at the heart of statutory interpretation. In the *Charter* context see *R. v. Big M. Drug Mart*, [1985] 1 S.C.R. 295 at 331 (setting out the requirement for a purposive analysis of the impugned legislation) and at 344 (requiring a purposive analysis of the subject Charter provision). See, generally, B. Dickson, “The Role and Function of Judges” (1980) 14 L. Soc. Gaz. 138.

<sup>8</sup> R.S.C. 1985, c.1 (5th Supp.) as am.

<sup>9</sup> *Report of the Royal Commission on Taxation* (Ottawa: Queen’s Printer, 1967). The heart of the Commission’s analysis of and recommendations for income taxation is found in vols. 3 and 4. Appendix A to vol. 3 is entitled “Problems of Tax Avoidance”. See also vol. 3, ch. 9 beginning at 103. There is a useful volume entitled “Consolidated Index” with monk-like attention to detail and cross-referencing. The Commission also published a series of Studies by tax professionals on a variety of topics. Further references in this article will be to the “Carter Commission Report” and the “Carter Commission”.

<sup>10</sup> *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act*, 1982, being Schedule B of the *Canada Act* 1982 (U.K.), 1982, c. 11.

<sup>11</sup> The composition of the evidence going to legislative purpose and effect and the mode of its delivery at trial remain problematic. For example, in *R. v. Heywood* (1994), 174 N.R. 81 (S.C.C.), Cory J. notes at 107: “The admissibility of legislative debates to determine legislative intent in statutory construction is doubtful”. At two recent meetings of the Constitutional Law Subsection of the Canadian Bar Association (Northern Alberta), in separate appearances, Stevenson J. (formerly of the Supreme Court of Canada) and Coté J.A. (of the Alberta Court of Appeal) voiced a distrust of legislative history and legislative effect evidence (in the context of Constitutional litigation). On the other hand, Hugessen J.A. in *The Queen v. Fibreco Export Inc.* (1995), 95 D.T.C. 5412 (F.C.A.) at 5413, while acknowledging the concerns, chastizes the trial judge for failing to admit such evidence, and opts instead to deal with the issue in terms of the weight to be given it.

While the allure of a purposive Heart of Darkness may attract the more adventurous, for most of us, the predictability and familiarity of plain-meaning Rotterdam is difficult to forsake.

Even Iacobucci J., the Supreme Court's leading tax practitioner and proponent of a plain meaning interpretation of the *Income Tax Act*, seems to be of two minds. In *H.B. Antosko v. Canada*<sup>12</sup> "plain meaning" provides him with the foundation for taxpayer relief while in *Friesen v. Canada*<sup>13</sup> he finds himself in purposive dissent to his plain meaning colleagues.<sup>14</sup> It would seem that there is either a healthy dialectic at work here or simple schizophrenia.

I opt for the former. Indeed, in my opinion, "sometimes plain meaning — sometimes purpose" is a potentially successful mantra, and while my default is purpose, as noted within, plain meaning has a role to play in emboldening entrepreneurial initiative and in controlling the Department of Finance. When to apply which is the key question, and that, essentially, is what this paper attempts to address.

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Given my acceptance of the importance of the purposive exercise, it is not surprising that I find myself in Hugessen J.A.'s camp. By definition, however, I accept that the evidence is untrustworthy. The best safeguard to ensure that it is properly vetted and challenged is, I believe, notice; and I would welcome rules that require that such evidence be provided to opposing counsel well before trial. I do not think that it is feasible to rely on witnesses to either deliver this material as oral evidence or be available to comment on the material submitted. The *Report of the Royal Commission on Taxation* speaks for itself and the best testing of this material by the opposing party is contradictory written material offered by opposing counsel, oral evidence in response or opposing counsel's argument. Opening the issue of the legislation's purpose and effect at the argument stage is too late; it reeks of purposive ambush and should unsettle even the most teleologically bent judge. On all of this see also G. Bale, "Parliamentary Debates and Statutory Interpretation: Switching on the Light or Rummaging in the Ashcans of the Legislative Process" (1995) 74 Can. Bar Rev. 1.

<sup>12</sup> [1994] 2 C.T.C. 25 (S.C.C.) — see footnote 61 and the text within under the heading "Recent Tax Avoidance Cases".

<sup>13</sup> (1995), 95 D.T.C. 5551 (S.C.C.) — dealing with section 10 and the taxation of land inventory write-downs.

<sup>14</sup> In *Friesen*, plain meaning prevails with the majority made up of Major, L'Heureux-Dubé and Sopinka JJ. (Gonthier J. joining Iacobucci J. in dissent). Note also the purposive enthusiasms of Iacobucci J. in *The Queen v. Crown Forest Industries Limited* 95 D.T.C. 5389 (in the context of interpreting a tax treaty). See also the recent Federal Court of Appeal split decisions in *The Queen v. Mara Properties Limited* 95 D.T.C. 5168 (dealing with a loss purchase transaction between unrelated taxpayers and the corporate reorganization provisions — leave to appeal granted by the Supreme Court of Canada) and *The Queen v. Fording Coal Limited A-656-94*, decision rendered November 15, 1995 (dealing with a "seeding transaction" that facilitated the transfer of oil and gas expenses between taxpayers). In *Mara Properties* Marceau and Stone J.J.A. are in the majority with purpose while McDonald J.A. is in dissent with plain meaning. Similarly in *Fording Coal* Strayer and Décaré J.J.A. are in the majority with purpose while McDonald J.A. is in dissent again with plain meaning.

## II. *The Three State Interests*

Secreted away in the fabric of his reasons for judgment in *Stubart*, Estey J. states that the *Income Tax Act* is complex legislation with three basic public policy objectives, or what he calls “state interests”. These are

- 1) the raising of revenue to fund government;
- 2) the achievement of equity among taxpayers in the raising of that revenue; and
- 3) the achievement of fiscal and social policies unrelated to the raising of revenue.<sup>15</sup>

As Létourneau J.A. has recently noted in dealing with a *Charter* challenge to section 125.5 of the *Income Tax Act* (the GST Credit):

Furthermore, when one looks at the larger context to determine whether the differential treatment created by the impugned provision amounts to discrimination within the meaning of section 15, one finds oneself in a complex social, political, legal, fiscal and economic environment where Parliament is, in the State’s interest, trying to raise revenues to fund government, achieve equity among taxpayers in so doing and implement fiscal and social policies unrelated to the raising of revenue.<sup>16</sup>

Accordingly, if the provision of the *Income Tax Act* is ambiguous, the first question becomes: is this provision primarily about government revenue, equity or something else? If the provision falls clearly within either division two or three, in my opinion, there may be a pre-emptive governing factor that expedites the purposive investigation.

### A. *Equity Among Taxpayers*

If the provision’s primary legislative objective is clearly number two (equity among taxpayers), a liberal interpretation facilitating the achievement of such a high priority objective<sup>17</sup> is called for.<sup>18</sup>

For example, in *Lister*, Létourneau J.A. adopts the purposive approach. He finds that the purpose of the GST Credit is to provide relief to lower income Canadians from the regressivity of a consumption tax: GST. He notes that this

<sup>15</sup> *Stubart*, *supra* footnote 4 at 6321, 6322. For example at 6321: “Whether the development [of doctrines of statutory interpretation] be by legislative measure or judicial action, the result is a process of balancing the taxpayer’s freedom to carry on his commercial and social affairs however he may choose, and the state interest in revenue, equity in the raising of the revenue, and economic planning”.

<sup>16</sup> *Lister v. The Queen* (1994), 94 D.T.C. 6531 at 6536 Robertson J.A. concurring, (F.C.A.).

<sup>17</sup> While it is pre-empting the story line, for the Carter Commission, nothing was more important than equity among taxpayers. See footnotes 52 and 69, *infra* and the accompanying text.

<sup>18</sup> Most of the “tax avoidance” provisions found within the *Income Tax Act* relate to particular issues endemic to an income tax regime and are therefore most appropriately dealt with under state interest one. See “The Contextual Approach and Tax Avoidance” *infra*.

purpose falls within Estey J.'s second state interest;<sup>19</sup> and accordingly, he proceeds to dispatch the Appellant with some gusto.

### B. *Fiscal and Social Policies Unrelated to the Raising of Revenue*

On the other hand, if the provision under scrutiny falls clearly within Estey J.'s third state interest, that is, fiscal and social policies unrelated to either the raising of revenue or equity among taxpayers, a jaundiced approach to the Finance Department's workmanship may be justified.<sup>20</sup>

The problem here is that, unlike state interests one and two, the *Act* may provide little or no intrinsic evidence as to where the legislature is coming from. A normative income tax structure (basically the first state interest) has a logic and depends on the interrelationship of statutory provisions that in themselves tell a purposive story.<sup>21</sup> The goal of equity among taxpayers is of such importance that the objective itself conveys a jurisprudential imperative. State interest three, however, provides neither of these comfort zones.

For example, the *Act* provides a variety of incentives to certain sectors and players in the economy. Principal residences are exempt from capital gains (subsection 40(6)); the oil and gas, mining, farming and fishing sectors enjoy a range of special incentives and special treatments (see, for example, sections 66, 70 and 119). Often these provisions contradict rather than implement the Carter Commission recommendations.<sup>22</sup>

With these sorts of provisions it may be difficult for a court to identify legislative purpose with any degree of certainty. For instance, is the special treatment of the oil and gas industry based upon a legislative concern about international threats to the uninterrupted supply of these vital commodities; about expedited regional development in Alberta, Saskatchewan and now Newfoundland; or about the visceral realities of electoral politics?<sup>23</sup>

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<sup>19</sup> *Lister*, *supra* footnote 16 at 6536, 6537 and 6539. This example should not be oversold. The purposive analysis of the *Income Tax Act* in the context of a *Charter* claim is, of course, mandated by *Big M Drug Mart* (see *supra* footnote 7). The point is that once embarked upon a purposive analysis of the *Income Tax Act*, the Federal Court of Appeal accepts Estey J.'s three-state-interest methodology.

<sup>20</sup> See the discussion on "tax incentives" in *Stuart*, *supra* footnote 4 at 6322.

<sup>21</sup> See, for example, the attempt by Michael J. McIntyre and Oliver Oldman to present foundational normative rules based on public policy choices in "Taxation of the Family in a Comprehensive and Simplified Income Tax" (1977) 90 *Harv. L.R.* 1573. See the *Carter Commission Report*, *supra* footnote 9, vol. 2, ch. 1 "Objectives of the Tax System" and, generally, ch. 7 through 10 in vol. 3.

<sup>22</sup> On principal residence exemptions see the *Carter Commission Report*, *ibid.* vol. 3, beginning at 357. See the *Carter Commission Report*, *ibid.* vol. 4, ch. 23 "Mining and Petroleum" and Chapter 25 "Other Industries" under the subheading "Farming" beginning at page 439.

<sup>23</sup> Bill C-259 (1972 Tax Reform) was referred to the Committee of the Whole of Parliament after second reading. Much of the debate from both government and non-government members involved parochial political appeals to the electorate. The story from

If the Finance Department is on a public policy frolic of its own unrelated to the normative tax structure and if the statutory provision is ambiguous, a “tough love” interpretive gambit in favour of the taxpayer over the government may be supportable on several grounds.

The first justification is Estey J.’s *laissez-faire* concern with unnecessary governmental intrusion into the lives and businesses of individuals and corporations.<sup>24</sup> For many, government is not to be encouraged in its more expansive urges.

Second, a restrictive rule of interpretation may discourage the government from using the tax system as a vehicle for providing business incentives, a practice that regularly attracts the disfavour of academic commentators.<sup>25</sup> If incentives it is to be, then at least have incentives that can be readily costed out and that are not buried in the *Income Tax Act*.

Third, there is hope that in the face of rigorous rules of interpretation the government will try harder in terms of better drafting and more comprehensive explanations of legislative purpose in Finance Department publications, in Departmental and Ministerial presentations to Parliamentary Committees and in Parliament itself.<sup>26</sup>

Finally, there is solace in the knowledge that if the judicial result is sufficiently unpalatable to the government, the law can be changed.

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the standing committees of Parliament is more edifying. Both the House Finance, Trade and Economic Affairs Committee (see, for example, the Report to the House on the White Paper, October 5, 1970, Minutes of the Standing Committee beginning at page 93:14) and the Senate Committee on Banking, Trade and Commerce (see, for example, The Minutes of the Proceedings of the Senate Banking, Trade and Commerce Committee on the *Proposals for Tax Reform* in June of 1970 and the Committee’s Parliamentary Report on the 1971 Tax Reform Legislation, November 4, 1971, Minutes of the Standing Committee beginning at page 47:1) held extensive hearings, backed by a professional staff, heard from Finance Department and other witnesses, and in the case of the Senate, published the written submissions from a variety of organizations (see the Minutes of the Proceedings on the *Proposals for Tax Reform*).

<sup>24</sup> See *supra* footnotes 15 and 20. At the Cambridge Lectures the summer before writing his judgment in *Stubart*, *supra* footnote 4, Estey J. telegraphed his discomfort with an aggressively intrusive government: “The Income Tax Act of 1972 is another example [of the hyperactive legislature]. By an accounting and legal profession twin convulsion, we replaced our principal revenue collecting tool with a new and complex set of rules and concepts. Every nook and cranny of the community was affected”. Estey J., “The Changing Role of the Judiciary”, in E.G. Baldwin ed., *The Cambridge Lectures 1983, Selected Papers Based Upon Lectures Delivered at the Conference of the Canadian Institute for Advanced Legal Studies held at Cambridge University, England* (Toronto: Butterworths, 1985) 329 at 331.

<sup>25</sup> See, for example, the Carter Commission’s position on tax incentives as set out in paragraph number 4 of the text associated with footnote 52 within.

<sup>26</sup> This, of course, explicitly signals one of the side-bar consequences of the purposive approach. We are, I believe inevitably, moving towards an Americanized system in which the legislature itself, and its committees will become an important forum in which self-serving purposive statements directed at the tax judiciary are rife. Hugessen J.A.’s weighing exercise (see footnote 11) is going to get tougher not easier.

I think it is fair to say that Rule 5 in the *Bon-Secours* codification authorizes such an approach to tax provisions falling squarely within the third state interest.<sup>27</sup> The key here, however, is to determine which side of the Rubicon you are on. If the provision is part of the normative tax structure (state interest one), the Prime Directive that gives primacy to vertical and horizontal equity among taxpayers<sup>28</sup> trumps the considerations enumerated above. If, however, you are in state interest three, for the reasons provided above, an interpretation that errs on the side of the taxpayer, may be justified.

*The Queen v. Fording Coal Limited*<sup>29</sup> is a good example of a case in which plain meaning might well triumph over purpose because of the state interest in play.

For whatever reason, Parliament has decided that exploring for oil, gas and minerals is a high risk endeavour that it wants to encourage. Once Elco Mining Limited rose to the Parliamentary bait; undertook the desired high risk exploration and development; incurred the costs; and, quite predictably, came up empty-handed (this is, after all, high risk territory); why should the courts be party to a Departmental bait and switch that frustrates the deduction of these government-induced outlays notwithstanding the plain meaning of the *Act*? Even from a purposive perspective, if the legislative purpose behind section 66.1 is the encouragement of exploration and development activity, once Elco Mining Limited has met that objective, what is so offensive about confirming that one of the sweeteners in the section 66.1 regime is the unusual portability of these high-risk outlays? For the four generic reasons provided above, it seems to me that in these circumstances, a court may quite happily hoist the Department of Finance with its own plain meaning petard.

In state interest three, while the prejudice is anti-government, if the government can satisfy the court that the clear legislative purpose of the provision is either being avoided or has not been triggered, the taxing authority may still prevail.

For example, in *The Queen v. Coopers & Lybrand Limited (Trustee of Hawboldt Hydraulics (Canada) Inc.)*<sup>30</sup> ("Hawboldt"), Isaac C.J. indicates a willingness to canvas the legislative history in order to identify the purpose of the particular investment tax credit regime provided under subsections 127(5), (9) and (10) of the *Act*:

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<sup>27</sup> Although the approach does effectively reverse one of the basic Duke of Westminster tenets. If the provision falls clearly within state interest three, rather than strictly interpret taxpayer concessions in favour of the government, the opposite is proposed. See *Inland Revenue Commissioners v. Duke of Westminster*, [1935] All E.R. Reprint 259 as discussed at some length in *Continental Bank of Canada v. The Queen* (1994), 94 D.T.C. 1858 beginning at 1870 (T.C.C.).

<sup>28</sup> See footnotes 52 and 69, *infra* and the text accompanying them.

<sup>29</sup> *Supra* footnote 14. See also *Central Supply Co. v. The Queen* 95 D.T.C. 434 (T.C.C. — Bell J.).

<sup>30</sup> (1994), 94 D.T.C. 6541 (F.C.A.).

[T]he relevant statutory provisions were designed to give Canadian manufacturers and processors an advantage over their foreign competitors in the domestic and foreign markets. It is also clear that Parliament had in mind specific target groups and specific target activities. The legislation was not intended to benefit every manufacturing activity or every manufacturer.<sup>31</sup>

The taxpayer's operations do not fall within the category to be favoured by the provision. Accordingly, for the Isaac C.J., an interpretation of ambiguous legislation in favour of the government is warranted.

Also, in dealing with state interest three, the court itself may be motivated by an overriding consideration. For example, in *The Queen v. Augart*,<sup>32</sup> the court was faced with the principal residence exemption in the context of oversized lots. To some, oversized minimum lot size zoning is a badge of systemic discrimination facilitated by government<sup>33</sup>. While perhaps only implicit in his reasons for judgment, Linden J.A.'s dissent is, I believe, best understood in the context of a judge who is responsive to the liberal interpretation of constitutional equality protections<sup>34</sup> and who is not willing to compound the perhaps inequitable<sup>35</sup> principal residence exemption by rewarding even further those who find shelter in minimum lot size neighbourhoods.

### C. Raising Revenue

The preceding pages have dealt with what might be called the easy cases. Most provisions in a taxing statute are about identifying the tax base and then providing the mechanisms necessary for the delivery of a portion of that base to government. This is state interest one terrain, the normative tax structure.<sup>36</sup>

While the provision under scrutiny may include intimations of the second and third state interests, if the provision is part of the normative tax structure,

<sup>31</sup> *Ibid.* at 6548. See also *Bastion Management Limited v. The Queen* (1995), 95 D.T.C. 5238 (F.C.A.).

<sup>32</sup> (1993), 93 D.T.C. 5205 (F.C.A.).

<sup>33</sup> These are governmental zoning regulations that effectively restrict the access of discrete and insular minorities to the tonier neighbourhoods (see, for example, ch. 9 of P.R. Dimond's, *Beyond Busing: Inside the Challenge to Urban Segregation* (Ann Arbor: University of Michigan Press, 1985)).

<sup>34</sup> On section 15 of the *Charter* see his dissent in *Egan and Nesbit v. Canada* (1993), 153 N.R. 161 (F.C.A.) (protecting the constitutional right of gay couples to be free of governmental discrimination) as well as his reasons for judgment in *Schachtschneider v. M.N.R.* (1993), 154 N.R. 321 (F.C.A.). Note also the new rule of interpretation that favours an interpretation that facilitates Charter values as set out in *Slaight Communications Inc. v. Davidson*, [1989] 1 S.C.R. 1038.

<sup>35</sup> Given the explosive appreciation of residential real estate in greater metropolitan areas like Toronto and Vancouver, it is, I believe, difficult to justify the government's failure to include any part of this increase in economic power in the comprehensive income tax base (see the discussion of the Carter Commission Report's focus on the Haig — Simons definition of income within).

<sup>36</sup> See footnote 21.

I believe a purposive analysis cannot rely on the sort of pre-emptive determinations noted above. The normative tax structure has an organic unity that demands a more comprehensive analysis. These provisions are part of a functioning whole and the analysis should begin by identifying the object and purpose of the provision within the wider context of the object and purpose of the tax structure as a whole.<sup>37</sup>

This is easier said than done, of course, but the exercise is not hopeless. And the promise, exciting. It has the potential to provide the judicial branch of government with new tools to assist the legislative and executive branches in achieving a more effective accommodation of the often contradictory public policy objectives of our income tax system.<sup>38</sup> The rest of the paper discusses certain recommended approaches to a purposive analysis of the *Income Tax Act*.

### III. Context and Purpose-Based Charter Jurisprudence

In the mid-eighties Dickson C.J. established legislative purpose as the *sine qua non* for the interpretation of both the *Income Tax Act* as well as the *Charter*.<sup>39</sup>

Since then, the Supreme Court has concentrated on developing a workable Charter jurisprudence while tending to avoid the *Income Tax Act*.<sup>40</sup> Accordingly, it should come as no surprise that the *Charter* jurisprudence has gone further in developing the promise and in avoiding the pitfalls of purpose-based analysis.

Today the mantra for *Charter* litigators is the word context. The *Charter* terrain is complex. For the difficult questions there are no easy rules. The quality of the answers is determined largely by the sophistication of the contextual analysis that calibrates and prioritizes a wide range of contextual considerations.<sup>41</sup> As L'Heureux Dubé J. notes in *Seaboyer*:

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<sup>37</sup> I would argue that Robert Couzin has advanced a derivative of this state interest one vs. state interest three methodology in his speculations on a preferred treatment of "normal losses" and "incentive deductions" in the rules suggested in "Current Tax Provisions", ch. 3 in *The Clarkson Gordon Foundation, Policy Options for the Treatment of Tax Losses in Canada*, (Toronto: The Clarkson Gordon Foundation, 1991) beginning at 3:38.

<sup>38</sup> On the objectives of the *Income Tax Act* see, for example, the *Carter Commission Report*, *supra* footnote 9, ch. 1, "Objectives of the Tax System" and the White Paper on Tax Reform, Hon. Michael Wilson, June 18, 1987, ch. 1, "The Objectives of Tax Reform".

<sup>39</sup> See footnote 9.

<sup>40</sup> For example, the Supreme Court refused the government's leave to appeal application on *Irving Oil* (1991), 91 D.T.C. 5106 (F.C.A.). See D.T.C. Current Cases, Appeals Filed, Supreme Court of Canada.

<sup>41</sup> This is also *Nichomachean Ethics* territory. In the vernacular of a modern Greek political philosopher: "Not the right answer stupid, the best answer." We have to begin by accepting the complexity of the subject matter (in Aristotle's case politics, in our's income taxation) and concede that the exercise is not about finding truth but rather about determining what seems to be the best accommodation based upon an assessment of which factors are important. See, for example, Aristotle, *Nichomachean Ethics* translated by M. Ostwald (New York: MacMillan Publishing Company, 1986) at 1094b line 11.

It is my view that the constitutional questions must be examined in their broader political, social and historical context in order to attempt any kind of meaningful constitutional analysis. The strength of this approach was discussed by Wilson J., in *Edmonton Journal v. Alberta (Attorney-General)* (1989), 64 D.L.R. (4th) 577. She states at 383-4 that, “[o]ne virtue of the contextual approach, it seems to me, is that it recognizes that a particular right or freedom may have a different value depending on the context.”<sup>42</sup>

Context is where the analysis of the normative tax structure is headed, following the comparable developments in the *Charter* jurisprudence. Indeed, context is expressly introduced in Rule 2 of the *Bon-Secours* codification. Also the *Lister* case is interesting because it explicitly imports the contextual analysis into the taxation law (see extract above associated with footnote 16). Similarly in *Hawboldt*, Isaac C.J. (the federal government’s lead counsel in *Big M. Drug Mart*) pitches his purposive analysis of subsection 125(5) in expressly contextual terms, beginning his peroration: “I start with context”.<sup>43</sup>

#### A. *The Purposive Approach and the Royal Commission on Taxation*

Unlike the *Charter*, the *Income Tax Act* of 1972 was preceded by a Royal Commission that explored things purposive almost obsessively. Chairman Carter had a favourite saying: “There is no good practice that is not based on sound theory”.<sup>44</sup>

For those willing to accept the Dicksonian challenge codified in *Bon-Secours* and who are prepared to seek a contextual analysis for the normative tax structure that attempts to identify and implement the foundational objects and purposes of our income tax regime, the *Report of the Royal Commission on Taxation* is an incomparable resource. Not only is it the genesis for both the 1969 White Paper<sup>45</sup> as well as the 1972 Act, but more important, it provides an unrivalled attempt at analyzing and rebuilding the income tax structure based on first principles.<sup>46</sup>

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<sup>42</sup> *R. v. Seaboyer* (1991), 83 D.L.R. (4th) 193 at 204 (S.C.C.). See now *Egan v. Canada* (1995), 124 D.L.R. (4th) 609 (S.C.C.) (in particular the dissenting judgment of L’Heureux-Dubé J.); *R. v. D.O.L.*, [1993] 4 S.C.R. 419 at 438.

<sup>43</sup> *Hawboldt*, *supra* footnote 30 at 6546.

<sup>44</sup> As reported by Commission member J. Harvey Perry, “Background and Main Recommendations of the Royal Commission on Taxation” in N. Brooks ed., *The Quest For Tax Reform: The Royal Commission on Taxation Twenty Years Later* (Toronto: Carswell, 1988) at 27.

<sup>45</sup> E.J. Benson, *Proposals for Tax Reform*, (Ottawa: Department of Finance, 1969) (*“Proposals for Tax Reform”*).

<sup>46</sup> Almost ten years after its publication, one of the leading United States tax academics, in an influential article, quoted at length from the *Carter Commission Report*, *supra* footnote 9 (see B. Bittker, “Federal Income Taxation and the Family” (1975) 27 *Stanford L. Rev.* 1389 at 1393).

The *Carter Commission Report* has its limitations. Most of its recommendations failed to be enacted.<sup>47</sup> Its fixation on the Haig-Simons definition of income<sup>48</sup> and the related conviction that taxpayer equity is built upon both the sanctity of a comprehensive tax base (a buck, is a buck, is a buck) as well as the identification of “economic power” in all its guises is even more contentious today than it was thirty years ago.

That said, the theoretical underpinnings of the *Commission Report* are still intellectually competitive. While we know more today than we did yesterday, the theoretical fault lines of the policy debate are not novel. Today, while the battle is fought in terms of consumption taxation vs. income taxation,<sup>49</sup> the basic political issue remains exactly as Carter found it over thirty years ago. Do we tend towards keeping government out of the boardrooms of the nation in order to facilitate the efficient deployment of the community’s capital? Or do we tend to let government in so that it can redistribute wealth, providing as many Canadians as possible with the economic critical mass necessary in a vibrant economy?

To the surprise of many,<sup>50</sup> the Royal Commission weighed in on the redistributive side:<sup>51</sup>

In our opinion there is a consensus among Canadians that the tax-expenditure mechanism (including transfers) is equitable when it increases the flow of goods and services to those who, because they have little economic power relative to others, or because they have particularly heavy responsibilities or obligations, would otherwise not be able to maintain a decent standard of living....

We believe that in order to achieve a more equitable distribution of output, the tax system should be consistent with the following objectives:

1. Most of the time most government expenditures should be financed through taxes that are allocated in proportion to ability to pay. This means, in effect, that

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<sup>47</sup> Much of the authority for the next several paragraphs is taken from Brooks, *supra* footnote 44.

<sup>48</sup> Defined by McIntyre and Oldman, *supra* footnote 21 at 1575 as “the market value of consumption enjoyed during the tax year plus the net change in savings”. See, for example, the Carter Commission Report, *supra* footnote 9, vol. 3, ch. 7 “Taxation Based on Ability to Pay”, in particular the subheading “Economic Power” beginning at 22.

<sup>49</sup> For a contemporary discussion see ch. 3 “Economic Aspects of Federal Income Taxation” in B. Bittker and L. Lokken, *Federal Taxation of Income, Estates and Gifts 2nd Edition* Volume 1 (Boston, New York: Warren Gorham & Lamont, 1989) at 3-1ff.

<sup>50</sup> As Brooks notes, *supra* footnote 44 beginning at 3, the Royal Commission itself was conceived on Bay Street and approved by Prime Minister Diefenbaker as a signal to the monied wing of the party that this prairie Conservative was not too Progressive.

<sup>51</sup> The *Carter Commission Report* was the product of an era in which the political vernacular conceded an ascendancy to the liberal point of view that today seems extraordinary. Lester Pearson’s minority government had recently enacted Medicare, the Canada Pension Plan and the Canada Assistance Plan. Lyndon Johnson had recently signed the Civil Rights Act of 1964 and the legislative framework for the Great Society. Harold Wilson was Prime Minister of Great Britain. The Progressive Conservatives were jockeying to replace John Diefenbaker with Robert Stanfield. George Romney and Nelson Rockefeller were the leading candidates for the Republican presidential nomination.

the government must seek to impose progressive marginal rates on all additions to personal economic power, without regard to the source of those increments in power. Wages, salaries, business profits, gifts and capital gains all increase the economic power of the recipients and should be treated on exactly the same basis for tax purposes...

4. It should also be a goal of the tax system to avoid tax concessions to particular industries and to particular kinds of income. While the efficacy of special treatment can be judged only in the light of the particular circumstances, such tax concessions are always inequitable, are frequently inefficient, tend to distort the allocation of resources, and erode the tax base. If such special concessions are to be given, they should be provided in a form that makes it possible to assess their costs, that is, revenue forgone, so that the concessions can be appraised at periodic intervals. Therefore, generally speaking, subsidies should be used rather than tax concessions.

In light of these criteria, we believe that the present tax system is inequitable in many important respects.<sup>52</sup>

As the recent health care debate in the United States has confirmed once again, dispassionate structural analysis of something that affects a significant portion of the economy is difficult in our political culture.

Nothing is more disruptive to the economy than income taxation.<sup>53</sup> Real tax reform is a perilous undertaking.<sup>54</sup> "Render therefore unto Caesar the things which are Caesar's"<sup>55</sup> are the words of a politician who is not seeking re-election. It takes something like a five million dollar Royal Commission with a staff of seventy-five professionals to overcome our inability to analyze objectively something like the income tax system.<sup>56</sup> The most important

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<sup>52</sup> *Commission Report, supra* footnote 9, vol. 2, ch. 1: "Objectives of the Tax System", at 10ff. The government was cautiously supportive of this perspective in its 1969 White Paper. See *Proposals for Tax Reform, supra* footnote 45 at 6, para. 1.6. The House Finance Committee discusses the debate at some length in its Report beginning at page 93:20 of the Standing Committee Minutes (see *supra* footnote 23 and *infra* footnote 56).

<sup>53</sup> "All levels of government together now require more than one-third of the gross national product in taxes, social security contributions and other revenue to provide public services" *Proposals for Tax Reform*, Benson, *supra* footnote 45 at 6.

<sup>54</sup> Michael Wilson + GST = Political Oblivion.

<sup>55</sup> *The Holy Bible*, (Oxford: Oxford University Press, Authorized King James Version), Matthew 22:21.

<sup>56</sup> We are all taxpayers. We all bring to the exercise a visceral conflict of interest. We all have a wallet and a sector (our own and our client's) to protect. Beyond these generic inhibitions, where the dominant political creed is a neo-conservative antagonism towards government itself, it is, I believe, difficult to engage in a thorough analysis of issues like vertical and horizontal equity. Equity becomes not so much an issue taxpayer vs. taxpayer; rather it is a matter of taxpayer vs. government. As the Report of the Finance Committee on the *White Paper, supra* footnote 23 notes: "Equity, according to the Royal Commission Report and the White Paper, is to be sought as *between taxpayers*, and results from comparable treatment of taxpayers by government. But to the average Canadian, judging from submissions received by the Committee, it seems to be equity *between himself and the government*" (the emphasis is the Committee's) at 93:22 of the Standing Committee Minutes. The author is not excluded from this rabble. The generic crankiness of the employee/taxpayer is more than offset by the fact that the author is paid by government to keep the collection machinery of government greased and running.

accomplishment of the Royal Commission was its capacity to look beyond the sacred cows in the economy.<sup>57</sup>

While we may not share the Commission's politics,<sup>58</sup> I would argue that the Royal Commission's Haig - Simons based<sup>59</sup> presentation of the basic, sometimes conflicting, objectives and intentions of our income tax system transcends the political and provides the authoritative purposive vernacular for those charged with understanding the *Income Tax Act*.<sup>60</sup>

## B. *The Contextual Approach and Tax Avoidance*

Having advanced a theory, it is now appropriate to test the contextual approach by applying it to tax avoidance, using the *Carter Commission Report* as the purposive gravamen.

### i) *Recent Tax Avoidance Cases*

The results in a number of recent tax avoidance cases must seem perverse to the reader who has not accepted that the courts are working from a contextual model. For those who have not found Oz and are working from the old rules, the same court, even the same judge, may seem to produce results that are contradictory. *Antosko*, *Bon-Secours*, the dissent in *Friessen*, *Mark Resources Inc.* and *Continental Bank*, are difficult to reconcile.<sup>61</sup>

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<sup>57</sup> The virulence of the criticism they engendered only serves to confirm the extraordinary nature of their accomplishments. Kenneth Carter died in 1969, a man under attack. See, for example, L. MacDonald "Why the Carter Commission Had to be Stopped" in Brooks ed., *supra* footnote 44 and the reference to "a near frenzy of denunciation" at 352.

<sup>58</sup> It may be argued that Carter's politics are out of the civil libertarian wing of the neo-conservative movement, and are not bleeding-heart-based at all. Simons was indeed one of Carter's intellectual heroes (see K. Carter, "Canadian Tax Reform and Henry Simons" (1968) 11 J. of Law & Econ. 231) but as one of the founders of the Chicago school, Simons looked upon the comprehensive tax base as a conservative tool to level the economic playing field and rout vested preferences from the economy (see Neil Brooks, "An Overview" in Brooks ed., *supra* footnote 44 at 7).

<sup>59</sup> See the discussion of the Haig - Simons definition of income in B. Bittker and L. Lokken, *supra* footnote 49 at 3-2.

<sup>60</sup> See *Carter Commission Report*, *supra* footnote 9, ch. 1 "Objectives of the Tax System", extract from Conclusions and Recommendations, vol. 2, at 18. See footnote 38.

<sup>61</sup> In *H. B. Antosko v. Canada*, *supra* footnote 12, by allowing the appeal and rejecting the reasons for judgment of Stone J.A. in the Federal Court of Appeal, Iacobucci J. seems to reject a purposive approach out of hand while four months later the same court produces *Bon-Secours* without any reference to *Antosko* (Iacobucci and Gonthier JJ. sat on both panels). See also footnote 14. On the tax avoidance/statutory interpretation beat, Bowman J. in *Mark Resources Inc.* (1993), 93 D.T.C. 1004 (T.C.C.) seems to adopt the purposive approach hollus bollus while exhibiting a surprisingly jaundiced perspective on it all in *Continental Bank of Canada et al. v. The Queen*, *supra* footnote 27.

If, on the other hand, you begin with the proposition that the exercise requires a calibration and prioritization of a variety of contextual factors, it is easier to understand the results. Each has a different mix of factors and the key to understanding the emerging jurisprudence is to identify those contextual factors that are determinative. For example, the results in both *Antosko* and *Mark Resources Inc.* are dictated by pre-eminent contextual factors.

In *Antosko* the Finance Department got “mirandized”.<sup>62</sup> Subsection 20(14) is not ambiguous. Indeed, it is a closed regime with deemed results elaborated in mandatory terms. The presence in the economy of non-tax-paying creditors is no secret. Accordingly, even though we are in state interest one territory, the case never gets beyond the first rule in *Bon-Secours*. The ordinary rule of interpretation here is that unambiguous provisions are to be interpreted as written, and while finding ambiguity is a subjective undertaking,<sup>63</sup> why come to the Finance Department’s aid when the provision is drafted with such blinding certainty?

The dominant contextual factor in *Mark Resources Inc.* is the shadow of *Bronfman Trust* and Dickson C.J.’s surprisingly restrictive analysis of paragraph 20(1)(c). For Dickson C.J., if the interest relates to the cost of the acquisition of capital, paragraph 18(1)(b) expressly precludes a deduction.<sup>64</sup> For the Chief Justice the exception in paragraph 20(1)(c) is offered by the legislature only for the self-serving purpose of generating taxable income. This is not GAAP.<sup>65</sup> This is not some derivative of a reasonable expectation of profit test.<sup>66</sup> In the Dicksonian world, paragraph 20(1)(c) is an exceptional deduction that can be taken only if there is a direct connection between the capital interest expense and taxable income. This is the pre-eminent factor that determines the case for Bowman J., and it explains why a judge, who in *Continental Bank* exhibits both an enthusiasm for the *Duke of Westminster* as well as some scorn for the nascent tax avoidance tools,<sup>67</sup> feels compelled to deny the 20(1)(c) deduction here.

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<sup>62</sup> Here the Department has bungled the drafting rather than the arrest.

<sup>63</sup> See, for example, *The Queen v. Fibreco Export Inc.* (1995), 95 D.T.C. 5412 (F.C.A.).

<sup>64</sup> Note the English Court of Appeal decision which places interest on income account: *Beauchamp v. Woolworth plc.*, [1989] 1 W.L.R. 50 (rev’d on other grounds by the House of Lords).

<sup>65</sup> GAAP matches the interest expense, whether on capital or income account, to the year incurred. See CICA Handbook at section 1520.03.

<sup>66</sup> By definition, once the outlay is found to be on capital account under paragraph 18(1)(b), it is not a 9(1)(a) or 18(1)(a) outlay or expense that attracts the reasonable expectation of profit presumption in favour of finding deductibility (unless there is no reasonable expectation of profit).

<sup>67</sup> *Continental Bank of Canada v. The Queen*, *supra* footnote 27 at 1870ff.

## ii) *The Royal Commission and Tax Avoidance*

In the particularly troublesome world of tax avoidance we are moving towards a contextual methodology that identifies a range of factors that must be prioritized and assessed in the context of the legislation under review.

*Bon-Secours* tells us that contextual factor number one is purpose. I have suggested that the first stop in the purposive investigation is the Royal Commission on Taxation, and I think it is fair to say that on tax avoidance the *Royal Commission Report* provides an important summary of the purpose and objectives of the income tax regime's avoidance controls:

### SUMMARY

1. It is necessary and desirable in any modern tax system to have effective provisions to counteract tax avoidance. However, a number of other objectives and guiding principles must also be kept in mind.
  - a) A taxpayer should not be penalized for deciding not to earn income, even if the reason for this decision is the reduction or avoidance of tax liability. Likewise if he gives up a right to income and does not retain any control over the income or source of income he should not be taxed on such income arising thereafter.
  - b) If a taxpayer arranges his affairs in such a way that he avoids tax on income or reduces his liability for tax on the income below what he would expect to pay under the general scheme and intent of the legislation, while continuing to enjoy the benefits of the income or continuing to control the income or its source, he should be taxed.
2. The courts should not depart lightly from the words of the statute where those words are clear and unambiguous and should not disregard the legal effect of a transaction. However, in order to work with the legislature to develop good tax laws and in order to avoid the necessity for numerous technical loophole-closing amendments, the courts should interpret the tax statute fairly and equitably and in such a way as to give effect to the legislative scheme, without any presumption being made either for or against the taxpayer. They should also have regard to the true nature and effect of transactions and take into account their economic substance as well as their legal effect.
3. Tax avoidance provisions in the legislation should be carefully designed to accomplish the objectives in paragraph 1 above so far as possible. While the "sniper" approach or the "shotgun" approach or an approach somewhere in between may be advisable in each area, the provisions should not be so broad or so rigid as to penalize *bona fide* transactions. Normally a provision should be expressed in sufficiently general terms that the courts will be able to interpret the words in the context of the legislative scheme and distinguish between the cases which are deserving of correction and those which are not. On the other hand, such provisions should not be so broad and general that they are devoid of any clear meaning and therefore ineffective in operation....
6. Section 137(1) [old 245(1)], which disallows expenses which would unduly or artificially reduce income, would probably be held applicable only in rare and

extreme cases, and should be retained mainly as a deterrent. Section 137(2) [old 245(2)], which imposes tax on benefits conferred, is so broad and general and so vague that it is unlikely to have much practical importance. Any provision of this kind should specify more particularly the circumstances in which it will apply.

7. Section 16(1) [56(2)], which provides for the constructive receipt by one taxpayer of a payment made to another, is sufficiently clear in its intent and at the same time is sufficiently general in its wording that it leaves room for interpretation and application by the courts according to each case, and it should be retained...68

In prioritizing the basic objectives of a taxation system, the Royal Commission established vertical and horizontal equity among taxpayers as the Prime Directive: "We assign a higher priority to the objective of equity than to all the others".<sup>69</sup>

For the Royal Commission both the express tax avoidance provisions as well as the related doctrines of statutory interpretation of the normative tax structure are to be the principal enforcement tools to meet the Prime Directive. Not only does the Commission's Summary, set out above, accurately predict the jurisprudential developments in *Stuart* and *Bronfman Trust*, it also provides a sensible purposive overview of what the courts are charged with accomplishing in this area of the tax law.

From this foundation, specific doctrinal aids with cryptic forms such as "substance over form", "commercial reality", "modified analysis of closely held corporations",<sup>70</sup> "principal and agency" and "step transaction" become more meaningful. If the particular doctrine can advance the Prime Directive without trashing other contextual factors of similar importance, why not take advantage of the court's enhanced capacity to achieve an equitable allocation of the tax burden?

### iii) *State Interest One and Tax Avoidance*

Certain tax planning gambits run smack into the normative tax structure. These planning strategies rely upon plain meaning interpretations of the *Act* that

<sup>68</sup> *Carter Commission Report, supra* footnote 9 vol. 3, app. "A" "Problems of Tax Avoidance" at 573.

<sup>69</sup> *Carter Commission Report, ibid.*, vol. 2 at 17.

<sup>70</sup> It seems difficult to dispute the fact that "when the same persons occupy both sides of the bargaining table, form does not necessarily correspond to the intrinsic economic nature of the transaction" (See B. Bittker and J. Eustice, *Federal Income Taxation of Corporations and Shareholders*, 5th ed. (Boston: Warren, Gorham & Lamont, 1987) at 4-21 and cases cited in footnote 64 at 4-22). The last three paragraphs in Dickson C.J.'s razor thin majority judgment in *The Queen v. McClurg* (1991), 91 D.T.C. 5001 at 5012 suggest that looking behind the closely-held-corporation's chador is a legitimate tax avoidance doctrine. But can he that giveth, taketh away? In Canada the closely held corporation is a creature of the *Income Tax Act*. The small business deduction *requires* incorporation. Surely if anybody is going to be forced to accept the consequences of the corporate veil it should be Finance.

are out of sync with foundational concepts. In these circumstances, a court is justified in resisting the attraction of plain meaning.

*Mara Properties*<sup>71</sup> is a case in point. The extent to which an income tax regime permits the transfer of losses between unrelated taxpayers is a basic policy choice, providing a key determinant for the tax base.<sup>72</sup> In Canada, Parliament has consistently opted to restrict such loss transfers.<sup>73</sup> In the words of the Royal Commission on Taxation “a full sharing of losses by the government would be repugnant to most Canadians”.<sup>74</sup> In this context, a purposive analysis of section 9 and subsection 88(1) is appropriate and might well induce a court to find that the transaction in *Mara Properties* was entered into with a conviction of loss; was not a scheme for profit-making with respect to the dealings in the particular property; and therefore, falls outside the business context required for there to be a determination of either profit or loss in accordance with subsections 9(1) and (2) of the *Act*.

#### iv) *The Accepted Norms of Commercial Reality Test*

In the lee of *Stubart* itself and *The Queen v. Irving Oil Limited*<sup>75</sup> it would be disingenuous to argue that the United States “business purpose” test<sup>76</sup> is alive and well in Canada. Until advised to the contrary by the Supreme Court of Canada, we have to accept that ours is a *Duke of Westminster* jurisdiction.

Despite that, however, I place the right of taxpayers to tax plan as aggressively as the letter of the law allows in a distinctly secondary tier of the contextual firmament.

The purpose of this rule is no longer grounded in the *noblesse oblige* of a conservative judicial branch of government imposing its own fiscal drag on the

<sup>71</sup> *Supra* footnote 14 — on appeal to the Supreme Court of Canada.

<sup>72</sup> See *Report of the Royal Commission on Taxation, supra* footnote 9, Volume 4, Chapter 22 “General Business Income” beginning at 252. See also Robert Couzin, “Current Tax Provisions Relating to Deductibility and Transfer of Losses” chapter 3 in *Policy Options for the Treatment of Tax Losses in Canada* (1991) The Clarkson Gordon Foundation (Scarborough, Ontario: Thomson Professional Publishing Canada).

<sup>73</sup> See Royal Commission Report, *ibid.*, Volume 2 at 155.

<sup>74</sup> Royal Commission Report, *ibid.*, Volume 4 at 253. See also *Morrissey v. Canada* 89 D.T.C. 5081 (F.C.A.) at 5081 for a discussion of the *Act*’s use of “chief source of income” (between 1917 and 1951) as a buffer against loss offsets from other sources of income of the same taxpayer. For Budget statements setting out a consistent government perspective on the need to restrict loss transfers see: Finance Minister Gordon’s 1963 Budget Speech, Hansard at 1005; Finance Minister MacEachern’s Budget Papers tables November 12, 1981 under the heading “Transfer of Losses on Change of Control”; Finance Minister Wilson’s Budget Papers, May 1985, titled “The Corporate Income Tax System, A Direction for Change”.

<sup>75</sup> *Supra* footnote 40.

<sup>76</sup> See *Gregory v. Helvering, Commissioner of Internal Revenue*, 293 U.S. 465 (1934).

social welfare state.<sup>77</sup> Today the justification for such a rule is more in keeping with the commentary of Estey J. in *Stubart*. If the tax planning gambit is well within normal commercial practice, even if the statutory provision relates to state interest one, it may be appropriate to “mirandize” the Finance Department, based on the *laissez-faire* policy concerns of Estey J. previously noted.

In *Mark Resources Inc.* Bowman J. notes:

It is fair to say that artificiality is in the eye of the beholder, and where one draws the line between ‘acceptable’ and ‘unacceptable’ tax avoidance schemes is a matter of perception. In that determination the fact that the scheme may have been predominantly or exclusively fiscally motivated plays a minor or even a non-existent role [case references omitted]. What is of far greater importance is whether the scheme falls within accepted norms of commercial reality.<sup>78</sup>

I would argue that the case law, as it applies to the normative tax structure, is relatively consistent with a rule that proposes a continuum from normal commercial practice at the one end to extra-ordinary commercial practice at the other. The transactions in *Irving Oil*, *McClurg* and *Stubart*, for example, are eminently foreseeable commercial practices and a court might reasonably conclude that they would be in the contemplation of the Finance Department. Accordingly, if not dealt with in the legislation, either through express exclusion in the primary provision, or through indirect exclusion in a generic tax avoidance provision that teleological investigation confirms was crafted with the subject avoidance problem in mind, why not assume that the Finance Department finds them permissible?<sup>79</sup>

Moving away from normal commercial practice on the continuum, the assumption that the events were in the contemplation of the Finance Department diminishes and the obligation of the court “to work with the legislature to develop good tax laws ... to avoid the necessity for numerous technical loophole closing amendments ... [and to] interpret the tax statute fairly and equitably to give effect to the legislative scheme” becomes more compelling.<sup>80</sup>

For example, the capital loss transactions that the English courts disqualify under the “step transaction” doctrine (and that Estey J. discusses at some length in *Stubart*) might be derailed in Canada in terms of being too far removed from normal commercial practice.<sup>81</sup>

<sup>77</sup> At the height of the Depression, the House of Lords had no trouble endorsing the Duke of Westminster’s rather ham-handed tax avoidance gambit (*Inland Revenue Commissioners v. Duke of Westminster*, *supra* footnote 27).

<sup>78</sup> *Mark Resources Inc. v. The Queen*, *supra* footnote 61 at 1009.

<sup>79</sup> We do not know whether the *Stubart* transaction would have survived scrutiny under the pertinent tax avoidance provision, then section 137. See *Stubart*, *supra* footnote 4 at 6309.

<sup>80</sup> In paragraph number 2 of the quote associated with footnote 68, *supra*. See also footnote 38. Here we are also getting into Dickson C.J.’s instruction to look at the “commercial reality” of the taxpayer’s actions — see *Bronfman Trust*, *supra* footnote 5 at 5067 and *The Queen v. McClurg*, *supra* footnote 70 at 5011 (see also final sentence, paragraph no. 2, of extract from *Carter Commission Report* associated with footnote 68 *supra*).

<sup>81</sup> Note that the capital gains subdivision of the Act, prior to GAAR, contained its own step transaction type tax avoidance provision in subsection 55(1).

### Conclusion

The promise of purposive analysis is certainly not convenience. The judge who is looking for formulas that rival, in their simplicity and ease of application, the rule in the *Duke of Westminster* will be disappointed. The promise here is not an easier path to judgment, but rather, a better path.

Experience teaches that an investigation of the intent of the executive and legislative branches of government and the purpose of the legislation is almost inevitably rewarded with new insights into the legislative provision under scrutiny. For example, the GST Credit is the product of surprisingly intense governmental consideration of the regressivity of consumption taxes, a process that dates back to the Royal Commission on Dominion Provincial Relations (Rowell Sirois).<sup>82</sup>

Revenue Canada's effort to turn the director's duty of care obligation in section 227.1 into a blanket personal indemnification for certain unsecured corporate debts loses ground when tested against the legislative purpose reported by the House Finance Committee:

The proposal has been necessitated by the fact that some corporations have been setting up separate companies without any assets for the exclusive purpose of engaging employees for contract work without remitting payroll taxes. Since these companies did not have any assets, Revenue Canada was not able to force liquidation of the company's assets for the payment of taxes. The proposal will enable Revenue Canada to pursue the company directors for the taxes in arrears.

While the principle of the proposal is sound, the Canadian Bar Association considers the potential scope of application of the proposal too broad. For this reason, it suggests that the expanded liability be applicable only when directors have "direct knowledge" of the company's non-compliance or where violations occur as a result of the director's "gross negligence."<sup>83</sup>

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<sup>82</sup> See *Lister*, *supra* footnote 16 at 6536, 6537.

<sup>83</sup> The Eighteenth Report to the House, Finance, Trade and Economic Affairs Committee, Minutes of Proceedings, 5-10-82 at 18:16. It must be assumed that the Committee was reporting on the purpose indicated by the Finance Department officials who testified in camera (see, for example, Committee Minutes of August 26, 1982 and September 10, 1982). The due diligence defence was added by the Finance Department after the Committee Report. For a discussion of the history of the section see E.G. Kroft, "The Liability of Directors for Unpaid Canadian Taxes" in *Report of Proceedings of the Thirty-Seventh Tax Conference*, 1985 Conference Report (Toronto: Canadian Tax Foundation, 1986) 30: 1-90 at 30:15. I would argue that section 227.1 is another example of the troubled relationship between the *Income Tax Act* and the closely held corporation. Why the director is singled out while the officers and owners escape responsibility (contrast section 227.1 with the wider net provided for in article 6672 of the *United States Internal Revenue Code*) is probably explained by the provision in our new BCA's that provides that the directors "shall manage the business and affairs of the corporation" (see, for example, subsection 102(1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44). But as Professor Gower has noted, our new corporate law statutes and reforms (including section 102) are directed at the widely held corporation and tend to have no sensible application to the closely held corporation. See L.C.B. Gower "Whither Company Law" (1981) 15 U.B.C.L. Rev. 385-401.

Rule 2 in the *Bon-Secours* codification is an important call to arms consistent with the Carter Commission's vision of the role of the judiciary in statutory interpretation, in general, and in tax avoidance, in particular. Government has the authority to establish tax policy. The tax courts have the responsibility to identify the purpose and intent of that policy and implement it. In the words of Holmes J.:

The Legislature has the power to decide what the policy of the law shall be, and if it has intimated its will, however indirectly, that will should be recognized and obeyed. The major premise of the conclusion expressed in a statute, the change of policy that induces the enactment, may not be set out in terms, but it is not an adequate discharge of duty for courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.<sup>84</sup>

Today our judges are being asked to create law based upon the public policy underpinnings rather than just discover that which is pre-ordained.<sup>85</sup> So long as our tax courts identify the contextual factors that are determinative and provide transparent reasons for judgment that enumerate the public policy choices, this should be an exciting time for tax court judges charged with doing their job based on: "empiricism not dogmatism, imagination rather than literalness".<sup>86</sup>

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<sup>84</sup> *Johnson v. U.S.*, 163 F. 30 at 32 (1st. Circuit 1908) as quoted by Bittker and Lokken, *supra* footnote 49 at 4-26 after noting: "It is far from clear, however, why the Code should be construed strictly against either the taxpayer or the government. A more salutary attitude was advocated by Holmes J., responding to the once-popular adage that statutes in derogation of the common law should be strictly construed".

<sup>85</sup> On the liberalization of the judging process, and for explicit answers to the question "Do Judges Create or Discover?" from two recent Supreme Court Chief Justices, see B. Dickson, "The Role and Function of Judges" (1980), 14 L. Soc. Gaz. 138-91 and B. Laskin, "The Role and Functions of Final Appellate Courts: The Supreme Court of Canada" (1975) 53 Can. Bar Rev. 469-81.

<sup>86</sup> Advice provided to the Supreme Court of Canada by B. Laskin, "The Supreme Court of Canada: A Final Court of and for Canadians" (1951) 29 Can. Bar Rev. 1038 at 1076.