THE SUPREME COURT OF CANADA'S TAX JURISPRUDENCE: WHAT'S WRONG WITH THE RULE OF LAW

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“These interpretative guidelines...are in my view appropriate to reduce the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction.” (Per Estey, J. in Stubart Invests. Ltd. v. The Queen, 1984).

This paper reviews the history of the Supreme Court’s tax jurisprudence focussing on the Court’s ongoing struggle to define its proper institutional role in the creation and interpretation of the tax laws. An empirical overview is first presented to document the changing nature and volume of the Court’s taxation caseload through history, and this is related to the evolution of Canada’s fiscal system. Selected judgments from differing periods are then examined to illuminate how the Court has conceived its role in the adjudication of tax issues. The author suggests that tax decisions have been strongly informed by a classical liberal vision of the rule of law and an overriding concern to protect taxpayer liberty, understood as the right to hold private property free from arbitrary state interference. This vision is closely linked to a history of strict construction of tax statutes and of toleration for tax avoidance, fuelling the endless “action and reaction” referred to by Estey, J. In the Supreme Court’s landmark ruling in Stubart.

In recent decades the Court has increasingly acknowledged the state’s interest in promoting values such as positive liberty and substantive equality through the tax system. However the author concludes that it has yet to formulate an interpretative stance that fully reflects such values. The challenge ahead is to reconceptualize the judicial role in tax cases to balance traditional individual liberty concerns with the need to protect the integrity of the tax system. This challenge is presented most starkly by the so-called general anti-avoidance rule (GAAR) enacted in 1988 and now on its way to the Supreme Court. The GAAR departs from a long tradition of piecemeal loophole-plugging by Parliament and instead gives a wide authority to the Courts to determine the legal limits of tax avoidance. As such the GAAR directly confronts the issue of judicial role. It calls for a new working relationship between legislative and judicial branches to repair the tax system’s chronic vulnerability to the creative manoeuvres of tax planners. The GAAR invites the Supreme Court of Canada in particular to become a more active, open partner in crafting a tax law that equitably and effectively advances Parliament’s policy design.

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Cet article relate l'histoire de la jurisprudence de la Cour suprême en matière fiscale, en mettant l'accent sur ses efforts constants pour définir son propre rôle institutionnel dans la création et l'interprétation de la loi. D'abord un survol empirique sert à documenter les changements dans la nature et le volume des affaires présentées à la Cour en droit fiscal à travers les ans; de tels changements sont liés à l'évolution du système fiscal canadien. Ensuite des jugements choisis à diverses époques sont examinés afin de jeter de la lumière sur la manière dont la Cour a conçu son rôle dans sa jurisprudence fiscale. L'auteure suggère que les décisions dans ce domaine ont été fortement influencées par une vision libérale classique de la règle de droit et par le souci primordial de protéger la liberté du contribuable - entendue comme le droit de détenir la propriété privée en étant à l'abri de l'interférence arbitraire de l'État. Cette vision des choses est étroitement liée à l'histoire de l'interprétation stricte des lois fiscales et de la tolérance à l'égard de l'évasion fiscale, qui ont nourri les interminables actions et réactions auxquelles se réfère M. le juge Estey dans la décision de principe de la Cour suprême dans Stubart.

Dans les dernières décennies la Cour a de plus en plus reconnu l'intérêt de l'État à promouvoir des valeurs telles que la liberté positive et l'égalité par le système fiscal. Toutefois, l'auteure conclut qu'elle n'a toujours par formulé un principe d'interprétation qui reflète de telles valeurs. Dans l'avenir le défi consistera à réconceptualiser le rôle du judiciaire dans les affaires fiscales, de manière à établir un équilibre entre les préoccupations pour la liberté individuelle et le besoin de protéger l'intégrité du système fiscal. Ce défi apparaît de la façon la plus éclatante dans la soi-disant règle générale anti-évasion passée en 1988 et présentement en route pour la Cour suprême. Cette règle se démarque de la manière traditionnelle dont le Parlement bouchait les trous, à la pièce; elle donne plutôt aux tribunaux le pouvoir de fixer les limites de l'évasion fiscale. En soi cette règle soulève la question du rôle du judiciaire. Elle fait appel à de nouveaux rapports entre les branches du législatif et du judiciaire pour remédier à la vulnérabilité chronique du système fiscal devant les manœuvres créatrices des planificateurs. En particulier, la règle invite la Cour suprême du Canada à devenir un partenaire plus actif et plus ouvert dans la définition d’un droit fiscal qui, de façon équitable et effective, met en œuvre les politiques du Parlement.
This paper compares the early and more recent histories of Supreme Court tax jurisprudence focusing on the Court's ongoing struggle to define its proper institutional role in the creation and interpretation of tax law. Part II presents a short quantitative overview of the changing nature and volume of the Court's taxation caseload through history, as well as rates of taxpayer versus governmental success across the decades. Parts III and IV examine the substance of the tax decisions from the perspective of how the Court has grappled with the still powerful legacy of 19th century strict constructionism in tax law and the severely restricted role it describes for judges. Part III begins the discussion by unpacking the critical ideas and norms that have shaped tax into a distinctive field of jurisprudence. Judicial reasoning in tax cases has been strongly informed by a classical liberal vision of the rule of law and an overriding concern to protect taxpayer liberty, understood in a negative sense as freedom from state interference with private property. I consider the historical roots of this sensibility and its tenacious hold on the judicial imagination into the present. The constricted role of judges in tax law is, I suggest, out of synch with the demands of a modern economy and tax system. The challenge facing the Court now is to assume greater responsibility for the elaboration of a just and efficient tax system. This task demands that important values such as the rule of law and individual liberty be rethought in less formalistic and more substantive terms. Part IV then pursues these themes through a close study of selected tax decisions of the Supreme Court of Canada, looking at both the formal doctrines adopted by the judges and how they are deployed in practice. Since its watershed 1984 decision in *Stubart Investments Limited v. Canada*, the Court has more often acknowledged the state's interest in promoting values such as positive liberty and equality through the tax system. However I conclude that *Stubart'*s effect is easily overstated and that the Court has yet to formulate an interpretive stance that adequately incorporates such values. Its most recent decisions suggest that strict constructionism is enjoying a renaissance in the doctrine and practice of tax interpretation. The task ahead is to reconceptualize the judicial role in tax cases to balance liberty concerns as traditionally understood with the need to improve the tax system. This challenge will present itself most starkly when the Court is called upon to apply the new general anti-avoidance rule ("GAAR"). In Part V I conclude with a brief discussion of the GAAR, which departs from a long tradition of ad hoc loophole-plugging by Parliament and instead gives a wide authority to the Courts to determine the legal limits of tax avoidance. As such the GAAR directly confronts the issue of judicial role. It calls for a new working relationship between legislative and judicial branches to repair the tax system's chronic vulnerability to the creative manoeuvres of tax planners.

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1 [1984] 1 S.C.R. 536 (hereinafter "*Stubart*").

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Part II: Quantitative Overview of Supreme Court of Canada Tax Decisions

Since its founding in 1875 the Supreme Court has handed down approximately 680 tax judgments. The tax caseload handled by the Court rose from a mere 18 cases in the period from 1875-1889, up to decadal highs of 116 in the 1960’s and 94 in the 1970’s. In the 1980’s the number of tax cases dropped off to 49, likely due to the enlarged constitutional role of the Court, and picked up slightly to 55 during the 1990’s. In terms of which taxing authorities were coming before the Court, municipal levies of various kinds overwhelmingly dominated the caseload until the 1920’s, mirroring their importance as a source of local revenue (and disputes) in the decades following Confederation, and the relatively undeveloped federal and provincial tax systems. During the 1920’s the number of cases dealing with federal or provincial taxes began to climb and since the 1930’s they have far outstripped municipal tax cases. As between the two senior levels of government, federal tax issues have consumed by far the greater amount of the Court’s time. Very few of the earliest cases dealt with taxes on income but again that has changed as income taxes have become the primary source of government revenue in Canada. By the 1940’s over one-third of the Court’s tax cases involved income tax issues and this rose to a high of about 63% in the 1960’s.

Perhaps the most interesting statistics are the rates of success for taxpayers versus revenue authorities in the Supreme Court of Canada. Prior to 1900 taxpayers did noticeably better, winning 62% of the time. But from 1900 through the end of the 1970’s governments gained the upper hand, winning more often than taxpayers in every decade, though in some decades like the 1920’s and 1930’s only slightly more often. During the 1960’s, the Court’s busiest decade for tax litigation, revenue authorities won about twice as often as taxpayers. Fascinatingly, the balance was reversed again after the 1970’s with taxpayers winning just over half the time in the 1980’s and almost 60% of the time in the 1990’s. This pattern is somewhat surprising considering that the principles for interpreting tax statutes tended to favour taxpayers more explicitly.

The conclusions presented in this Part are based on an analysis of tax decisions in two QuickLaw databases, Supreme Court Judgments and Supreme Court Reports, which together cover the entire history of the Court since 1875. Figures are approximate due to some difficult judgment calls about what should be treated as a tax case per se, and what should not though it may raise tax issues peripherally. I am heavily indebted to Freya Kodar for her stoic assistance with this research. Any errors in the data or analysis belong to me.


For these purposes I have counted only those cases which involve direct contests between a taxpayer and a taxing authority. This excludes, for example, references to the Court and inter-governmental tax disputes.
prior to 1984, as discussed in the next two Parts of the paper. The 1980's are generally thought to mark the end of the Court's routine application of the strict construction rule under which ambiguities in a taxing provision were read in favour of the taxpayer. The Stubart decision in 1984 ushered in a new era in which the Court was also to consider the legislative context and purpose of tax provisions. However the win/loss statistics do not reflect any improvement in governmental success rates since that time and in fact they suggest that governments began doing worse than taxpayers for the first time since 1900. There are many possible explanations for this, including luck or coincidence, or the possibility that as smaller numbers of tax cases could be granted leave to appeal to the Court in the hectic 1980's and 1990's the Court may have selected carefully those cases in which it felt taxpayers had the strongest arguments. Another possible explanation, and one that tends to support my analysis of the Court's recent tax decisions in Part IV below, is that the Stubart interpretive guidelines and their subsequent elaborations have not in practice led judges to attach any greater weight to governmental interests.

Part III:

*The Debate over Judicial Roles in Tax Law: Two Concepts of the Rule of Law*

No monolithic generalizations can be imposed upon the substantial and varied body of tax jurisprudence produced by the Court over the past century and a quarter. However it is possible to identify some critical themes that run through many of the decisions. They include a propensity to construe taxing statutes in favour of taxpayers rather than governments, an insistence upon the liberty of citizens to arrange their affairs to reduce or avoid tax burdens, and a strong preference that statutory gaps be closed by legislative amendment rather than judicial innovation. These themes are frequently drawn together in the assertion that Courts must be concerned first and foremost in tax cases to preserve the rule of law. Ultimately these common themes all relate to the proper institutional role of the Court in the tax system and the normative values that should inform adjudication in this field of law. Questions of institutional role and adjudicative values certainly are not unique to taxation law, and in tax as elsewhere they are contested among different judges and across different historical periods. But the particular way in which the Court has worked through these fundamental questions has helped to mark off tax law as a distinct body of jurisprudence, with a style of reasoning and a normative stance that sets it somewhat apart from other legal discourses.

The final two Parts of the paper examine the substance of the Supreme Court's tax jurisprudence by looking at how it has grappled with these fundamental issues through time. In the balance of Part III I expand on the content of the rule of law ideal that has dominated tax decisions and suggest some possible reasons for its persistence over time. I observe that the traditional conception of the judicial role in tax cases is based not only upon concerns of transparency and democratic accountability, but also upon a normative judgment
that individual liberty should be promoted over all other values in tax adjudication. Further, the Court has generally understood liberty in this context specifically in terms of negative liberty, or freedom from state interference. This preoccupation with negative liberty, I argue, has failed to produce the legal certainty and other advantages claimed for it, and is increasingly out of step with the modern Canadian economy and state. I suggest that the Court rethink its role in tax cases to advance the positive dimensions of liberty in which citizens can rely on state assistance to expand their capacities for self-realization. Valuing positive liberty would require greater protection and a more expansive reading of the state’s revenue raising capacity and its ability to affect the distribution of resources through the tax system. Part IV then goes on to illustrate these themes and arguments by surveying selected Supreme Court tax decisions.

The Power of Negative Liberty in Judicial Thinking about Taxation

A defining characteristic of tax jurisprudence historically has been its almost single-minded insistence that tax cannot be imposed in the absence of clear, unambiguous statutory authority. To permit otherwise, the Courts have cautioned, would pose a grave threat to the rule of law. The idea of the rule of law is key to our constitutional order and pervades judicial reasoning across the board. In the tax realm, however, it tends to be asserted with extra intensity. The meaning of the rule of law is multifaceted and has been the subject of considerable debate.6 Most basically it is defined as a system of government by laws, rather than individuals ruling arbitrarily according to their personal preferences or interests. Such laws must be created through an established constitutional process, usually assumed to mean enactment by a representative Parliament, and must be generally applicable to everyone including legislators and government officials. Thus all government action must be authorized by law. The rule of law is also said to demand that laws be knowable in advance so that citizens can plan their affairs and anticipate with certainty when and how the state will interfere with them.

Hutchinson and Monahan have referred to these stock requirements of legality as a “thin” version of the rule of law because it treats justice purely as a matter of correct procedures.7 It calls for an impossibly extreme separation of powers in which judges are not to review the substantive fairness of legislative policy, but merely to apply neutrally the law enacted by Parliament. Between the lines of this proceduralist model of the rule of law is in fact a substantive

6 See J. Shklar, “Political Theory and the Rule of Law”, in A.C. Hutchinson and P. Monahan, eds., The Rule of Law: Ideal or Ideology (Carswell, 1987) 1-16, for a review of different meanings attached to this phrase through history.

value commitment to a social order characterized by minimal government interference with private power. However its ideological specificity remains implicit and often denied by the model’s official neutrality. Hutchinson and Monahan contrast this with “thicker” versions of the rule of law in modern legal theory which also embrace substantive ideals of justice far more openly. In these renderings of the rule of law, judges are understood as active collaborators in the law making process. Though judges are seen as constrained to some extent by the macro policy decisions of legislators and the statutory words used to express those policies, these theorists argue that Courts play an inevitable and desirable role in advancing justice ideals through their interpretive choices. Judicial independence is understood not as an apolitical neutrality, but rather as a quality of moral autonomy that allows judges to choose interpretations of the law that advance what they understand to be the justice norms of the community.

Contrasted with these more nuanced models, the formalistic “thin” version of the rule of law seems something of a caricature from nineteenth century classical liberalism. In fact, however, it resonates strongly with much judicial discourse on taxation both in the past and to a large extent, I will argue, in the present. It informs a constellation of doctrines that typically are offered to justify why a taxpayer must be allowed to succeed in avoiding liability for tax. The most famous of these is the doctrine of strict construction, “more accurately described as pro-taxpayer interpretation,” whereby ambiguities in a taxing statute are to be interpreted in favour of the taxpayer. In recent years the Supreme Court has sought to distance itself from this traditional rule of strict construction. However as I argue in Part IV, its legacy remains strong, both in the new interpretive methodologies the Court has offered to replace strict construction, and in the way it has applied these methodologies in particular cases. Closely related to strict construction is the doctrine of form over substance, which states that transactions are to be characterized for tax purposes according to their legal form rather than their commercial or economic substance. A third is the principle that taxpayers are entitled to arrange their affairs to minimize their tax burdens. Thus the fact that a transaction is motivated purely by a desire to avoid tax does not invalidate it in any way. Though on rare occasions these doctrines have been applied against a taxpayer’s interest, it is fair to say that overall they have extended “an open invitation to tax avoiders”.

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8 Ibid., at 101-02 and 106-08.
11 This maxim is generally traced back to the famous case of IRC v. Duke of Westminster, [1936] AC 1 (HL), in which the Duke obtained a deduction for wages paid to household servants by entering formal agreements that characterized the amounts as annuity payments rather than wages.
Graeme Cooper has pointed out that these doctrines “can be viewed as an application of the rule of law notion in a tax context - that government having stated through a law the tax consequences of various transactions and events is not free either to vary those consequences or to amplify them with the benefit of hindsight. No tax can be imposed unless the government has actually exercised the legal power to impose it.”

Also consistent with the so-called thin version of the rule of law is the judiciary’s anxiousness to maintain a radical separation of powers in the tax area. For example, it is common in tax cases for Courts to suggest legislative amendment as the most appropriate way to clarify ambiguities, rather than relying on judges to bridge the gaps. They have been keen to disclaim any role in crafting tax policy themselves, and until recently have been reluctant to interpret tax statutes purposively by reference to legislative objectives. However the cycle of strict interpretation followed by legislative amendment has often been a vicious one for governments, as the enactment of ever more specific language is taken to confirm that instances not explicitly set out in the legislation are not within the intended scope of a provision. This has created tremendous incentives for taxpayers, or more accurately for tax lawyers and accountants, to search for or invent the narrowest of technical loopholes, resulting in yet more litigation and further amendments. This endless process of “action and reaction,” as it was described rather wearily by Estey, J. in Stuwart, is responsible for the current state of our Income Tax Act which in its commercially published format runs to over 1600 constantly mutating pages of small print, most of it unintelligible to any but the most highly specialized experts.

It is somewhat ironic then that the justification offered for a strict constructionist approach to taxation is that it promotes the values of transparency and democratic accountability. Requiring legislative drafters to meet a high standard of precision and clarity, it is argued, will help to ensure that the tax consequences of any action can be known in advance and that tax burdens are imposed only by elected representatives of the people, not via judicial or administrative discretion. In keeping with the thin version of the rule of law, these values are framed in entirely proceduralist terms. Judges are to be officially agnostic about the substantive merits of the government’s tax policy choices. In principle, they are committed to imposing any system of taxation that is enacted by Parliament with sufficient precision. But here lies the critical contradiction. Judges have the power to determine what it means for legislation to be sufficiently clear to justify imposing tax liability. In choosing among competing plausible interpretations of the law, judges cannot escape the need to make value judgments based on criteria external to the statute about what is the most appropriate outcome. When judges construe tax provisions strictly

they are not engaging in value-free, mechanical application of the rules but are playing out a classical liberal vision of social justice.\textsuperscript{15}

The traditional doctrines of tax jurisprudence stem from an underlying view that taxes are by nature a suspect form of government action. They are construed \textit{prima facie} as an impingement on liberty. More precisely, it is the classical liberal idea of negative liberty - or “liberty from”\textsuperscript{16} - that is implicitly ranked above all other values in tax adjudication. Charles Taylor has defined negative liberty theories as those “which want to define freedom exclusively in terms of the independence of the individual from interference by others...”\textsuperscript{17} Negative definitions of liberty fuel what Joel Bakan calls the “anti-statist” element of liberalism which assumes that “state power, not the oppressive and exploitative social relations that typify civil society, is the primary threat to human liberty and equality.”\textsuperscript{18} Thus legal rights tend to be understood as “protecting individuals from public (state) interference in their private affairs but not requiring positive assistance by the state”.\textsuperscript{19} By contrast, theories of positive liberty recognize that without a basic level of material and other resources individuals have no real possibility of exercising their formal legal rights to pursue their own vision of a good life. Isaiah Berlin expressed the problem as follows:

\begin{quote}
...to offer political rights, or safeguards against intervention by the state, to men who are half-naked, illiterate, underfed, and diseased is to mock their condition; they need medical help or education before they can understand, or make use of, an increase in their freedom. What is freedom to those who cannot make use of it? Without adequate conditions for the use of freedom, what is the value of freedom?\textsuperscript{20}
\end{quote}

Liberalism has thus developed to include a concept of positive liberty - “freedom to” as well as “freedom from” - in which individuals must be able to call upon state assistance to ensure they have a meaningful range of choices.\textsuperscript{21} A certain degree of social equality is therefore a precondition for the universal enjoyment of freedom. Adding this positive dimension to the concept of liberty has the effect of moderating the hyper-individualism of classical liberalism. Though freedom must still ultimately be enjoyed and exercised by individuals, its achievement is acknowledged to “[reside] at least in part in collective control over common life.”\textsuperscript{22} This has dramatic implications for the role of the state and

\textsuperscript{18} J. Bakan, \textit{Just Words: Constitutional Rights and Social Wrongs} (University of Toronto Press, 1997) at 47.
\textsuperscript{19} \textit{Ibid.}
\textsuperscript{20} Berlin, \textit{supra} note 16 at 124.
\textsuperscript{22} Taylor, \textit{supra} note 17, at 211.
the tax system. Instead of being viewed primarily as a threat to freedom, a robust state is recast as essential to the promotion of liberty. And it cannot perform this function without the capacity to collect and spend tax revenue in redistributive ways. While taxes might still be seen as interfering with the negative liberty rights of taxpayers, they may also be viewed simultaneously as necessary to promote the positive liberty of those same taxpayers as well as all other members of the community. Understood in this broader way, the background norm of liberty could be applied in a more balanced way in tax cases to support the interests of the state in the integrity of the tax system, as well as the interests of individual taxpayers in avoiding liability.

Despite its general flourishing in legal theory and social discourse, however, the idea of positive liberty has made few inroads into tax jurisprudence. The tenacious hold of negative liberty on the judicial imagination in tax cases may be explained in part by the historical importance of tax revolts in the birth of liberalism. As Stuart Bottomley et al. have noted, "The cry 'No taxation without representation' from the 17th century onwards illustrates how democratic controls over fiscal matters were demanded some time in advance of demands for democracy as a general method of government."23 This principle was echoed recently in *Re Eurig Estate*,24 in which the Supreme Court of Canada struck down Ontario's probate fee regulations as an unconstitutional tax. The main ground relied on by the majority was that probate fees were levied not by legislation but by executive regulation. Major J. held for the majority that the statute granting power to make the probate fee regulations did not actually authorize the imposition of a tax, and since the probate fees did amount to a tax they violated "the principle of no taxation without representation".25 It may be that taxes somehow still epitomize in popular and judicial consciousness the dangers of unchecked state power. They pose a direct challenge especially to the economic dimension of liberty, triggering anxieties about state intrusion upon private property and upon the efficient working of markets. As Neil Brooks has expressed it, "[j]udges...sometimes seem to operate on the assumption that there is such a thing as a self-regulating, free and neutral private marketplace and that any interference by government regulation or taxation with the property rights acquired in this marketplace is an unjustified interference with the natural order of things."26 He reminds us that markets are not natural phenomena but


creatures of law and policy in the first place, and hence should be no more sacrosanct than the policy decisions embodied in taxation laws. Judges may resist this view in part because tax cases present an asymmetrical contest between a government authority and a private citizen. Like criminal prosecutions, tax litigation may raise the spectre of a powerful state ranged against a hapless individual, reflected in such credos as "The power to tax is the power to destroy." It is against this image of taxpayer as underdog that the Courts have defined their role in terms of the protection of negative liberty.

For a number of reasons the traditional normative tilt of tax jurisprudence is increasingly unsatisfactory. It has become clear that strict construction does not deliver the hoped for procedural benefits of greater certainty, transparency and democratic accountability, and that tax statutes are instead becoming more technically obscure and inaccessible. Even more importantly, the simplistic image of the taxpayer in need of protection from an overwhelmingly greater state power is no longer realistic. The balance of power between governments and private actors has shifted dramatically under the forces of capital accumulation and trade and investment liberalization. In the new economy, nation states are increasingly at the mercy of transnational corporations in both the design and enforcement of tax policy. The heightened mobility of capital gives the wealthiest taxpayers tremendous political influence over tax policy making in the countries where they do business. Not only is it easier to move business operations and financial assets across borders, but they have refined the art of playing one country’s tax rules off the next and making strategic use of international tax havens. We are still far from developing the international laws and political institutions that could regulate these manoeuvrings and ensure that global market actors pay a reasonable level of tax. In the meantime, the globalization of markets is eroding the economic base that supplied nation states with the fiscal capacity for redistribution:

As long as capital remained distinctly national, it had an interest in allowing a part of its revenue to be collected as taxes for the purposes of maintaining the national state, or more precisely, the general conditions of production. When capital began to lose its character as a national existence, it began to find fewer advantages in contributing tax revenues to the ‘nation’. To view governments or taxes simply as threats to individual liberty in this context is entirely anachronistic. Governments are the only institution that can place any check on untrammelled market power to maintain the modicum of social equality that is necessary for the practical enjoyment of individual liberty.

29 G. Teeple, Globalization and the Decline of Social Reform (Toronto: Garamond Press, 1995) at 95.
Liberalism’s historical focus on curtailing abuses of public power must not blind us to potential tyrannies of private power.\(^{30}\)

At the close of 125 years, the great challenge for the Supreme Court of Canada is to dispense finally with the legacy of strict construction, in substance as well as in name, and to lead the country’s tax judges toward a more open role in the improvement of the tax system.\(^{31}\) In doing so the Court need not and should not abandon liberty or the rule of law as important values. Much can be achieved simply by adopting more modern, substantive definitions of these values. In particular, the Court should broaden its conception of liberty to take fuller account of the state’s capacity to promote the positive liberty of citizens through its tax policy. In the conclusion to this paper, I suggest that Parliament’s enactment of a general anti-avoidance rule in the late 1980’s is a clear invitation to the Court to take on just such a role.

Part IV:

What the Judges Said:
A Sampling of Critical Themes in the Supreme Court’s Tax Discourse

This Part reviews a small selection of cases in detail to illustrate the critical themes and normative values that have informed the Court’s tax jurisprudence in the past, and its ongoing struggle in the present to define its institutional role in the area of tax law. It first illustrates the predominance of negative liberty values in early Supreme Court tax discourse but also some occasional departures from this framework. Debate over the Court’s proper role in tax cases has intensified since 1984 when it officially rejected the traditional doctrine of strict construction in the landmark Stubart decision.\(^{32}\) Its rulings since that time have offered a sometimes confusing array of interpretive approaches and messages about the Court’s possible role in ensuring a fair, efficient and administrable tax system. Again illustrating with the cases, I conclude that much of this confusion stems from the Court’s reluctance to break fully with negative liberty as the dominant norm within tax law. While in the last fifteen years the Court has taken some tentative steps away from the rigid rule-of-lawism of earlier tax doctrine, much remains to be done to adapt the Court’s institutional role to a modern tax system and state. A major challenge for the Court in future is to dispense with

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\(^{31}\) A number of tax scholars and practitioners have made similar arguments in recent years, and have articulated detailed proposals as to how the Courts should begin to approach the application of tax statutes. These include Neil Brooks’ discussion of judges as “pragmatic tax analysts” (supra note 26); D.G. Duff’s “pragmatic approach” (“Interpreting the Income Tax Act - Part 2: Toward a Pragmatic Approach”, (1999) 47 Can. Tax J. 741-798); and J.S. Wilkie’s argument for “a more activist interpretive attitude” “Looking Forward into the Past: Financial Innovation and the Basic Limits of Income Taxation”, (1995) 43 Can. Tax J. 1144-66, at 1164-66.
the notion of tax as only and always an impingement on individual liberty and as somehow qualitatively different than other forms of law in this respect. The Court should embrace the more collaborative role it necessarily must play in improving the tax system and curtailing tax avoidance. As discussed in the paper’s conclusion, the enactment of the GAAR provides the Court with the perfect opportunity to advance tax jurisprudence in this manner.

The Early Beginnings of Strict Construction

The importance of negative liberty concerns in the Court’s approach to taxation was evident in its very first tax decision, handed down in 1877. In *Nicholls v. Cumming* the two residents of the Town of Peterborough sued the local tax collector to recover 41 chests of tea seized for non-payment of municipal taxes. The dispute surrounded a discrepancy between the assessment notice received by the taxpayers, which stated the value of their personal property as $2,500, and the town’s final assessment roll in which that value was revised to $25,000, one suspects to correct a clerical error in the notice. The taxpayers received no notice of this revision. The roll was eventually certified by the town clerk and approved by a local Court in accordance with the statute and tax was charged on the $25,000 amount, almost doubling the taxpayers’ final tax bill. A unanimous Supreme Court overturned the Ontario Court of Appeal and ruled the assessment illegal because the taxpayer had not been notified personally of the revised valuation, despite a provision in the statute declaring the final roll to be valid and binding “notwithstanding any defect or error”.

Beyond the specific facts and merits of the case it is interesting to observe how the Court began more generally to mark out tax as a special arena of law and to ally itself firmly with the protection of individual rights over state interests in this context. In several passages members of the Court singled out taxation as an especially threatening aspect of state power, treating it as “an interference with private rights of property” akin to expropriation (per Strong, J. at 427), and suggesting that any duty or charge should be construed strictly in favour of the subject (per Ritchie J. at 422). Richards C.J. warned that the statutory power of assessors to determine the value of private property meant they could “[impose] burthens which might be unjust on any taxpayer, and this might be done by design, or want of care or capacity to form a correct opinion as to value...” (at 408). He conceded the possibility of taxpayers relying on obvious mistakes in a notice of assessment to “escape paying [their] fair share of taxes” (at 419). However the Chief Justice saw the Court first and foremost as a bulwark against overreaching revenue authorities:

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32 *Supra* note 1.
33 (1877), 1 S.C.R. 39M.
...I think it more consistent with justice that the fundamental rule which ought to prevail is that the provisions that the Legislature has made to guard the subject from unjust or illegal imposition should be carried out and acted on, though, at times, a ratepayer may escape taxation, rather than a single individual should be oppressively taxed without an opportunity of being heard against the illegal imposition. (at 419).

The Court of Appeal had held the ratepayer liable for tax on the higher value stated in the town's assessment roll, citing the municipality's need to rely on the roll in setting its tax rates to ensure sufficient funding for local government services. However in the Supreme Court these concerns were dismissed as mere "inconveniences" that "should have no weight whatever in a case of this kind" (per Ritchie J., at 423).

Also prefigured in Nicholls v. Cumming was the Court's tendency to shift responsibility to legislators for clarifying the meaning of taxing statutes. According to Ritchie J., "if the taxpayer's privileges under the statute may lead to results too inconvenient, it will be for the Legislature to restrict or take them away..." (at 424) In fact, before the Court rendered its judgment the Legislature had already amended the saving provision in the statute to specify that the final assessment roll was valid notwithstanding any error in a notice of assessment or any failure to deliver a notice. The old provision, in force at the time in question, had more generally preserved the validity of the roll against "any defect or error committed in or with regard to [the] roll." Chief Justice Richards noted the amendment would "probably" prevent actions such as the taxpayers' in the future (at 422), but it had no effect on his ruling in the present case. In an analytical move that became popular in the Court's tax decisions, Strong J. took the amendment to confirm that his narrow reading of the original provision was correct (at 432). The other choice, of course, would be to view the amendment as clarifying the intended meaning of the original provision. Thus began in the Court's very first tax decision the cycle of encouraging ever more detailed legislation, to be followed by ever more strict constructions.

From its earliest years the Court referred regularly to the notion of strict construction to help resolve cases involving taxes of any kind. For example in the 1885 case of Re Lewin a municipal tax was to be imposed on the total value of a taxpayer's real and personal property, provided that shares were not to be valued above their stated par value. Corporations were to be assessed on the value of their property in the same manner as individuals. The appellant corporation was a bank that had been assessed for tax on the $1.1 million value of its cash, real estate and other assets. Though not disputing this valuation the bank argued that its assessable property should be limited to the $1 million par value of its issued share capital, an argument that defied the logic of the statute since those shares were not property of the bank but rather of its shareholders. The Supreme Court nevertheless held for the bank stressing that "there is to be no liability to taxation unless the tax is imposed by unambiguous language".

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34 26 mCCP 323 (OCA), per Burton J. at 331.
35 (1885), 11 SCR 484.
36 per Strong J. at 489.
Strong, J. held that the par value limitation should be construed in the bank’s favour as follows:

...I am of opinion that this provision is not to be confined to the assessment of shares in the hands of individual holders, but applies also to the assessment of the corporate body itself in respect of its capital. As I have said before, the rule is that there is to be a strict construction against the burden of the tax, and it is also the rule that where there is an exemption or restriction, that it is to be liberally construed in favour of persons for whose benefit it is enacted.\(^{37}\)

Three years later in *Grinnell v. Canada*,\(^{38}\) the Court’s first ruling on a federal tax statute, the taxpayer was held not liable to pay customs duty at the higher rate applicable to automatic sprinklers, but at the lower rate applicable to brass manufactures, because he had imported the sprinklers in almost-complete form and then assembled the parts at little cost in Canada. In so deciding the Court quoted the following passage from the English House of Lords decision in *Partington v. The Attorney General*\(^{39}\) that now stands as one of the most oft-cited expressions of the strict construction rule in Canadian tax law:

...as I understand the principle of all fiscal legislation, it is this: if the person sought to be taxed comes within the letter of the law he must be taxed however great the hardship may appear to the judicial mind 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. In other words, 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. (quoted by Sir W.J. Ritchie, C.J., at 136)

The traditional doctrine of strict construction was cited by the Supreme Court of Canada as late as 1983.\(^{40}\) A year later however, in *Stubart*, the Court would begin setting its own agenda on the interpretation of tax statutes.

*Beyond Strict Construction: Alternative Conceptions of the Judicial Role.*

The Court’s own critique of strict construction and its attempt to chart a different course for itself are usually dated from the 1984 decision in *Stubart*.\(^{41}\) It is true that this case marked a striking shift in the Court’s expression of what judges should do with tax statutes. However a close review of *Stubart* and the Court’s tax decisions since then suggest that its doctrinal rejection of strict constructionism is far from complete.

\(^{37}\) at 490. Note that this passage calls for pro-taxpayer interpretation of both charging and relieving provisions. This conflicts with more even-handed statements of the rule which call for taxing provisions to be read in favour of the taxpayer, and exempting provisions to be read in favour of the revenue. This latter portion however tended to be honoured more often in the breach.

\(^{38}\) (1888), 16 SCR 119.

\(^{39}\) (1869), L.R. 4 H.L. 122.

\(^{40}\) *Morguard Properties Ltd. v. City of Winnipeg* (1983), 3 D.L.R. (4th) 1 (SCC)

\(^{41}\) Supra note 1.
Before entering the post-Stubart era, however, it is important to recognize that it was preceded by a long history of dissenting or alternative judgments that questioned the merits of strict construction. In other words, strict construction’s hold on the Court has never been absolute. Members of the Court have ventured at times into a range of alternative approaches to tax interpretation, deploying these variously in favour of taxpayers or governments.\textsuperscript{42} A very early example is the decision in \textit{Dame Mary Wylie v. The City of Montréal},\textsuperscript{43} where the Court employed an overtly purposive analysis to find that a private, for-profit girls’ school fell within the municipal tax exemption for “educational institutions”. The case bears a striking resemblance to a much more recent decision, \textit{Notre-Dame de Bon-Secours v. Communauté Urbaine de Québec},\textsuperscript{44} in which the Supreme Court made its strongest statement ever about the need for purposive interpretation. Similarly, more than a century earlier, the majority in \textit{Wylie} held that the term “educational institutions” should not be limited to public institutions because such a narrow reading would “frustrate the object the legislature may have had in view, namely, the encouragement of education...To exempt such an institution from local taxation is but a very moderate encouragement to the cause of education, and one to which it is by no means unreasonable to suppose the legislature may have considered it, in the public interests, justly entitled.”\textsuperscript{45}

The city had argued that exempting provisions are to be construed strictly in favour of the taxing authority, a frequently noted but seldom applied corollary to the strict construction rule. However the Court held there was no ambiguity to construe against the taxpayer and then avoided any further mention of strict construction.\textsuperscript{45}

The \textit{Wylie} case is notable for its free-wheeling departure from the traditional doctrines of tax interpretation. Ultimately however it did not pose a challenge to the dominant perspective on taxation as an impingement on negative liberty rights, since a purposive analysis was applied to relieve \textit{Wylie} from tax.

\textit{Stubart and After: Strict Construction in Drag?}

The \textit{Stubart} decision has been widely hailed as a watershed in Canadian tax jurisprudence that “opened the first significant breach in the rule that tax legislation must be strictly construed”.\textsuperscript{46}

Since decided it has been cited by many judges and others to support the view that the traditional strict construction rule is no longer a part of Canadian

\textsuperscript{42} Duff conceptualizes these alternative approaches as “objects and intentions”, “contextual analysis” and “the golden rule”, and finds evidence of all these in particular cases that predate \textit{Stubart}: D.G. Duff, “Interpreting the Income Tax Act - Part I: Interpretive Doctrines” (1999) 47 Can. Tax J. 464-533, at 477-82.

\textsuperscript{43} (1886), 12 S.C.R. 384.

\textsuperscript{44} 95 D.T.C. 5017 (S.C.C.).

\textsuperscript{45} \textit{Wylie}, supra note 43, at 389 (per Sir W.J. Ritchie C.J.).

\textsuperscript{46} \textit{Notre-Dame de Bon Secours}, supra note 44, per Gonthier J. at 5021.
tax doctrine. Certainly it is true that a lawyer arguing a tax case is unlikely to get away any longer with simply relying on the Duke of Westminster. However the question remains to what extent the change in interpretive methodologies has actually delivered substantively different kinds of reasoning or decisions. I suggest in this section that while the Court has tended since Stubart to discuss more openly and sensibly the role of judges in a modern tax system, it has yet to operationalize these insights fully in the way it actually disposes of interpretive issues. Many of the tax rulings in this most recent period of the Court’s history are still saddled with the ideological baggage of strict construction, even as they abandon it in name.

Stubart itself involved two related corporations, one profitable and the other not, which completed certain transactions designed to shift income from the former to the latter. The transactions were conceded to be purely tax motivated, to allow the tax losses of the non-profitable corporation to be deducted against the profits generated by its sister corporation, reducing the total tax burden of the corporate group as a whole. In order to achieve this result the profitable corporation transferred its business to the loss corporation and then agreed to operate the business on behalf of the loss corporation as its agent. The profitable corporation would continue to manage the business as it always had but profits would accrue to the account of the loss corporation. As Estey, J. pointed out several times in his reasons, the Crown expressly declined to rely on an anti-avoidance provision in the statute that may have applied to prevent the deduction of the losses. Instead, it called upon the Court to adopt a common law business purpose test, similar to that used in the United States and, at the time, emerging in the U.K. The test would have judges disregard tax motivated transactions that had no independent business or other non-tax purpose. As Estey J. observed, this argument placed squarely at issue “the role and function of a court.”

In answering this question Estey J. acknowledged openly the competing values at play in tax avoidance cases and the need to “[balance] 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”. The ITA, he recognized, had evolved “from a mere tool for the carving of the cost of government out of the community, to an instrument of economic and fiscal policy for the regulation of commerce and industry of the country through fiscal intervention by government.” As such Courts could not be concerned just with protecting taxpayers from state encroachment but must also act to protect the community’s interest in the integrity of the tax system. To strike this balance he offered some new guidelines for interpretation by which the statute could be “extended to reach conduct of the taxpayer which has the designed effect of defeating the expressed intention of Parliament.”

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47 at 574.
48 at Ibid.
49 at 576.
50 at 578.
Challenging the special status of tax legislation, Estey, J. proposed that it be subject to the same rules of construction as any other statute, citing the modern principle that "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament." Because the tenor of this decision was so groundbreaking in tax jurisprudence it has been easy to overstate its practical significance. Read carefully, Estey J.'s new interpretive guidelines were hedged and qualified in several passages that seemed to cling to the old idea of clear or plain meaning in tax legislation:

Courts today apply to this statute the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable.

Otherwise, where the substance of the Act, when the clause is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question.

[quoting a House of Lords decision:] It may seem hard that a cunningly advised taxpayer should be able to avoid what appears to be his equitable share of the general fiscal burden and cast it on the shoulders of his fellow citizens. But for the Courts to try to stretch the law to meet hard cases...is not merely to make bad law but to run the risk of subverting the rule of law itself. Disagreeable as it may seem that some taxpayers should escape what might appear to be their fair share of the general burden of national expenditure, it would be far more disagreeable to substitute the rule of caprice for that of law: Ransom v. Higg, 50 Tax Cas. 1 at p.94 (1974).

The ambivalence of these passages about the possible continuing importance of plain or literal meaning in tax interpretation was reinforced by the Court's own application of these guidelines to the Stubart facts. Ruling in favour of the taxpayer, Estey J. emphasized the lack of any explicit provision barring the loss corporation from acquiring new sources of income through non-arm's length transactions in order to use up past years' losses. The Court largely ignored its own admonition to take into account the context and purpose of technical provisions relied upon by the taxpayer. Estey, J. focussed narrowly on the wording of the loss carryforward provisions, in effect construing them strictly in favour of the taxpayer, and seemed to give no weight to the Act's general policy against the consolidation of profits and losses among related corporations.

Most importantly, the Court in Stubart rejected outright the Crown's argument for a business purpose test that would invalidate purely tax motivated transactions. The decision reaffirmed in Canadian law the traditional principle from the Duke of Westminster that taxpayers are entitled to arrange or rearrange their affairs solely for the purpose of avoiding taxes. This was one of the main messages taken from the case by legal observers and it significantly moderated the apparent radicalism of introducing purposive and contextual interpretation
into tax law. In this respect the decision simply entrenched the protection of negative liberty, or freedom from state interference, as the normative backbone of tax adjudication. The preservation of this principle implies a limited scope for the Courts to reimagine their role in tax cases, for it imbues the interpretative task with the idea that judges should always be most vigilant to protect individual liberty and to impose only those tax burdens that are very specifically authorized by statute. Keeping the Duke principles effectively muted the potential of Estey, J.’s interpretive guidelines to protect the public interest in advancing the policy objectives of a progressive tax system. It was in part the perceived inefficacy of the Stubart guidelines to curtail tax avoidance, in light of the Court’s positive endorsement of tax planning as a fundamental right of Canadians, that led the government to introduce the general anti-avoidance rule in 1988.

In its judgments since 1984 the Court has attempted to elaborate and apply the Stubart guidelines. The results have been mixed but increasingly they suggest that the reported death of strict constructionism has been much exaggerated. There are two main ways in which the legacy of strict construction has resurfaced in tax doctrine. The first is the Court’s explicit retention of strict construction as a “residual presumption” to be applied to ambiguities that cannot be resolved by reference to any other method of interpretation. Only a year after his decision in Stubart, Estey J. himself introduced this idea in the case of Johns-Manville v. The Queen. The taxpayer operated an open pit mine and the issue was whether the cost of purchasing land around the widening periphery of the mine each year was deductible as a current expense or was on account of capital. Holding that the common law tests for distinguishing current from capital expenses did not lead conclusively to any result on the facts of the case, Estey J. noted that “if the interpretation of a taxing statute is unclear, and one reasonable interpretation leads to a deduction...and the other leaves the taxpayer with no relief from clearly bona fide expenditures in the course of his business activities, the general rules of interpretation of taxing statutes would direct the tribunal to the former interpretation. That is the situation here...” Though he characterized it as a “residual principle,” Estey J.’s reliance on this presumption to decide in favour of the taxpayer seemed to trivialize his earlier assertion in Stubart that tax statutes were no longer special and would be subject to the ordinary rules of interpretation. Nonetheless, the existence of a residual pro-taxpayer presumption was confirmed once more in Notre-Dame de Bon-Secours where the Court offered a set of interpretive principles known as the “teleological approach.”

55 85 D.T.C. 5373 (S.C.C.).
56 at 5382.
57 at 5384.
58 Supra note 43.
The issue in *Notre-Dame* was whether a residence operated on a non-profit basis to provide housing to elderly, poor individuals, mostly women, qualified for a full exemption from municipal property taxes as a "reception centre", or whether only the shelter portion of the residence which provided special care and services to less independent residents was exempt. The statute imposing the tax provided for apportionment where only part of a property qualified for the tax exemption. The Supreme Court read the definition of a "reception centre" liberally and concluded the taxpayer was entitled to a full exemption for the entire property. Writing for the Court, Gonthier J. emphasized the social policy purposes behind the legislation, without stating in any detail why he thought those purposes extended to the particular residence at hand. After reviewing *Stubart* and other decisions on the proper approach to interpreting tax statutes, Gonthier J. concluded that "[t]he first consideration should...be to determine the purpose of the legislation, whether as a whole or expressed in a particular provision."59 The judgment then laid out a summary of principles to be applied in construing tax statutes. It began by enjoining courts to follow "the ordinary rules of interpretation", then stressed the central importance of legislative purpose, and concluded with the following:

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.60

The difficulty with this approach, I suggest, is that the pro-taxpayer presumption is unlikely to be confined to a merely residual role. It conflicts directly with the Court's first principle that tax laws are subject to the ordinary rules of interpretation, and is sure to perpetuate the idea of tax legislation as special and deserving of more sceptical readings. Instead of being used as a truly residual tool it more likely will function as a kind of bottom line, in terms of the values that Courts should prioritize in choosing among more than one plausible interpretation. It communicates a preference for finding in favour of the taxpayer that is likely to inform not only the last stage of the interpretive process but all stages before it. Interpretive choices about the ordinary meaning of a provision, its legal and social context, and its possible purposes, will all be influenced by the retention of the pro-taxpayer presumption and its underlying normative view that the negative liberty rights of taxpayers ultimately must be the Courts' top concern.

The second and lately more prominent way in which strict constructionism is reasserting itself in Supreme Court tax jurisprudence is through the concept of plain meaning. This is the idea that some interpretive disputes can be resolved by reference to the plain meaning of the taxing provision, thereby pre-empting any contrary interpretation based on the context or purpose of the provision, or the policy implications of such a reading. In the post-*Stubart* era the revival of

59 at 5022.
60 at 5023.
plain meaning can be traced most clearly to *Canada v. Antosko*.\(^{61}\) In this case the Court was asked to determine whether interest accrued on a bond prior to its purchase by the taxpayer could be received tax free under s.20(14) of the ITA, even if the vendor of the bond had never paid tax on the accrued interest because it was a tax exempt entity. Section 20(14) in effect allocates pre-transfer interest accruals to the vendor of a debt instrument by requiring the vendor to include such amounts in income and allowing the purchaser who actually receives the interest to deduct it from income. Iacobucci J. writing for the Court held in favour of the taxpayer, rejecting the Minister's argument that the deduction is conditional upon the interest having been taxed to the vendor of the bond. After pointing out that *Stubart* rejected the notion of a business purpose test and reviewing *Estey J.'s* interpretive guidelines, Iacobucci J. stated as follows:

> While it is true that the courts must view discrete sections of the Income Tax Act in light of the other provisions of the Act and of the purpose of the legislation, and that they must analyze a given transaction in the context of economic and commercial reality, such techniques cannot alter the result where the words of the statute are clear and plain...In the absence of...ambiguity, such that the Court must look to the results of a transaction to assist in ascertaining the intent of Parliament, a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts.\(^{62}\)

The notion that "unambiguous" provisions could generate interpretive disputes that reach the Supreme Court of Canada seems self-evidently absurd, and indeed in *Antosko* the Federal Court of Appeal took a different view of the meaning of s.20(14) and held in favour of the Minister. Modern theories of statutory interpretation stress that conclusions about the meaning of language are never self-generating but always grounded in some way upon background assumptions about the context and purpose of the legislation, as well as judgments about the likely effects of adopting a particular meaning. The plain meaning rule denies these elements of judicial reasoning and really amounts to a refusal to give reasons for choosing a particular interpretation. As Brian Arnold has argued the plain meaning rule often functions in effect as a rule of strict construction.\(^{63}\) It subscribes to the same kind of literalism as strict construction and tends to foreclose discussion of the reasons why a provision is perceived as ambiguous or not. Likewise, it attempts to confine the role of judges to apolitical rule application and to remove them from substantive policy decisions about the proper ambit of a taxing provision.

Despite these criticisms the Supreme Court appears increasingly committed to a plain meaning approach to tax interpretation. Its recent decision in *Shell Canada Ltd. v. Canada*\(^{64}\) moves aggressively in this direction. Shell borrowed

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\(^{61}\) [1994] 2 SCR 312.

\(^{62}\) at 326-7. See also *Friesen v. The Queen*, 95 D.T.C. 5551 (S.C.C.); and most recently *Shell Canada v. The Queen* 99 D.T.C. 5669 (S.C.C.).


\(^{64}\) [1999] 3 S.C.R. 622.
New Zealand $150 million at an interest rate of 15.4%, and then swapped that loan for US dollars under a forward exchange contract with a bank. The contract allowed Shell to hedge the risk of fluctuations in the relative value of the two currencies by fixing the number of US dollars that would be required to repay the New Zealand loan when it came due. As expected, the New Zealand dollar fell against the US dollar and Shell received a large foreign currency gain upon repaying the loan in U.S. currency. Overturning the Federal Court of Appeal, the Court held, inter alia, that Shell was entitled to deduct interest at the full 15.4% rate under the New Zealand debenture, not at the much lower rate it would have paid on an equivalent US dollar loan as a capital gain rather than as ordinary business income. McLachlin J. (as she then was) took the opportunity to stake out a strong plain meaning approach to tax legislation. For a unanimous Court she wrote:

...it is well established in this Court’s tax jurisprudence that a searching inquiry for either the “economic realities” of a particular transaction or the general object and spirit of the provision at issue can never supplant a court’s duty to apply an unambiguous provision of the Act to a taxpayer’s transaction. Where the provision at issue is clear and unambiguous, its terms must simply be applied.65

McLachlin J. went on to distance the Court from some of its earlier, more purposive readings of the Stubart decision and to signal a clear retrenchment back toward the position that it is not the Court’s role to prevent tax avoidance or ensure an equitable distribution of the tax burden:

...the Federal Court of Appeal seems to have discerned in the Act an intention that courts, to be fair to less sophisticated taxpayers, should be alert to preventing taxpayers from using complex transactions designed to minimize their tax liability. It was said that courts should somehow look through transactions and impose tax according to their true economic and commercial effects. There are some obiter statements in some cases that may be said to support this view: Bronfman Trust, supra at 53, [page 644] per Dickson C.J.; Stubart Investments Ltd. v. The Queen, [1984] 1 S.C.R. 536, at 576, per Estey J.

However, this Court has made it clear in more recent decisions that, absent a specific provision to the contrary, it is not the courts’ role to prevent taxpayers from relying on the sophisticated structure of their transactions, arranged in such a way that the particular provisions of the Act are met, on the basis that it would be inequitable to those taxpayers who have not chosen to structure their transactions that way....The courts’ role is to interpret and apply the Act as it was adopted by Parliament. Obiter statements in earlier cases that might be said to support a broader and less certain interpretive principle have therefore been overtaken by our developing tax jurisprudence. Unless the Act provides otherwise, a taxpayer is entitled to be taxed based on what it actually did, not based on what it could have done, and certainly not based on what a less sophisticated taxpayer might have done....With respect, this approach fails to give appropriate weight to the jurisprudence of this Court providing that, in the absence of a specific statutory bar to the contrary, taxpayers are entitled to structure their affairs in a manner that reduces the tax payable...66

65 at 641-42.
66 at 643-44.
This section of the paper was subtitled "Stubart and After: Strict Construction in Drag?", to raise the question (somewhat hyperbolically) of whether the Supreme Court's current approach to tax interpretation is nothing more than traditional strict construction dressed up to look like something else. Such a conclusion would be both too cynical and too simplistic. Since 1984 many of the Court's decisions have explored more openly, thoroughly and rigorously a variety of interpretive sources including the legislative context and purpose of tax provisions, and the tax policy reasons supporting different readings of the statute. These explorations have been enlightening for readers of the Court's decisions and undoubtedly have affected the disposition of some cases, as well as the reasoning employed to get there. What I do conclude however is that the Court's tax jurisprudence is still weighed down by the historical baggage of strict constructionism and its ideological preoccupation with protecting negative liberty rights. The Court continues to treat tax statutes as different from and more threatening than other kinds of legislation, and to heed doctrines that are founded upon on an archaic and "thin" version of the rule of law. These entanglements have too often inhibited the Court from assuming its appropriate and much needed role as a collaborator with Parliament in the elaboration of a fair, efficient and administrable tax system. In the concluding Part of the paper I suggest that the advent of the general anti-avoidance rule presents the Court with a golden opportunity to break away from the Duke of Westminster and more generally the strictures of nineteenth century tax doctrines, to define a modern role for judges in tax adjudication.

Part V: Conclusion:

Going for the GAAR: Embracing a New Role for the Court

In 1988 the federal government passed through Parliament an amendment to s.245 of the ITA that created a new general anti-avoidance rule, more fondly known as GAAR. The reasons cited by the government for taking this bold step included its frustration with the Courts' unwillingness to introduce a judicial business purpose rule, and with the high costs of attempting to curtail tax avoidance through piecemeal, post facto amendments. These statements, as well as the language of the GAAR, send a strong message to the judiciary and especially to the Supreme Court of Canada that it should take a more active, policy oriented role in drawing the limits of legal tax avoidance. The GAAR has not yet made its way up to the Supreme Court but is likely to arrive there soon.67 Responding to the GAAR is certainly one of the most important challenges the Court will face in the tax area in the coming years.

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67 New s.245 is only applicable with respect to transactions entered into on or after September 13, 1988.
Essentially, the GAAR gives explicit legislative authority to the Courts to recharacterize or ignore transactions that are entered into primarily for the purpose of avoiding tax.\(^{68}\) The initial White Paper version of the GAAR provoked strong objections from some members of the tax planning community who argued the provision would undermine the rule of law by conferring discretion on administrative officials and judges to impose what they considered to be appropriate tax consequences. The government responded by redrafting the GAAR and the final version included a saving provision that states,

> For greater certainty, [the GAAR] does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse or abuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole.\(^{69}\)

The saving clause is likely to be read as a kind of object and spirit test, so that tax avoidance transactions will nonetheless be irreproachable if they are found not to violate the statute’s purposes. There is a danger that it will be applied so expansively by judges that it will render the GAAR no more effective to reign in tax avoidance activities than the object and spirit guidelines in Stubart. Unless the Court is prepared to take a substantive position on what is a fair way to tax transactions reassessed under GAAR, it will wind up once again simply deferring in a procedurist manner to the legislature’s decisions about whether to enact language in the rest of the Act that is specific enough to catch the taxpayer. One can imagine a kind of circular reasoning to the effect that because the taxpayer managed to squeeze her tax planning transaction within the technical provisions of the Act, literally construed, they must not violate the object and spirit of the legislation.\(^{70}\) The problem with such an analysis is that tax planning transactions will almost always seek to take advantage of or get around some other provision of the Act. The whole purpose of the GAAR can only be to prevent some forms of tax avoidance which otherwise would be unassailable on the Courts’ reading of a particular section. Superficial assessments of the object and spirit of the Act would effectively defeat the GAAR’s purpose of drawing tighter limits around tax avoidance planning.

Just as the Supreme Court has risen to the challenge of a new institutional role in the constitutional area, it should accept the GAAR as a clear request from Parliament that it begin making and implementing some of the particularized decisions about what avoidance activities are not acceptable. I have argued that in making these substantive judgments it should take into account the positive liberty interests of the taxpayer and other citizens in maintaining a degree of equality and rationality in the distribution of the tax burden. To answer the question in the title of this paper, the rule of law as it has been deployed in most tax cases is not wrong so much as grossly incomplete.

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\(^{68}\) s.245(2). A transaction is outside the scope of GAAR if it was undertaken “primarily for bona fide purposes other than to obtain the tax benefit”: 245(3).

\(^{69}\) s.245(4)

\(^{70}\) For an example of this sort of disappointing analysis see Jabs Construction LTD. v. The Queen 99 D.T.C. 729 (T.C.C.).
As Hutchinson writes, "it is difficult to argue with the idea that governance should be ordered and predictable rather than chaotic and capricious."71 The problem arises when some judges take the view that the thin version of the rule of law is actually attainable on its own, without any reference to ideals of justice, thereby relieving them of the obligation to defend the normative bases for their decisions. Not only in applying the GAAR, but in applying all taxing provisions, the Supreme Court of Canada needs to fatten up its version of the rule of law and take up its rightful place within the tax policy process.

71 Supra note 7, at 196.