INTERPRETING THE *INCOME TAX ACT*: PURPOSE v. PLAIN MEANING AND THE EFFECT OF UNCERTAINTY IN THE TAX LAW

KERRY HARNISH*

This article analyzes a pivotal current debate within the tax community — rules for interpretation of the Income Tax Act. *The author examines the recent history of the debate over whether the interpretive rule should be purposed-based or plain meaning. The author then goes on to pose an argument favouring purposive interpretive rules. The analysis involves reference to ss. 12 and 44(f) of the Canada* Interpretation Act, *the effect of uncertainty in tax law, and case studies examining the* Schwartz *and* Savage *decisions of the Supreme Court of Canada.*

L'auteur analyse le débat critique auquel se livrent actuellement les fiscalistes, en ce qui touche les règles d'interprétation de la Loi de l'impôt sur le revenu. Il examine les propos récents tentant de déterminer si la règle devrait être axée sur les fins ou sur l'esprit de la loi. L'auteur plaide en faveur de règles d'interprétation téléologiques. Il fonde son analyse sur les articles 12 et 44(f) de la Loi sur l'interprétation du Canada, l'effet d'incertitude en droit fiscal, et des études de cas portant sur les décisions de la Cour suprême du Canada dans Schwartz *et* Savage.

TABLE OF CONTENTS

* B. Commerce (Saint Mary's), LLB/MBA (Dalhousie), of the Department of Finance (Tax Policy Branch/Tax Legislation Division), Ottawa, Ontario. Member of the Barristers' Society of Nova Scotia since 1983. The views expressed in this paper are my own and they do not necessarily represent the position of the Government of Canada or the Departments of Finance, Justice or National Revenue. I wish to thank Lawrence Purdy of the Department of Finance (Tax Legislation Division) and Marc Cuerrier of the Department of Justice (Finance's Tax Counsel Division) for their insightful comments on an earlier draft of this article.

I. INTRODUCTION

> A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.
>
> Mr. Justice Oliver Wendell Holmes[1]

A pivotal debate is occurring within the tax profession, both in the academic press and the courts. Arguments are being marshalled as to what rule of interpretation should be paramount when interpreting the *Income Tax Act*.[2] Should the primary rule for interpreting tax law be grounded in the *legislated purpose (object) approach* or the *modern judicial plain meaning approach*?

This is not just a scholastic debate, unconnected to the real world. At its core, this debate is related to the troubles facing the body politic at the end of the millennium. In particular, modern Canadian society faces the challenge of better balancing the rights and responsibilities of all its members, including not only lay individuals but also corporations, government, the judiciary, the media and tax advisers.

The purpose of this article is to advance the debate as to how these often conflicting interests can best be balanced in the income tax context. This article makes a case for a primary interpretative rule based on purpose. This case avoids the traditional left/right political dichotomy where those on the left invariably advocate for a purpose-based rule while those on the right stress plain meaning. To do so, however, it will first be necessary to review where the debate has gone thus far.

II. FULCHER, SHARLOW, ARNOLD: AN ARGUMENT IN THE ACADEMIC PRESS

The debate as to how legislation, and particularly tax legislation, ought to be interpreted has recently been reflected in the Canadian legal and tax press. In a paper published in the December 1995 issue of the *Canadian Bar Review*,[3] J.E. (Ted) Fulcher advanced the thesis that a liberal statutory purpose approach is necessary to interpret tax legislation where the state interest is the raising of revenue (as opposed to achieving equity among taxpayers in the raising of that revenue or the achievement of some other policy objective). This emphasis on the state's objectives did not go unanswered for long. In the March 1996 issue of the *Canadian Bar Review*,[4] Karen Sharlow took

---

1 *Towne* v. *Eisner, Collector of Internal Revenue for the Third District of New York*, 245 U.S. 418 at 425 (1918).

2 R.S.C. 1985 (5th Supp.), c. 1 [hereinafter the "*Act*"]. Unless otherwise stated, statutory references in this article are to the *Act*.

3 J.E. (Ted) Fulcher, "The Income Tax Act: The Rules of Interpretation and Tax Avoidance. Purpose vs. Plain Meaning: Which, When and Why?" (1995) 74 Can. Bar Rev. 563.

4 K. Sharlow, "The Interpretation of Tax Legislation and the Rule of Law — REJOINDER — J.E. (Ted) Fulcher — (1995) 74 Can. Bar Rev. 563" (1996) 75 Can. Bar Rev. 151.

serious issue with Fulcher's view. To Sharlow, the approach advocated by Fulcher would undermine the rule of law and the integrity of the tax system.[5]

Sharlow's rejoinder can be summarized as follows. The tax system is self-assessing and taxpayers cannot hope to know the purpose of particular provisions of the *Act*. If judges manipulate the words employed in the *Act* to meet some objective claimed to them by the Crown, the rule of law in society will fail. The source of the idea that the statutory purpose approach should be paramount is, in part, based on an unstated and mistaken premise that there is a "normal" amount of tax for each taxpayer. Fulcher's mistake may be his view that interpretative techniques being developed in the *Charter of Rights and Freedoms* case law can properly be applied to the vagaries of the tax system. After all, tax laws are confiscatory in that they "authorize the taking of property without compensation."[6] The purpose-based approach to interpretation should be limited to cases where the purpose of a provision can be inferred from its wording and used as a guide to the proper interpretation of the provision. In Sharlow's opinion, Fulcher's suggestion should be rejected without more.

A somewhat less detailed critic, Brian Arnold, penned a three paragraph review for the *Canadian Tax Journal*.[7] Among other things, Arnold aptly notes that Fulcher advances a thesis for which no full explanation is provided.

In large part, this article advances the thesis that an interpretation of the words used in an enactment is scrupulous only if the interpretation respects the enactment's object (purpose).

III. WHY PURPOSIVE INTERPRETATION BELONGS IN THE TAX COURTS

A. PURPOSE v. PLAIN MEANING (WHERE WE HAVE BEEN/WHERE WE ARE)

1. The Source of the Purpose (Object) Rule

Those advocating a plain meaning approach to interpreting the *Act* tend to be selective, in that they refrain from adopting the same approach to s. 12 of the Canada *Interpretation Act*,[8] which states:

> Every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

---

5 *Ibid.* at 152.

6 *Ibid.* at 153.

7 B. Arnold, Review of "J.E. (Ted) Fulcher, 'The Income Tax Act: the Rules of Interpretation and Tax Avoidance, Purpose v. Plain Meaning: Which, When and Why?' (December 1995), 74 Can. Bar Rev. 563" (1996) 44 Can. Tax J. 599.

8 R.S.C. 1985, c. I-21 (an apparent drafting error in s. 1 refers to c. I-23 rather than c. I-21).

Indeed, some advocates of the judicial plain meaning approach fail to even reference this crucial enactment.

Stephen W. Bowman has traced s. 12 of the Canada *Interpretation Act* back to *Heydon's Case (1584)*[9] in a recent *Canadian Tax Journal* piece reviewing where we have been and where we are with respect to interpreting Canadian taxing statutes.[10] Bowman indicates that:

- the antipathy of the judiciary to criminal, tax, expropriation and similar legislation was so strong in the 16th to 19th centuries and throughout the early 20th century that a strict and literal interpretative approach evolved to render the "mischief remedy" rule generally inapplicable in some areas,[11]

- the Supreme Court's 1984 decision in *Stubart Investments Ltd.* v. *M.N.R.*[12] did not reverse this long-standing strict and literal approach to interpreting tax legislation; rather it "confirmed that it had evolved into a more sophisticated set of principles better equipped to interpret modern tax legislation" (including principles that concern the purpose of particular legislation and the substance of particular transactions),[13]

- the current interpretative trend by the Supreme Court of Canada strongly favours taxpayers although it is unclear how much of the underlying analysis rests on the court's approach to the "substance doctrine" that is included in its list of interpretative principles,[14] and

- while the strict and literal approach usually loads the dice against the Crown and keeps tax liabilities to a minimum, this has contributed to a detailed and complex legislative drafting style in common law jurisdictions with increasing propensity to amend — all of which results in a self-perpetuating, ever-widening tax code.[15]

Bowman then goes on to offer his considered opinion on the practical implications and merits of applying the above-described interpretative approach. While he refers to the approach as being a purposive approach to interpreting tax legislation, this article refers to the approach as being the *modern judicial plain meaning approach* because

---

9 (1584), 76 E.R. 637 (K.B.).

10 S.W. Bowman, "Interpretation of Tax Legislation: The Evolution of Purposive Analysis" (1995) 43 Can. Tax J. 1167.

11 *Ibid.* at 1173-74.

12 84 D.T.C. 6305 (S.C.C.).

13 Bowman, *supra* note 10 at 1177.

14 *Ibid.* at 1181-83.

15 *Ibid.* at 1183-84.

the application of its purposive aspects is restricted to those areas where, after applying the plain meaning approach, ambiguity or uncertainty remains.[16]

2. The Supreme Court's Position

Before concluding from Bowman's article that the Supreme Court of Canada has driven a plain meaning stake through the heart of the Canada *Interpretation Act*'s purposive approach, however, two additional points should be noted. First, one of the most recent interpretive statements by a member of the Supreme Court of Canada has at least as much to do with the desire to reconcile conflicting judgments as it does with any clear expression of fundamental principles. Iacobucci J. of the Supreme Court of Canada explained the Court's approach to interpreting tax legislation in his keynote speech at the Canadian Bar Association's annual tax conference on 4 June 1996. As reported by Robert McMechan in *Canadian Tax Highlights*, Iacobucci J. indicated that:

> A close reading of the two decisions [*Antosko* v. *M.N.R.*[17] and *Corporation Notre-Dame de Bon-Secours* v. *Communauté Urbane de Quebec*[18]] reveals that the plain-meaning approach encompasses the purposive approach. If the words of the statute are clear and plain, the result is not altered by legislative purpose or object. If the words are not clear and plain, the teleological approach must be followed. If ambiguity remains, the issue is resolved in favour of the taxpayer. However, Justice Iacobucci stated that in interpreting tax treaties the purpose of the treaty provision must be considered even if no ambiguity exists. Perhaps the court will provide further elucidation in future cases.[19]

What Iacobucci J. is trying chiefly to do here is to square the *Antosko* decision, which he wrote and which does reference the plain meaning rule, and the *Corporation Notre-Dame de Bon-Secours* decision, which was written by Gonthier J. and which includes no such reference in the guiding interpretative principles. The fact that Iacobucci J. considered it necessary to engage in such an exercise suggests that the Supreme Court of Canada will not necessarily adhere to his somewhat strained formulation in any "elucidation" that it might provide in a future case.[20]

Second, an interpretive canon based on whether an enactment is "clear and plain" may be a good deal less pure than its advocates suggest. Cory J. of the Supreme Court of Canada put a rather interesting twist on the "ambiguity" aspect of applying the plain meaning rule in 1996 when he stated:

---

16 *Ibid.* *E.g.* Bowman states at 1184 that:
> So long as the courts remain firmly anchored by the plain meaning of the statutory language, the application of the purposive approach will be *confined* to those areas where genuine ambiguity exists. [Emphasis added.]

17 94 D.T.C. 6314 (S.C.C.), Iacobucci J. (L'Heureux-Dubé, La Forest, Gonthier and Major JJ. concurring).

18 95 D.T.C. 5017 (S.C.C.), Gonthier J. (L'Heureux-Dubé, McLachlin, La Forest, Sopinka, Cory, and Iacobucci JJ. concurring).

19 R. McMechan, "The Purpose of Teleology" (1996) 4 Can. Tax Highlights 49.

20 Assuming that it is accepted that plain meaning should be the approach, one explanation for using a purposive approach for the interpretation of tax treaties is that the purpose of such conventions is the prevention of double taxation (*i.e.*, a non-revenue raising purpose). Nevertheless, the appropriateness of drawing such a distinction is questionable.

> Thus, when there is neither any doubt as to the meaning of the legislation nor any ambiguity in its application to the facts then the statutory provision must be applied regardless of its object or purpose. I recognize that *agile legal minds* could probably find an ambiguity in as simple a request as "close the door please" and most certainly in even the shortest and clearest of the ten commandments.... *Even if the ambiguity were not apparent, it is significant that in order to determine the clear and plain meaning of the statute it is always appropriate to consider the "scheme of the Act, the object of the Act, and the intention of Parliament".* What then was Parliament's intention in enacting the 1990 legislation?[21]

In summary, while it is correct to say that the Supreme Court of Canada currently shows a tendency to rely on the plain meaning approach to interpret tax statutes, and that the purposive approach called for by the Canada *Interpretation Act* may yet remain subjected to a modern judicial plain meaning gloss, it is not at all apparent that the current debate is moot. The legislated purposive approach, in other words, still shows signs of life.

3. The Legislative Substance Rule

Section 44(f) of the Canada *Interpretation Act* states:

> 44. Where an enactment, in this section called the "former enactment", is repealed and another enacted, in this section called the "new enactment", is substituted therefor,
>
> ...
>
> (f) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment.

The extent to which the purpose underlying a substituting enactment becomes law is disclosed by the substance of the enactment. In this regard, it would seem that the purpose of an enactment would be relevant in an enquiry as to the extent that a new enactment is not in substance the same as the former law. For example, when reading

---

[21] *M.N.R.* v. *Province of Alberta Treasury Branches*, 96 D.T.C. 6245 at 6248 (S.C.C.) [emphasis added], La Forest and McLachlin JJ. concurring, Major and Iacobucci JJ. dissenting. Linden J. referenced the above-mentioned *dicta* in *M.N.R.* v. *Duha Printers (Western) Limited*, 96 D.T.C. 6323 at 6328-29 (F.C.A.), rev'g 95 D.T.C. 5301 (T.C.C.), Isaac C.J. concurring (Stone J. allowing the Crown's appeal for different reasons). [Leave to appeal granted by the Supreme Court of Canada, [1996] S.C.C.A. No. 432 (QL).] The Federal Court of Appeal found in *Duha Printers* that the corporate taxpayer was not entitled to deduct $460,786 of non-capital losses obtained from an "unrelated" corporate taxpayer on an amalgamation (s. 111 of the *Act* denies the flow-through of non-capital losses of a corporation that undergoes a corporate change of control unless certain specific conditions are met). Note: the taxpayer had entered into a complicated series of transactions with the view to creating a corporate "relationship" between the taxpayers before their amalgamation so that the change of control loss denial rule would not apply (this position had been adopted as a filing position by the taxpayer but was reassessed by Revenue Canada).

statutory law consideration should be given to whether the purpose of any particular enactment is to

- codify, with some substantive difference, common law and court of equity rules established over time by the judiciary (*e.g.*, the *Criminal Code of Canada*, *Partnership Acts* and *Sale of Goods* codes),
- enact completely new law (*e.g.*, addressing the state's need to finance itself by way of an income tax — as was the case with the "temporary" *1917 Income War Tax Act*),
- consolidate law previously found in a former enactment, or
- revise the substance of an existing enactment (with the purpose and substance of the change being its interpretative context).

Otherwise, a significant risk exists that an enactment's interpretation will occur out of context.

4. Legislative Object (Purpose) Read In Conjunction With Legislative Substance

When ss. 12 and 44(f) of the Canada *Interpretation Act* are read together, the primary rule of interpretation set down by Parliament for a substitution in the tax law is, as is the case with any other substitution in federal law enacted by Parliament, as follows:

> While every enactment is deemed remedial and should be given such fair, large and liberal construction as best ensures the attainment of its *objects [purpose]*, an enactment does not operate as new law except to the extent of any *substantive* difference between the new enactment and the former enactment.

The point is this. The constraint on construing a substituting enactment in the fair, large and liberal manner that best ensures the attainment of its object is the "substantive difference" in the enacted words.[22] The relevance of the plain meaning of words when

---

[22] While the decision of the Supreme Court of Canada in *R.* v. *McIntosh*, [1995] 1 S.C.R. 686 [hereinafter *McIntosh*], appears to suggest otherwise, Lamer C.J.C. (Sopinka, Cory, Iacobucci and Major JJ. concurring) did not address the implications of ss. 12 and 44(f) of the Canada *Interpretation Act* when he stated at 697 (para. 18) that:

> Where the language of the statute is plain and admits of only one meaning, the task of interpretation does not arise (*Maxwell on the Interpretation of Statutes* (12th ed. 1969) at 29).

The *McIntosh* case concerns the law of self-defence as codified in ss. 34 and 35 of the *Criminal Code of Canada*. In particular, whether the self-defence justification is available to an initial aggressor who, having provoked an assault, kills the other person without having retreated from the conflict to the extent feasible. Nor did McLachlin J. cite those provisions of the Canada *Interpretation Act* when she stated in dissent (La Forest, L'Heureux-Dubé and Gonthier JJ. concurring) at 712 (para. 59) that:

read in conjunction with the purpose underlying those words is that plain meaning has a correlative role to play in determining substantive difference:

> The plain meaning of words when considered in the context of an amendment's object help a reader determine whether a substantive difference is being posed by words found in the amendment given its purpose when read in conjunction with the statute and its purpose as a whole and, if a substantive difference does exist, the extent of that substantive difference.[23]

Construing a revision as a consolidation unless a substantive difference exists between the new and old enactments should act as a balance or check on the legislated purpose-based approach found in s. 12 of the Canada *Interpretation Act*, and on the judiciary's approach to plain meaning, so that purpose and plain meaning are not used as mutually exclusive tools for judicial activism. Notwithstanding this, the above analysis suggests that it is the existence of legislative uncertainty in the tax law that appears to be the event that, in the minds of at least some of the judiciary, switches on the teleological (object/purpose) approach to interpreting tax legislation.

B. THE PLAIN MEANING HURDLE

The primary purpose of the *Act* is the antithesis of the rule in the *Duke of Westminster*[24] case. The primary purpose of the *Act* is the raising of revenue for the

---

> The point of departure for interpretation is not the "plain meaning" of the words, but the intention of the legislature.

And McLachlin J. adds at 718-19 (para. 74) that:

> The argument that Parliament intended to effect a change to the law of self-defence in 1955 rests finally on the presumption that a change in wording is intended to effect *substantive* change. But this presumption is weak and easily rebutted in Canada, where making formal improvements to the statute book is a minor industry. This is particularly the case where, as in this case, there is evidence of a drafting error: *Driedger*, at pp. 450-51. [Emphasis added.]

Moreover, Lamer C.J.C. was careful to indicate in his decision that McLachlin J.'s contextual approach to gleaning Parliament's intent is a reasonable approach — but that there were three reasons why it lent no support to the Crown's contention that the words "without having provoked the assault" should be read into s. 34(2) of the *Criminal Code* (see 698-703 (paras. 21-30) for those reasons). Given those three reasons, the *dicta* of the Chief Justice on plain meaning — on the effect that the plain meaning of "without having provoked the assault," as enunciated in s. 34(1) and s. 35 of the *Criminal Code*, had on precluding a context-based approach to interpreting s. 34(2) — were not necessary to reach the conclusion drawn by the majority as a whole and are *obiter dicta*.

[23] With respect to the role that plain meaning should play in interpreting enactments, questions raised by the Supreme Court's decision in *McIntosh*, *ibid.*, include: whether the majority were judicial activists who used the plain meaning interpretative approach to change the law of self-defence if, as the dissenting Justices contended, Parliament intended no substantive change to that law by its 1955 revisions of the *Criminal Code*; and whether the *ratio* of the *McIntosh* decision is that an apparent drafting error in a statutory revision can result in a substantive change to the law if the plain meaning of the words found in the revision cannot be interpreted in any other reasonable manner notwithstanding that the object of the revision was a consolidation purpose (*i.e.*, while a presumption exists that consolidation does not effect new law and which is not easily negated, this presumption can be rebutted if the plain meaning of the revision is clear and compelling with a citizen's liberty hanging in the balance).

[24] *The Commissioners of Inland Revenue* v. *Duke of Westminster* (1935), [1936] A.C. 1 (H.L.).

benefit of all.[25] Shortly after the House of Lords rendered its decision in the *Duke of Westminster* case, Professor John Willis stated the following about tax "evasion" and "avoidance":

> The attitude of the courts towards tax evasion is rather remarkable. The House of Lords has solemnly ruled it not only legal but moral to dodge the Inland Revenue [*Inland Revenue Commissioners* v. *Levene*, [1928] A.C. 217 at 227 (Lord Summer)]. Time and again courts have decided that Acts should not be construed so as to permit evasion of them, but by a series of sophistries about the word "evasion" they have succeeded in satisfying themselves that evasion of a taxing statute is not "evasion" at all but is "keeping within the permissible limits". The results of this curious attitude were until recently thought to be mitigated by a rule that the question whether the financial arrangements of a tax payer fell outside the Act or not was to be determined by looking not at the precise legal effect but at the substance of those arrangements. In 1936, however, the House of Lords rejected the "substance doctrine" in no uncertain terms and permitted the Duke of Westminster to...
>
> The conclusion seems to be that the attitude of the courts towards taxing Acts is at present uncertain....[26]

Has much really changed in this regard in the last sixty years?

It is arguable that the thrust of Willis' article is that the various rules of interpretation are mutually exclusive tools selected precisely by a judge to reach a pre-determined conclusion given the evidence and the views of the presiding judge. In this regard, the manner in which tax law is interpreted may be a matter of *class*. It should, therefore, be recognized that, from a democratic perspective, the rules of interpretation and how they are used by the judiciary, tax professionals and Revenue Canada have important implications for all. In this context, democratically elected Parliament is not asking too much of Canadian society when it states in the Canada *Interpretation Act* that the application of a particular piece of tax legislation to any set of facts and documents is to be done with reference to the legislation's underlying purpose.

The difficulty with the modern judicial plain meaning interpretative approach (plain meaning unless the words are uncertain) is that it seeks to fetter an otherwise objective enquiry into the application of tax legislation to particular facts. This is because the subjectively based arguments that are inevitably advanced as to whether or not particular words used in an enactment have a plain meaning ignore the purpose of the enactment, although surely the context in which particular legislation is drafted and enacted is extremely relevant to any objective enquiry as to the meaning of the legislation. Restated, requiring that a plain meaning enquiry be held on the issue of whether particular tax legislation is uncertain, the meaning of which is in dispute, is analogous to holding an extra-legal *voir dire* on the admissibility of objective evidence

---

[25] There are, of course, many secondary purposes (*e.g.*, individuals are encouraged to save for their retirement through RRSP deductions and tax deferrals).

[26] J. Willis, "Statute Interpretation in a Nutshell" (1938) 16 Can. Bar Rev. 1 at 26 [footnotes omitted].

that can assist in reaching a logical conclusion as to what should be justice in a given case.

Moreover, such a plain meaning barrier, which is controlled by a tax professional, Revenue Canada and, if necessary, by a judge, none of whom are accountable to the electorate, introduces an unwarranted level of subjectivity into the interpretative process that can only heighten the overall *uncertainty* in society as to the application of particular tax laws.

In contrast, the legislated teleological/purpose approach forces tax professionals, Revenue Canada and the judiciary to focus on the broader objective record (including budgetary statements and detailed explanatory notes) for the purpose of determining what Parliament's objective was in enacting particular legislation and the meaning of that legislation.[27] Under the teleological approach, only when this review of the broader objective record is complete can one move on to determine whether the legislation as written satisfies the purpose. The fact that there may be arguments about what the purpose is should not turn that review into a debate as to whether or not a plain meaning can be found in the legislation. Rather, the argumentative focus should be on whether or not the statutory language applies to the facts in a manner that reflects its underlying purpose.

Further, interpreting tax law should not be, as Sharlow notes, about determining a normal amount of tax for each taxpayer, because there is no such amount.[28] Paraphrasing Sharlow, it is inappropriate to assess tax on the basis of whether the taxpayer has self-assessed (or Revenue Canada has reassessed) an amount that is less (or more) than a "normal" amount for the taxpayer.

In this regard, requiring reference to an enactment's underlying purpose restricts the ability of the Crown, taxpayers, tax advisers and the judiciary to engage in sophistry, thereby reducing uncertainty created by subjectively based standards and concerns. As the previously-noted *dicta* of Holmes J. notes, words are not transparent crystals; they are the skin of a living thought and their meaning may vary greatly in colour and content. It is from circumstances and context that one finds the true meaning of words and circumstances and context cannot be properly framed in a particular tax case unless one focuses on "why" the words under review were enacted.

As well, important implications for the long-term integrity of the tax system flow out of the issue of whether the primary interpretative tool that is used by tax professionals (on behalf of clients), Revenue Canada and the judiciary rests on a purpose or plain meaning foundation. These implications are discussed below.

---

[27] For commentary on the admissibility of budgetary and other materials, see: 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; and Bowman, *supra* note 10 at 1186-88.

[28] Sharlow, *supra* note 4 at 153.

C. THE CONTEXT: THE EFFECT THAT LEGISLATIVE UNCERTAINTY MAY HAVE ON TAXPAYERS

As the debate progresses, an important issue is the effect legislative uncertainty has on taxpayers. In 1992 Peggy A. Hite and Gary A. McGill conducted a survey of the American literature concerning taxpayer compliance with tax laws.[29] While the Hite and McGill article should be read on its own, some of their findings are set out below for the purpose of relating them to the effect uncertainty in the tax law *may* have on taxpayers in a self-assessing tax system (and government and tax advisers). In particular,

- much of the traditional research examining taxpayer compliance behaviour uses a "deterrence theory framework" with the thrust of the findings being that taxpayers are "deterred" into compliance by perceptions about probabilities of detection and the severity of the penalties associated with non-compliance,[30]

- recent research has advanced the analysis by considering the role tax advisers have in the compliance decision,[31]

- the primary role of the adviser is the resolving of "uncertainty" in the tax law and risk adverse taxpayers report higher levels of income when uncertainty in the law is increased,[32]

---

29 P.A. Hite & G.A. McGill, "An Examination of Taxpayer Preference for Aggressive Tax Advice" 45 Nat. Tax J. 389. Hite and McGill concluded their own study by noting that taxpayers prefer conservative advice, want to make their own reporting decisions and disengage advisers when in disagreement with aggressive advice (at 398). Hite and McGill also state that:

> Taxpayers may simply want to pay the "correct" tax and preparers may think the "correct" tax is the lowest tax liability that can be achieved with defensible — but not assured — tax return positions (at 399).

When reading the article, however, it should be noted that Hite and McGill applied their model to "individuals" rather than "taxpayers" such as corporations. Also, the Hite and McGill model deals with hypothetical situations rather than actual experiences.

30 *Ibid.* at 389-90. The Hite & McGill references: C.R. Tittle, *Sanctions and Social Deviance: The Question of Deterrence* (New York: Praeger, 1980); and H.G. Grasmick & D.E. Green, "Legal Punishment, Social Disapproval and Internationalization as Inhibitors of Illegal Behavior" (1980) 71 Jour. Crim. L. 323.

31 *Ibid.* at 390. With research centred around demand for services, levels of compliance on such returns, and the factors affecting the compliance decision.

32 *Ibid.* at 390. The Hite & McGill reference: S. Scotchmer, "The Effect of Tax Advisors on Tax Compliance" in J.A Roth & J.T Scholz, eds., *Taxpayer Compliance: Social Science Perspectives* (Philadelphia: University of Pennsylvania Press, 1989) 182. With respect to reporting higher levels of income under uncertainty, they also referenced J. Alm, "Uncertain Tax Policies, Individual Behavior, and Welfare" (1988) 78 Am. Ec. Rev. 237; P.J. Beck & W.-O. Jung, "Taxpayer's Reporting Decisions and Auditing Under Information Asymmetry" (1989) 64 Acct. Rev. 468; and P.J. Beck *et al.*, "Experimental Evidence on Taxpayer Reporting under Uncertainty" (1991) 66 Acct. Rev. 535.

- preparers are "enforcers of the law" in *unambiguous* situations and "exploiters of the law" in *uncertain* contexts,[33]

- returns prepared by Chartered Public Accountants ("CPAs") took more aggressive positions than non-CPA prepared returns[34] with one study suggesting that tax professionals play an audit lottery game[35] which is consistent with their exploiter role,[36]

- while a taxpayer's risk attributes were important, another study suggests that a tax preparer's vulnerability to things such as penalties, loss of clients and firm reputation were the key factors,[37]

- moreover, taxpayer "risk attribute theory" is based upon interviews done with tax practitioners. An alternative view is that practitioners are actually motivated to influence the reporting decision (*e.g.*, based upon the levels of penalties, the audit lottery gambit and firm reputation),[38]

- this is because:

> Eisenstein, a noted tax practitioner and former Treasury official, observed that "tax avoidance is a thriving business, and tax lawyers are an essential component of the business. They are the retained *rationalizers* that keep the business going."[39]

The Canadian tax community, including representatives of government, the private accounting institutes/bar associations and the judiciary, should pause to reflect on these

---

33 *Ibid.* at 390. The Hite & McGill reference: S. Klepper & D.S. Nagin, "The Role of Tax Practitioners in Tax Compliance" (1989) 22 Pol. Sci. 167. Other literature concerning the effect tax preparers have on taxpayer compliance that they referenced includes: S. Klepper & D.S. Nagin, "Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution" (1989) 23 Law & Soc'y Rev. 209; and S. Klepper, M. Mazur & D.S. Nagin, "Expert Intermediaries and Legal Compliance: The Case of Tax Preparers" (1991) 34 Jour. Law & Econ. 205.

34 *Ibid.* at 390. The Hite & McGill reference: F.L. Ayers, B.R. Jackson & P.A. Hite, "The Economic Benefits of Regulation: Evidence From Professional Tax Preparers" (1989) 64 Acct. Rev. 300. Hite and McGill define "aggressive" as follows:

> The term "aggressive" is used throughout this paper to mean taking a pro-taxpayer position on a questionable item. This is not equivalent to tax evasion. An aggressive position as used here refers to a situation where there is some reasonable probability that a particular tax return stance will not be upheld by an IRS review and subsequent legal challenge. [See footnote 2 of their paper at 400.]

35 *Ibid.* at 390-92. The Hite & McGill reference: S.E. Kaplan *et al.*, "An Examination of Tax Reporting Recommendations of Professional Tax Preparers" (1988) 9 J. Econ. Psych. 427.

36 *Ibid.* at 391.

37 *Ibid.* at 391. The Hite & McGill reference: V.C. Milliron, "A Conceptual Model of Factors Influencing Tax Preparers' Aggressiveness" in S. Moriarity & J. Collins, eds., *Contemporary Tax Research* (Norman, OK: Centre for Economic and Management Research, College of Business, 1988) 1.

38 *Ibid.*

39 *Ibid.* at 391 [emphasis added]. The Hite & McGill reference for the Eisenstein statement is L. Eisenstein, *The Ideologies of Taxation* (New York: Ronald Press, 1961) at 205.

findings. In particular, and with respect to uncertainty in Canadian tax law, the Hite and McGill review may suggest that *uncertainty* in the tax law has the potential to raise revenues for both government and tax professionals, with taxpayers caught in the middle.

This paradox results from the fact that, left to their own devices, American individual taxpayers appear willing to overstate their income to the benefit of government coffers if penalties are perceived to be severe. American tax professionals, meanwhile, are more than willing to take aggressive positions that they consider likely to benefit their clients. The American taxpayer may be the one who pays most heavily for uncertainty in American tax law, which is also a self-assessing system. The unadvised taxpayer deals with uncertainty by overstating income, and pays the fisc; the professionally-advised taxpayer is encouraged to enter an audit lottery by taking aggressive filing positions, and pays the accountants, lawyers and, if the lottery gambit is thwarted by the revenue authorities, the treasury.

Canadians should not ignore the possibility that uncertainty in the tax law affects Canadian taxpayers and the revenues of government and tax professionals. Ignoring these possibilities could result in important long-term adverse implications for the health of the many-faceted interrelationships existing between government, tax professionals, the judiciary and taxpayers.

One further point should be made before the conclusion of this section on uncertainty in the tax law. It is possible that the Canadian judiciary's traditional use of a "legislative uncertainty switch" to turn on the purpose approach for the interpretation of taxing statutes may contribute to uncertainty in the tax law, notwithstanding that such an approach may have its advantages for the judiciary vis-à-vis its relationship with Parliament and the executive branch of government (*i.e.*, by permitting the judiciary to decide when to consider the purpose of legislation).

D. ATTITUDES ON TAXATION AND THE FAIRNESS OF THE TAX SYSTEM, THE RULE OF LAW, CONFISCATION WITHOUT COMPENSATION? AND THE PRIMARY PURPOSE OF TAXATION

1. Attitudes on Taxation and the Fairness of the Tax System

The attitudes of Canadians about the tax system coalesce around four distinct taxpayer groups, according to the KPMG Centre for Government Foundation and Canadian Facts which surveyed over 1,000 Canadian taxpayers in both 1994 and 1995. The breakdown is as follows[40]:

---

[40] KPMG Centre for Government Foundation and Canadian Facts, "Canadian Taxpayer Attitudes Survey — January 1996" (http://www.kpmg.ca/centre/vl/cg_96tax.htm).

KPMG's Distinct Groups (and Percentages)

	Model Citizens	Honest, But Resentful	Upset & Nervous	Tax Anarchists
1994	22%	28%	34%	16%
1995*	29%	27%	29%	14%

* 1% rounding error

KPMG describes each of the groups in the following manner:

"Model Citizens" — Model Citizens tend to believe that Canadians get good value for their taxes, that the present system is fair, that Revenue Canada should increase its enforcement activities and that people are not foolish to pay all their taxes.

"Honest But Resentful" — People in this segment feel that the majority of people are honest and would not cheat. However, they believe that the system is unfair, taxes are squandered and good value for taxes paid is absent.

"Upset and Nervous" — This segment believes that taxes are unfair, wasted and provide little value to taxpayers. They feel that most people avoid paying all their taxes and want to see stronger action taken to stop cheating.

"Tax Anarchists" — These members of the population are very similar to the upset and nervous in their views on fairness, waste and value for taxes. However, tax anarchists believe people are foolish to pay all their taxes and are opposed to Revenue Canada taking more initiatives or increasing penalties.

The good news is that this study indicates a noticeable improvement in the attitude of Canadians towards taxation between 1994 and 1995 and that most Canadians have not yet lost hope in the system. The bad news is that it appears that over 70 percent of individuals appear to think that the tax system is unfair and revenue is mostly wasted. Most Canadians also want Revenue Canada to increase its enforcement efforts. The frustration of average taxpayers in this regard has reached the point where Revenue Canada received 28,000 referrals of unsolicited information from the general public on other taxpayers in fiscal 1995-96.[41]

None of this should be surprising. Among other things, Canada is a tax jurisdiction where it does not appear that *unidentified* tax evaders and avoiders need fear Revenue Canada making successful demands on third parties for information that will identify them for the purpose of enforcing Canadian tax laws. This is because the Supreme Court of Canada ruled in 1984 that a brokerage company did not have to provide

[41] Revenue Canada, "Fast Facts Backgrounder" (http://www.rc.gc.ca/menu/EmenuMLJ.html). This accompanied a report issued on 25 March 1997 by the Honourable Jane Stewart, Minister of National Revenue, entitled: *Compliance: From Vision to Strategy*.

brokerage account information to Revenue Canada which it would then use to identify investors engaged in tax evasion and avoidance schemes; it was said that Parliament could have written a rule in this regard if it wanted to permit such intrusions.[42] Nevertheless, and subsequent to Parliament enacting the third party "requirement to provide documents" rule found in s. 231.2 of the *Act* and domestic "security transaction" reporting rules in *Income Tax Regulation* 230, the Quebec Superior Court ruled that a financial institution (*i.e.*, a federation of *caisse populaires*) did not have to comply with a February 14, 1994 court order to provide information in respect of 317 *caisses* in the federation for which it acted as an intermediary to Revenue Canada — that information concerned details about 9,704 transactions totalling $75 million sent offshore from 1991 to 1993 by clients of the individual *caisses*.[43] Revenue Canada could have used the information to identify the persons for the purpose of enforcing Canadian tax laws in respect of residents holding offshore bank accounts.

Such third party demand enforcement activities are described by many to be intrusive "fishing expeditions" that unjustifiably violate the rights of the citizenry. If this is the case, then there is a rather obvious hole in our self-assessment tax system that is the equivalent to permitting motorists to evade roadside breathalyser checks. Yet, such roadside checks are permitted as a justifiable limitation on our individual rights. See the Supreme Court of Canada's decision in *R.* v. *Hufsky* wherein Le Dain J. states for the Court the following:

> In view of the importance of highway safety and the role to be played in relation to it by a random stop authority for the purpose of increasing both the detection and the perceived risk of detection of motor vehicle offences, many of which cannot be detected by mere observation of driving, I am of the opinion that the limit ... on the right not to be arbitrarily detained guaranteed by s. 9 of the *Charter* is a reasonable one that is demonstrably justified in a free and democratic society [by s. 1 of the *Charter*].[44]

After a minority of Canadian taxpayers moved billions of dollars offshore to tax havens[45] in highly questionable schemes from a tax law perspective, often facilitated by financial institutions and rationalized by some professionals,[46] Parliament responded in 1997 by enacting the foreign asset disclosure rules found in ss. 233.2 to 233.7 of the *Act*. But unlike in the case of a Revenue Canada third party demand for information, the foreign asset reporting rules depend, for the most part, on the honesty of the very people sending their assets offshore.

Think of it this way. The average person, whose only source of income is most often a salary, pays his or her sales taxes as an unidentified consumer at the point-of-purchase and pays income tax as an identified employee every two weeks through

---

42 *James Richardson and Sons Ltd.* v. *M.N.R.*, 84 D.T.C. 6325 at 6330 (S.C.C.), rev'g 82 D.T.C. 6204 (F.C.A.).

43 *Fédération des Caisses Populaires Desjardins de Québec* v. *M.N.R.*, 1995 Can. Rep. Que. 207 (Que. Sup. Ct.).

44 [1988] 1 S.C.R. 621 at 636. See also *M.N.R.* v. *McKinlay Transport Ltd.*, 90 D.T.C. 6243 (S.C.C.).

45 S. Cameron, "Offshore Billions" *Maclean's* (9 October 1995) 54.

46 S. Slutsky, "Ethical pains in tax paradise" *The Financial Post* (10 October 1995) 27.

payroll withholdings. Those taxes are collected on behalf of the government by other taxpayers pursuant to constitutionally valid laws that are in effect third party demands in respect of both unidentified and identified persons.

Ironically, the state's ability to collect tax is most impaired — and information is thus most crucial — in the case of income realized by residents of Canada in respect of activities such as the placement of capital offshore, especially when compared to the state's ability to collect tax on employment income which is, arguably, one of the easier sources of income to tax given the revenue authority's facility to identify employers and employees in the community. It is precisely those people who invest offshore that have the greatest opportunity to evade or avoid Canadian tax laws. Yet it appears that these people cannot be the subject of a Revenue Canada third party demand unless they are identified. But, if they do not report under the "self-reporting" foreign disclosure rules, how can they be identified unless Revenue Canada can make third party demands for financial information from persons likely to deal with such unidentified taxpayers?

2. The Rule of Law

As mentioned earlier in this article, Sharlow expressed the concern that the rule of law will fail if judges manipulate the words of the *Act* at the behest of the Crown to meet some objective claimed by the Crown that is not stated in the *Act* itself.[47] In defining the "rule of law" Sharlow states that:

> The Supreme Court of Canada has said, "The 'rule of law' is a highly textured expression ... conveying, for example, a sense of orderliness, of subjection to known legal rules and of executive accountability to legal authority."[48]

The focus here should be panoramic. Not only can the written word mean different things to different people with varying shades of meaning in differing circumstances, an individual's perspective can affect his or her interpretation of particular words in particular circumstances. *If* government, the tax profession, the judiciary and taxpayers were to manipulate the words of the tax law for their separate reasons, such manipulation would raise grave concerns because what the many may put up with over the short term cannot be sustained over the long term.

The difficulty with Sharlow's article is not her concern that an activist judiciary can undermine the citizenry's respect for the rule of law, as this is a valid concern. Rather, it is this. The modern judicial plain meaning approach to interpretation itself results from judicial activism. It seeks to introduce a dominant interpretative rule to the exclusion of purpose. The legislated approach in this regard is to base the interpretation of an enactment on its "purpose," as enunciated by ss. 12 and 44(f) of the Canada

---

47 Sharlow, *supra* note 4 at 152. Bowman also acknowledges this concern in his article on statutory interpretation (*supra* note 10 at 1184-85).

48 *Ibid.* at note 7. The Supreme Court citation is *Repatriation Reference*, [1981] 1 S.C.R. 753.

Interpretation Act, with plain meaning having a correlative role in determining the substantive difference between a new and former enactment.[49]

The rule of law and the willingness of the many to respect it and pay the price of taxation would be undermined if the means to manipulate the tax law, planned or otherwise, were built into the system for the benefit of the few. The rule of law is part of the collective compact that governs Canadian society. That compact is between each and every one who chooses to take advantage of the opportunities offered by Canadian society. The compact does not provide that the price of taxation is to be paid by the uninformed, or by those too poor to afford professional advice. To paraphrase Cory J. in *Province of Alberta Treasury Branches*, the tax law should not be about agile legal minds finding or creating uncertainty in the clearest of statements to the benefit of the few.[50] In the tax context, it is about all persons shouldering the burden of taxation.

Rhetorically speaking to those who stress plain meaning, surely Parliament would have enacted a pro-avoidance rule rather than the general anti-avoidance rule found in s. 245 of the *Act* if it intended for bright and clever tax professionals to fashion what can be a mind-boggling series of transactions designed to achieve tax benefits with or without economic substance. Moreover, tax avoidance structures for the benefit of the few have the potential to pervert the democratic authorization by the many of the one collective activity without which no civilization can survive.

3. Confiscation Without Compensation?

While some may say that taxation in Canada is an authorized confiscation without compensation (as Sharlow has[51]) this view is a misstated concern about the power that the state can bring to bear on the citizenry without monetary compensation. Clearly there is compensation for the price of taxation in the form of a stable social, economic and political environment.

Note, for example, that Canada is ranked as the number one place in the world to live under the *United Nations' Human Development Index*, which is "an average of measures of life expectancy, educational attainment and per capita income."[52] This quality of life does not come cheaply. In large part, it is paid for with tax revenues.

---

49 Also see related commentary on Lamer C.J.C.'s decision and McLachlin J.'s dissent in the 1995 Supreme Court of Canada decision of *R.* v. *McIntosh* (*supra* notes 22-23).

50 *Supra* note 21.

51 *Supra* note 4 at 153 where Sharlow states that:

> Interpreting a statute to decide the validity of a Charter challenge requires a balancing of individual rights against legitimate state interests. That is a value-laden exercise, and properly so. But value judgments of that kind have no place in tax cases. *Tax laws are confiscatory; their function is to authorize the taking of property without compensation.* By definition they infringe property rights. Although property rights have no constitutional protection, it does not follow that they are up for grabs. There is no legal principle that justifies a court in enhancing the Crown's taxation power by applying extra-legal considerations to the interpretation of tax laws.
>
> What then is the proper role of statutory purpose? [Emphasis added.]

52 P. Knox, "Canada still place to live, UN says" *Globe & Mail* (12 June 1997) A1, A9.

From a business perspective, Canada is ranked as the third best place to do business in the world over the next five years (behind the Netherlands and the United Kingdom) by The Economist Intelligence Unit (which is related to *The Economist* news magazine).[53] There is much to criticize in the argument that taxation is confiscation without compensation and it should, therefore, be strongly rejected without more.[54]

4. The Primary Purpose of Tax Law

The elected representatives of Canadians can at any time increase, reduce or change what is collected (and spent) from the whole. It therefore needs to be questioned whether Parliament, private and public tax professionals, the judiciary and the citizenry believe that the primary purpose of tax law is the raising of revenue to pay for the benefits flowing to all from the state. Sheldon Silver indicated at the 1994 Canadian Tax Foundation's Annual Tax Conference that he felt there had been an attitudinal shift in Canadian society on the purpose of tax law around the end of the 1960s.[55] Among other things, Silver stated to the membership that:

> With the implementation of the new Act in 1972, a new attitude began to prevail. The provisions of the new Act are far more specific in nature, and it is often difficult, if not impossible, to discern the general intent of Parliament. Transactions, if done one way, can result in certain tax consequences; if done another way, they can often result in quite different tax consequences. Very often, these differences in tax treatment appear to be arbitrary in nature.
>
> Further, as cases came before the Canadian courts after 1972, Canadian judicial attitudes appear to have changed. ...
>
> The avoidance cases deal with and discuss business purpose, form and substance, object and spirit, step transactions, sham, artificiality, economic substance, and a number of other concepts, often without establishing a consistent rationale from case to case. However, a trend does appear to be emerging. Cases such as *Stubart*,[56] *Bronfman*,[57] *Irving Oil*,[58] *Friedberg*,[59] *Husky Oil*,[60] *Bowens*,[61] *Continental*

---

53 H. Branswell, "Canada has third best business climate in the world" *Ottawa Citizen* (15 May 1997) C3.

54 While Sharlow also suggests that the purposive approach to interpreting tax legislation is an extra-legal consideration (see *supra* note 51), this is wrong because it is mandated by s. 12 of the Canada *Interpretation Act*.

55 S. Silver, "Ethical Considerations in Giving Tax Opinions" in *Report of the Proceedings of the Forty-Sixth Tax Conference, 1994 Conference Report* (Toronto: Canadian Tax Foundation, 1995) at 36:1.

56 *Supra* note 12.

57 *M.N.R.* v. *Bronfman Trust*, 87 D.T.C. 5059 (S.C.C.).

58 *M.N.R.* v. *Irving Oil Ltd.*, 91 D.T.C. 5106 (F.C.A.). Leave to appeal refused, [1991] 3 S.C.R.

59 *M.N.R.* v. *Friedberg*, 93 D.T.C. 5507 (S.C.C.), aff'g 92 D.T.C. 6031 (F.C.A.).

60 While Silver is referring to *Husky Oil Ltd.* v. *M.N.R.*, 95 D.T.C. 316 (T.C.C.), the Federal Court of Appeal dismissed the Crown's appeal at 95 D.T.C. 5244 (F.C.A.).

61 While Silver is referring to *Bowens* v. *M.N.R.*, 94 D.T.C. 1853 (T.C.C.), the Federal Court of Appeal dismissed the Crown's appeal at 96 D.T.C. 6128 (F.C.A.).

Bank,[62] and *Antosko*[63] *suggest that, in the absence of fraud or sham, the legal form of a transaction cannot be ignored, and that at the very least an attempt to avoid tax, whether successful or not, is not improper.*[64]

While Silver associates this attitudinal shift with the specificity of provisions found in the modern *Act*,[65] an alternative or more determinate explanation exists. It may be more than coincidental that the timing of the *1972 Act* coincided with a surge into the economy of the post-war baby boomers. The collective memory of the hungry 1930s and the hardships of the war years was fading; the wants and values of the "me" generation were in the ascendancy. Many members of that generation, having abandoned the values of their parents, sought out new solutions to old problems, including through government intervention into the economic and social fabric of the nation. Many of these demands found their way into the *Act* in the form of new programs designed with some secondary non-revenue-raising economic or social purpose.[66]

Placing a host of non-revenue-raising purposes into the tax law can make it more difficult to discern the purpose of particular provisions. Nevertheless, the primary purpose of tax law remains the raising of revenue by the state for the benefit of all.

E. AN EXAMPLE OF THE TANGLED WEB OF UNCERTAINTY WEAVED BY ALL OF US

From a practical perspective, in describing what she viewed to be the proper role of the statutory purpose approach, Sharlow reviewed the Supreme Court of Canada's

---

62 While Silver is referring to *Continental Bank of Canada and Continental Bank Leasing Corp.* v. *M.N.R.*, 94 D.T.C. 1858 (T.C.C.), the Federal Court of Appeal reversed the findings of the Tax Court at 96 D.T.C. 6355 (F.C.A.), Linden J. (Isaac C.J. and McDonald J. concurring). [Leave to appeal granted by the Supreme Court of Canada, [1996] S.C.C.A. No. 451 (QL).]

63 *Supra* note 17.

64 Silver, *supra* note 55 at pages 36:4-5 [emphasis added]. *Note*: the last sentence of the quotation should be read with reference to a list of cases referred to in note 19 of Silver's paper. For a review of many of the cases referred to above, see P. Barsalou, "Review of Judicial Anti-Avoidance Doctrines in Selected Foreign Jurisdictions and Supreme Court of Canada Decisions on Tax Avoidance and Statutory Interpretation" in *Report of the Proceedings of the Forty-Seventh Tax Conference, 1995 Conference Report* (Toronto: Canadian Tax Foundation, 1996) at 11:1.

65 The first edition of the *1972 Act* does not represent a shift in drafting styles (see the *Canadian Income Tax Act*, 42d ed. (Don Mills: CCH Canadian Limited, 1972)). Rather, there is a reordering of many of the provisions found in the *1952 Act* and the addition of a number of new provisions resulting from the tax reform process that occurred during the previous seven years (*e.g.*, the *1966 Carter Report* and the *1969 White Paper on Tax Reform*).

66 For example, on the job creation side, see: the corporate "Canadian manufacturing and processing profits" tax rate reduction (s. 125.1 of the *Act*); the "investment tax credit" program (ss. 127(5) to 127.1 of the *Act*); and "employment tax credit" (former ss. 127(13) to 127(16) of the *Act*). On the social policy side, see: moving expenses (s. 62 of the *Act*); child care expenses (s. 63 of the *Act*); "child tax benefit" (s. 122.6 of the *Act*) which replaced the "child tax credit" program (former s. 122.2 of the *Act*); the "credit for dependent non-infirmed children under the age of 18" (former s. 118(1)(d) of the *Act*); and the "family allowance benefit" paid to parents by the Department of Health and Welfare.

findings in *M.N.R.* v. *Bronfman Trust*[67] and *Tennant* v. *M.N.R.*[68] with respect to the deductibility of interest rule in s. 20(1)(c) of the *Act*. Those cases were said to be instances in which the purpose of s. 20(1)(c) could be inferred from its wording and used as a guide to reach the proper interpretation thereof.

This article will review *Schwartz* v. *M.N.R.*[69] from the perspective of whether a damage award for a breach of an employment contract is income from "employment," an "other source [as enunciated in subdivision d to Division B of Part I]," or a "non-enumerated source [the s. 3(a) residual]" under ss. 3, 5, 6 and 56 of the *Act*.

1. Five Reasons for Considering the Schwartz Case

The *Schwartz* decision has been selected for five reasons. First, it is not a tax-avoidance case and presents a more difficult challenge vis-à-vis making the case for why the modern plain meaning approach should be rejected as a dominant rule of interpretation. Second, it was considered by each level of the judiciary. Third, most citizens should be able to understand the fact pattern and the underlying issue being decided in the case: is any portion of a taxpayer's wrongful dismissal award subject to taxation where the taxpayer did not "commence" employment. Fourth, the issue has both "income" and "deduction" aspects to it. Fifth, the deduction aspect of wrongful dismissal awards brings into play the non-revenue raising purpose of encouraging taxpayers to save for their retirement.

2. The Respective Court Findings

Allan M. Schwartz was enticed to leave his law partnership and become Dynacare's Senior Executive Vice-President for a salary of $250,000 per annum plus share options. While Schwartz contractually obligated himself to Dynacare, the company terminated his contract without just cause before he actually commenced employment (and after he tendered his resignation from his partnership). Schwartz negotiated $360,000 in damages for wrongful dismissal (lost wages, stock options, mental distress and professional embarrassment) and $40,000 for costs.

There were many legal nuances to the arguments advanced on behalf of the Crown and Schwartz as to why $360,000 was or was not subject to income taxation under the *Act*. Nevertheless, and given that the case wound its way through all levels of the judiciary, the findings of the respective courts should be considered first:

- The Tax Court Judge accepted as credible Schwartz's testimony that no specific allocation of the $360,000 had been made by him and Dynacare between the income portion (salary and stock options) and non-income amounts (embarrassment, etc.). The Tax Court Judge then rejected the Crown's arguments that the amount was a "retiring allowance" under s. 56(1)(a)(ii) of

---

67 *Supra* note 57.

68 96 D.T.C. 6121 (S.C.C.).

69 96 D.T.C. 6103 (S.C.C.), rev'g 94 D.T.C. 6249 (F.C.A.) (rev'g 93 D.T.C. 555 (T.C.C.)).

the *Act*, an employment "benefit" under s. 6(1)(a) of the *Act* or income from a source to which s. 3(a) of the *Act* applies.

- The full panel of the Federal Court of Appeal who heard the Crown's appeal reversed the Tax Court Judge's finding on the basis that he was wrong to find that there was no evidence to indicate any allocation of the $360,000 between the income and non-income portions could be made. In particular, there were solicitor settlement letters in evidence between the taxpayer's counsel and Dynacare indicating that $267,000 was for lost stock options and $75,000 for lost wages.[70] Accordingly, and while the Federal Court of Appeal agreed that no portion of $360,000 was a "retiring allowance," it substituted a finding of fact that $342,000 ($267,000+$75,000) was income within the express contemplation of the employment source found in s. 3(a) of the *Act*.

- The full panel of the Supreme Court of Canada who heard the taxpayer's appeal reversed the Federal Court of Appeal. This reversal was done on the basis that, while the Federal Court of Appeal was correct in finding that the amount was not within the meaning of the definition of "retiring allowance" in s. 248(1) of the *Act*, it had erred in inferring from the letters that the parties had "agreed" to allocate the amount between employment income and non-income amounts in the manner suggested. The trial transcript of Schwartz's testimony indicated that his testimony was contrary on this point and, given no adverse finding on the trial court judge's part as to Schwartz's credibility, the letters were insufficient to serve as a basis for interfering with the trial judge's duties as the trier of fact (thus none of the $360,000 settlement was income from a "non-enumerated source" under s. 3(a) of the *Act*).[71] [Note: unlike at the Federal Court of Appeal level, the Crown argued for the application of the "non-enumerated source" rule in s. 3(a) rather than the more specific "employment" source reference (detail in respect of the importance of this nuance is provided below).]

While all Supreme Court Justices were in agreement in this regard, they split on the issue of whether s. 3(a) of the *Act* could apply to an "non-enumerated source" as held by the majority. To the majority,[72] s. 3(a) applies to non-enumerated sources but, in the case at bar, that paragraph did not apply because to do so would give preference to a general statement in the law over the more detailed definitions of "retiring allowance" and "employment" in s. 248(1) of the *Act*. To the minority,[73] the Court's finding in this regard was *obiter dicta* and Major J. set out for the minority a list of reasons why the Court should not have decided the non-enumerated source issue in s. 3(a), including suggesting that s. 56 of the *Act* would be left with no purpose.[74]

---

70 *Schwartz* (F.C.A.), *ibid.* at 6251.

71 *Schwartz* (S.C.C.), *supra* note 69 at 6114.

72 La Forest J. (L'Heureux-Dubé, Gonthier and McLachlin JJ. concurring).

73 Major J. (Sopinka and Iacobucci JJ. concurring).

74 In doing so, however, Major J. acknowledged that s. 3(a) appears to contemplate non-enumerated sources of income and that the preamble to s. 56 of the *Act* specifically states that it is not meant to restrict the generality of s. 3 (*Schwartz* (S.C.C.), *supra* note 69 at 6120).

3. An Extremely Relevant Question Asked During Oral Argument

To the above comments it should be added that one member of the Supreme Court asked counsel for the Crown an extremely relevant question during oral argument, a tape-delayed broadcast of which was televised on the Parliamentary channel. The thrust of the question was as follows: whether, if asked, a person on the street would think that Schwartz was an employee of Dynacare at the time he settled his claim given that he had yet to take up that employment and was in fact working for someone else. As might be expected, counsel for the Crown replied to the effect that Schwartz had an employment contract and the related legal issues were questions to be decided using legal principles rather than what the person on the street might think.

This question is fascinating given the context of interpreting tax legislation. It is interesting to consider how people in, for instance, Nova Scotia would respond to that question. Visualize their lordships on a wharf in rural Nova Scotia trying to explain to the locals why the Supreme Court of Canada was being called upon to determine whether Parliament intended for income from employment to include any portion of $400,000 received in settlement for the breach of an employment contract. Surely, practically speaking, the answer is rather obvious. Not that Schwartz can be blamed for taking the position that he did. Legally speaking, the answer is *uncertain.*

4. Backward into the "Uncertain" Law

a. Major J.'s Minority View on S. 56 (Redundancy?)

To understand this concern fully, it is necessary to move backward into the relevant law from Major J.'s minority view that s. 56 of the *Act* would be left with no purpose if s. 3(a) were interpreted to apply to other non-enumerated sources. It is submitted that, with all due respect to Major J., there is a fundamental structural reason in the *Act* that indicates he is wrong in this regard.

In particular, the "other sources of income" amounts enumerated in s. 56 of subdivision d to Division B of Part I of the *Act* can be eligible for two different types of reduction that would not otherwise be available if there were a straight inclusion of such income amounts into a taxpayer's income under s. 3 of the *Act*. First, many of the paragraphs in s. 56 in subdivision d to Division B of Part I include internal rules that limit the inclusion into income of the particular source enumerated therein. For example, see the internal offsets found for "training allowances" in s. 56(1)(m),[75] "scholarships, bursaries, etc." in s. 56(1)(n)[76] and "research grants" under s. 56(1)(o).[77]

---

[75] The training allowance inclusion for *National Training Act* receipts does not apply to amounts paid to a taxpayer "as or on account of an allowance for the taxpayer's personal or living expenses while the taxpayer is away from home."

[76] The scholarship, fellowship or bursary, or prize for achievement income inclusion results in a s. 3(a) income inclusion to the extent the amount exceeds the greater of: $500, and the total of ... (see the provision for further details). Nor does the inclusion apply to a "prescribed prize" (see Part LXXVII, Reg. 7700: *Income Tax Regulations*, SOR/89-473, for a definition).

Second, many of the amounts listed in s. 56 and included in a taxpayer's income computation under s. 3(a) are also "deductions" described in s. 60 in subdivision e[78] to Division B of Part I of the *Act* and which result in the reduction of a taxpayer's income as computed under s. 3(c) of the *Act*. For example, see the deduction from income provided for a taxpayer's "retiring allowance" by s. 60(j.1) of the *Act* if the taxpayer's receipt is a "retiring allowance" to which s. 56(1)(a)(ii) applies.

Section 3 of the *Act* would, in the absence of such internal off-set and deduction rules, require taxpayers to add the full amount of such other sources of income to their income. Accordingly, s. 56 is not redundant. Moreover, the following analysis will consider in more detail the interrelationship existing in the *Act* between "other sources of income" and "other deductions from income" listed in ss. 56 and 60, "employment income" as computed under ss. 5 to 8 and "enumerated" and "non-enumerated" sources of income to which s. 3 of the *Act* applies.

b. The Definitions of "Retiring Allowance" and "Employment"

Section 56(1)(a)(ii) of the *Act* applies, and s. 60(j.1) can apply, to retiring allowances. With respect to the definition of "retiring allowance" in s. 248(1) as read in conjunction with the definition of "employment" in s. 248(1) of the *Act*, its wording does not, as is the case with s. 80.4, contemplate an *intended office or employment* (*i.e.*, actual employment service appears to be required). This finding of the Supreme Court in the *Schwartz*[79] case is not inconsistent with the language found in s. 44(f) of the Canada *Interpretation Act*, which suggests that the legislative substance of the definition of "retiring allowance" in s. 248(1) cannot be said, on a fair, liberal and objective reading, to pick up income amounts arising before an employment service began given the wording of the 1981 amendment to s. 80.4 of the *Act*.

While it is not clear why the language used in s. 80.4 of the *Act* differs in this regard, a perfectly good legislative and policy answer can be advanced as to why Parliament and the citizenry may feel employee retiring allowances should be construed more narrowly than employee loans to which s. 80.4 applies.[80] More specifically, only

---

77 A research grant can be reduced by expenses incurred to carry on the research *except* ... (see the list in the provision of amounts in s. 56(1)(o), including personal and living expenses and amounts that have been reimbursed, that are within the meaning of the exception — such amounts cannot, therefore, be deducted from the grant).

78 Which is entitled: "Deductions in Computing Income."

79 *Schwartz* (S.C.C.), *supra* note 69 at 6119.

80 The answer is possible because of the decisions of La Forest and Major JJ. on the legal nuances at play. The litigants and the Court appear to have been so focused on the "income" aspects of retiring allowances that they overlooked the "deduction" aspect of the matter, and that the 1981 amendments also enacted s. 60(j.1) of the *Act*. That enactment *capped* the deduction of retiring allowances transferred to tax-deferred retirement funds. Such deductions were restricted by then s. 60(j.1) to an amount not in excess of $2,000 for each year of pensionable employment service plus $1,500 for each year of pensionable service. See *infra* note 112 for further details and more recent restrictions. As of 1981, s. 80.4 contemplates an intended office or employment, s. 60(j.1) contemplates actual service for rollover purposes, and the definitions "retiring allowance" and "employment" in s. 248(1) are silent in this regard.

those taxpayers who have *commenced* employment should be entitled to treat their breach of employment contract awards as retiring allowances and thereby benefit from the retiring allowance rollover rules found in s. 60 of the *Act* (*i.e.*, *Schwartz*-like settlements should be considered to be employment income). Under s. 3(c) of the *Act*, subdivision e deductions, such as that to which current s. 60(j.1) applies, reduce a taxpayer's inclusion into income of a retiring allowance to which s. 56(1)(a)(ii) and s. 3(a) of the *Act* apply.

In any event, the non-applicability of the retiring allowance rules found in subdivisions d and e to Division B of Part I of the *Act* to Schwartz's damage award raises a more essential interpretative issue.

c. Employment Income Under S. 5?

The next step in the analysis of the *Schwartz* case returns to the fundamental question that needs to be answered: was any portion of the $400,000 received by Schwartz employment income under s. 5 in subdivision a to Division B of Part I of the *Act*. The answer should be "yes." Section 5 applies to:

> ... income ... from an office or employment [that] is the salary, wages and *other remuneration*, including ... [emphasis added].

It is submitted that the purpose that can be inferred from s. 5 and used as an interpretive guide is one of raising revenue from individuals who are remunerated in any manner because of a contract of employment or an office, including compensation received in the form of a wrongful dismissal settlement or award. Without more, this inference is subjectively drawn from the words in s. 5 and open to contextual error. The risk of this contextual error is narrowed in the case of wrongful dismissal amounts because they are rarely structured to be "salary or wages" — the interpretative issue turns on the meaning of "other remuneration" in s. 5. The broader objective record indicates that the object of the words "other remuneration" is to ensure that income from an "office or employment source" includes *non-salaried forms of compensation* received in a taxation year as a consequence of an employment or office and that this intention extends to legislators and judges receiving salaried or non-salaried forms of compensation from the Crown.[81]

---

[81] The reference to "other remuneration" in s. 5 of the *Act* can be traced back to 1919 amendments to the 1917 *Income War Tax Act*. See S.C. 1919, c. 55, ss. 1 and 2. Amendments found in ss. 1 and 2 of that statute ensured that income from an office or employment was broadened (by s. 2(1) of the statute) to include the following types of non-salaried compensation:

> salaries, indemnities *or other remuneration* of members of the Senate and House of Commons ... members of Provincial Legislative Councils and Assemblies and Municipal Councils ... any Judge of any Dominion or Provincial Court appointed after the passing of this Act, *and of all persons whatsoever whether* the said salaries, indemnities or other remuneration are *paid* out of the revenues of His Majesty in respect of His Government of Canada, or of any province thereof, or *by any person*, except [*e.g.*, amounts paid to the Governor General]. [Emphasis added.]

This change followed a heated debate in 1918 on the appropriateness of the then-existing exemption for judges. See *House of Commons Debates* (17 May 1918) at 2155-61 (which also

Section 5 picks up at least $342,000 of Schwartz's receipt if the section is read fairly and liberally with a view to attaining its purpose, and subject to any exclusions or deductions available to employment income under ss. 6 to 8 of the *Act* ($400,00 less the $40,000 received to pay legal fees and the $18,000 for embarrassment, etc.)[82] It should be noted, however, that by using a plain meaning approach the Federal Court of Appeal had concluded twenty years earlier in *M.N.R.* v. *Atkins*[83] that Atkins' wrongful dismissal settlement amount of $18,000 was not "salary" or "other remuneration" paid under the contract of employment even though it appears to have been measured with reference to salary otherwise payable (see below for the calculation).

Of course, the proposed purpose-based approach as to the application of s. 5 to Schwartz's settlement can be countered by noting that, unlike in the case of Atkins, Schwartz was never (within the plain meaning of) "in the service of some other person" as stated in the definition of "employment" in s. 248(1). Ignoring the possibility that Schwartz's receipt related to an "office" rather than an "employment," the answer to this challenge is twofold.

First, at the time the *Atkins* case was decided, the amendment to s. 80.4, which created the uncertainty, did not exist. At that time, it is quite possible that the application of a purpose approach to s. 5 for the purpose of calculating a taxpayer's income from "employment," as defined in s. 248(1), would have reached a different result from that which could fairly and liberally be reached after the amendment of s. 80.4. After all, the $18,000 amount paid to Atkins was in lieu of a nine month notice period of 14 October 1970 to 13 August 1971 in respect of his annual salary of $22,300 with a potential maximum profit bonus of $2,000 (9/12 x $24,300 = $18,225); post-dismissal negotiations also resulted in other benefits such as corporate support through a scholarship plan of the cost of his daughter's education.[84]

Second, additional support for the application of s. 5 to wrongful dismissal awards can be found in s. 6(3) of the *Act*. That is to say, s. 6(3) can be applied to amounts that might not otherwise be employment income to which s. 5 applies — for example, to damages in respect of breached contractual obligations that arise *before* actual employment begins. Section 6(3), which is almost identical to s. 25 of the *1952 Act*, states that:

---

includes a brief discussion at 2155 on whether the "indemnities" of Members of Parliament were taxable as income). There was also a subsequent debate on the decision to grandfather judges appointed prior to the passage of the bill (see *House of Commons Debates* (19 June 1919) at 3713-20).

82 Taxpayers may deduct under s. 8(1)(b) the cost of legal fees incurred to collect (and post-1989, to establish a right to) "salary or wages" to which s. 5 applies.

83 76 D.T.C. 6258 (F.C.A.), aff'g 75 D.T.C. 5263 (F.C.T.D.). Note: both levels of the Federal Court distinguished *Quance* v. *M.N.R.*, 74 D.T.C. 6210 (F.C.T.D.) which is a case where the taxpayer accepted 9.5 months of continuing salary after having been dismissed without notice and was held to have received "salary" within the meaning of s. 5. The *Atkins* case was said to be different in that the settlement amount was not purely and simply salary (see (F.C.T.D.) at 5269-70).

84 *Atkins* (F.C.T.D.), *ibid.* at 5265.

6(3) An amount received by one person from another

(a) during a period while the payee was an officer of, or in the employment of, the payer, or

(b) on account, in lieu of payment or in satisfaction of an obligation arising out of an agreement made by the payer with the payee immediately *prior to,* during or immediately after *a period that the payee was* an officer of, or *in the employment of, the payer,*

shall be deemed, for the purposes of section 5, to be remuneration for the payee's services rendered as an officer or during the period of employment, *unless* it is established that, irrespective of when the agreement, if any, under which the amount was received was made or the form or legal effect thereof, it cannot reasonably be regarded as having been received

(c) as consideration or partial consideration for accepting the office or entering into the contract of employment,

(d) *as remuneration or partial remuneration* for services as an officer or *under the contract of employment,* or

(e) in consideration or partial consideration for a covenant with reference to what the officer or employee is, or is not, to do before or after the termination of the employment. [Emphasis added.]

The application of a purpose-based interpretative approach to s. 6(3) would consider $342,000 of the $400,000 received by Schwartz to be employment income under s. 5. This is because s. 6(3)(b) would apply unless the amount cannot reasonably be regarded as having been received under paragraph (d) as "remuneration or partial remuneration ... under the contract of employment." Section 6(3) would, when read fairly and liberally with its object in mind, result in a net inclusion of $342,000. That is to say, $400,000 less the $40,000 reimbursement of legal expenses[85] and $18,000 for embarrassment, assuming the letters provide some evidence to the effect that those amounts cannot reasonably be regarded as having been received as remuneration or partial remuneration under the contract of employment.

Nevertheless, it must be noted in this regard that the Federal Court of Appeal states from a plain meaning perspective in the *Atkins* decision that:

In so far as section 25 of that *Act* [now s. 6(3)] is concerned, on the facts, it cannot be contended with any seriousness that the amount in question can reasonably be regarded as falling within paragraph (i), (ii) or (iii) of that section [now s. 6(3)(c) to (e)].[86]

---

[85] This $40,000 reduction occurs under s. 6(3) itself and is not dependent upon the applicability of s. 8(1)(b), which may permit a deduction from employment income for legal expenses incurred only in respect of "salary or wages" (see *supra* note 82).

[86] *Atkins* (F.C.A.), *supra* note 83 at 6259. See also the more detailed analysis of this issue by Collier J., who distinguished the *Quance* decision ((F.C.T.D.), *supra* note 83 at 5271-72).

The above analysis suggests this is erroneous *dicta*. Further, La Forest J. states in *Schwartz* that:

> Clearly then, at the end of the 1970's, it had been settled and accepted by all, including the Minister of Revenue, that damages received by an employee, from his ex-employer, as a result of the latter's cancellation of the employment contract, did not constitute income from office or employment taxable under s. 5(1) or a retiring allowance taxable under s. 56(1)(a)(ii) of the *Act*.[87]

This suggests that the plain meaning approach to interpreting tax legislation has the potential to plough its way relentlessly forward through the tax law. That is not to say that old precedent should be overturned by lower courts. Such an approach would cause an uncertainty upheaval in the settled state of the case law. However, it should be pointed out that appellate courts can overturn past decisions made by lower courts. Of course, the matter must be before the appellate court.

The amount included in Schwartz's income by the Federal Court of Appeal was $342,000 because the amount was employment income within the express words of s. 3(a) rather than a windfall.[88] Rather than reference its decision in *Atkins*, the Federal Court of Appeal applied its more recent decisions with respect to determining whether damages were "profits of a trader" in *M.N.R.* v. *Mohawk Oil Co.*[89] and *M.N.R.* v. *Manley*.[90] The Federal Court of Appeal does not appear to have wanted to confront the *Atkins* decision directly given that it was a decision of that court.

d. Non-Enumerated Sources

As noted by La Forest J. in the *Schwartz* case, the Crown shifted its argument in the Supreme Court in that it chose not to argue that the settlement award was income from an employment source.[91] Rather than argue that the income was employment income to which s. 5 and s. 6(3) apply, the Crown argued that $360,000 of the settlement was income from an "non-enumerated" source, being the "employment contract" that was

---

87 *Schwartz* (S.C.C.), *supra* note 69 at 6110.

88 *Schwartz* (F.C.A.), *ibid.* at 6253-54.

89 92 D.T.C. 6135 (F.C.A.) [Note: Stone J. actually wrote the decision.] Leave to appeal refused, [1992] 2 S.C.R. viii.

90 85 D.T.C. 5150 (F.C.A.); adopting at 5154 the methodology employed by Lord Diplock to damage awards in *London & Thames Haven Oil Wharves Ltd.* v. *Attwooll*, [1967] 2 All E.R. 124 at 134 (C.A. Civ. Div.). With respect to the *Atkins* case, Mahoney J. states at 5154 that:

> I take *Atkins* as authority, which I must respect, for the proposition that an amount paid in settlement of a claim for damages for wrongful dismissal is not salary, taxable as income from an office or employment under s. 5(1) of the *Income Tax Act*. That is nothing more than an application of the well known principle that a taxpayer is entitled to the benefit of any doubt as to legislative intention to tax. It is an application in a case where the fisc evidently elected to plead legislative intention on a single, and as it turned out, erroneous basis. Income tax appeals in this Court are, of course, ordinary actions in which the issues are defined by the pleadings. The Court makes no decision on what might have been pleaded but was not. *Atkins* is not, and does not purport to be, authority for the proposition that damages, or an amount paid to settle a claim for damages, cannot be income for tax purposes.

91 *Schwartz* (S.C.C.), *supra* note 69 at 6107 and 6115.

terminated by Dynacare. That is to say, the $360,000 was not "employment income" rather it was income from the non-enumerated source — the employment contract. Given this, the Supreme Court refuses, in the case of a settlement amount paid for breach of an employment contract, to recognize an "employment contract"[92] as a "non-enumerated" other source to which s. 3(a) applies because s. 3(a) also applies to the more plainly detailed "other source" of income known as a retiring allowance received for the loss of an employment contract.[93]

The Crown's argumentative focus in the *Schwartz*[94] case appears to have changed the dynamics of the case and, as suggested above, meant that the Supreme Court would not be called upon to overturn directly the s. 5 and s. 6(3) precedent established by the Federal Court of Appeal in the *Atkins*[95] case.

It thus appears that the Crown made a tactical decision to seek the Court's views on the non-enumerated source issue. The reasons for such a decision could include the difficulty that the Crown may have perceived on the s. 5 and s. 6(3) issue given that the *Atkins* decision was not mentioned by the Federal Court of Appeal in its decision.[96] Moreover, the *Schwartz* fact pattern appears to have presented the Crown with an excellent opportunity to obtain a conclusive finding on the non-enumerated source issue (which it did).

It is unclear whether the Supreme Court would have overturned the *Atkins* decision if it had been asked a *direct* question on the s. 5 and s. 6(3) issue rather than an *indirect* question via the unenumerated source rule in s. 3(a) of the *Act*.

e. Cross Checking the Analysis:
The *Savage* Case and the Proper Role of Plain Meaning

As suggested by La Forest J. in the *Schwartz*[97] case, the s. 3(a) issue considered in that case is somewhat analogous to the situation the Supreme Court considered in *M.N.R.* v. *Savage*.[98] There are two reasons why this article examines the *Savage* case after considering the taxability of damages for a breach of an employment contract as a "retiring allowance" under s. 56(1)(a)(ii) and s. 60(j.1) or as employment income under s. 5 of the *Act*. First, considering the *Savage* case after analyzing the *Schwartz* case better traces (and improves understanding of) the logic underlying s. 3. In this regard:

---

92 In contrast to employment income, to which s. 5 applies.

93 The "enumerated" other source that is more fully detailed to be a "retiring allowance" to which s. 56(1)(a)(ii) applies and to which s. 60(j.1) of the *Act* can apply.

94 *Schwartz* (S.C.C.), *supra* note 69.

95 *Supra* note 83.

96 *Schwartz* (F.C.A.), *supra* note 69. La Forest J. sets out the historical background in detail including commentary as to the correctness of the *Atkins* decision, *supra* note 83 (*Schwartz* (S.C.C.), *supra* note 69 at 6108-11).

97 *Schwartz* (S.C.C.), *ibid.* at 6117.

98 83 D.T.C. 5409 (S.C.C.).

1. Section 3 in Division B of Part I of the *Act* provides the basic mathematical formula for computing a taxpayer's "income" under Part I.

2. In calculating income of a taxpayer for a taxation year under Part I, the taxpayer should do so by:

   (a) *adding* to the taxpayer's income for the year:

      (i) each net amount for the year calculated under the detailed rules in the *Act* that apply to the enumerated sources of income in s. 3(a) (*i.e.*, from an office or employment under *subdivision a* to Division B of Part I and from a business or a property under *subdivision b* to Division B of Part I of the *Act* — but taxable capital gains are not income to which s. 3(a) applies), and

      (ii) each amount for the year from each other source of income not listed in s. 3(a) and, for this purpose, *subdivision d* to Division B of Part I of the *Act* provides a partial list of those sources and indicates the extent to which such listed amounts are to be so included (*e.g.*, see retiring allowance and scholarships sources detailed in s. 56),

   (b) *adding* to the taxpayer's income for the year the amount by which, if any,

      (i) all of the taxpayer's taxable capital gains (subject to a special taxable net gain adjustment for listed personal property) for the year as computed under *subdivision c* to Division B of Part I of the *Act*,

      exceeds

      (ii) all of the taxpayer's allowable capital losses for the year less allowable business investment losses (which are fully deductible against income under s. 3(d) below rather than being confined to taxable capital gains) for the year as computed under *subdivision c* to Division B of Part I of the *Act*,

   (c) *deducting* from the taxpayer's income for the year the amount, if any, that is the total of the taxpayer's *subdivision e* to Division B of Part I deductions (*e.g.*, retiring allowances under s. 60(j.1)) not otherwise taken into account, and

   (d) *deducting* from the taxpayer's income for the year the amount, if any, that is the total of all of the taxpayer's losses for the year from an office, employment, business, property or as an allowable business investment loss,

> and it is this amount, if any, that is the taxpayer's "income" for the year under Part I of the *Act*.[99]

Second, understanding of the relationship that exists between general provisions and more detailed provisions in the *Act* is strengthened if a reader first moves out from s. 3 into the *Act* to consider the more detailed rules that apply to s. 3(a)'s enumerated and other sources of income. Once that task is accomplished, the reader is better placed to return to s. 3 for the purpose of adding and deducting the various computations made in this regard. Only then should the residual aspect of the s. 3(a) other source of income rule be applied to income amounts not more fully detailed in the *Act*. Consider the *Savage*[100] case in this regard.

In the *Savage* case, the Supreme Court of Canada considered the relationship existing between:

- an internal $500 offset rule available to achievement prizes for scholarships and bursaries in s. 56(1)(n) in subdivision d to Division B of Part I of the *Act*,
- employment income under s. 5 in subdivision a to Division B of Part I of the *Act*, and
- the application of s. 3(a) to a receipt that is both an achievement prize to which s. 56(1)(n) applies and employment income to which ss. 5 to 8 apply.

Therefore, the application of the residual aspect of the s. 3(a) non-enumerated source rule was not an issue.

More specifically, Savage received $300 from her employer as a result of successfully passing three life insurance courses voluntarily taken. While the majority for the Supreme Court moved out from s. 3 of the *Act* to determine that the $300 amount fell within the employment income calculations to which ss. 5 and 8 apply,[101] the Court also indicated that there remained an issue as to whether the amount could be excluded from income from a source to which s. 3 applies by reason of the $500 prize offset available in s. 56(1)(n) of the *Act*.[102] After concluding that Savage's $300 receipt was within the express meaning of the $500 prize offset available to a taxpayer for amounts received into income "for achievement in a field ordinarily carried on by the taxpayer," Dickson J. stated upon returning to s. 3 that:

---

99 It is this income that forms the Part I base from which a taxpayer's taxable income is computed (see s. 2 in Division A and Divisions C and D). Tax is then applied to taxable income (see the computation of tax rules in Division E). Of course, there is a host of special rules, exceptions, exemptions and so on that ratchet up the complexity of the tax law.

100 *Supra* note 98.

101 Because the amount paid was related to (or in connection with) her employment.

102 *Supra* note 98 at 5414, Dickson J. (Ritchie, Lamer, Wilson JJ. concurring). McIntyre J. agreed that the $300 payment was a prize for an achievement in a field or endeavour and exempt from tax but indicated that he would dismiss the appeal without expressing an opinion on any other matter addressed by Dickson J. (at 5416).

> Section 56(1)(n) makes it clear that a prize for achievement is income from a source under s. 3 just as income from an office or employment is income from a source under s. 3. If a prize under $500 would still be taxable under ss. 5 and 6, it would have to follow on the Crown's argument that a prize under $500 would *equally* be taxable under s. 3. *That cannot be right.* That would mean that a prize over $500 would be taxable under s. 56(1)(n) and a prize up to $500 would be taxable under s. 3. The $500 exclusion in s. 56(1)(n) would never have any effect [in the context of an *employee's*[103] prize]. It seems clear that the first $500 of income received during the year falling within the terms of s. 56(1)(n) is exempt from tax. Any amount in excess of $500 falls under s. 56(1)(n) and is taxable accordingly.[104]

At least two things should be noted from this *dicta*. First, Dickson J. is highlighting the fact that, in that case, there were clearly two separate income sources for which the $300 receipt could be income under s. 3(a) of the *Act*: the s. 5 "employment" source and the "other" source to which s. 56 provides a partial list.[105] This differs from the *Schwartz* case where the Supreme Court was not asked whether any portion of the $360,000 settlement was employment income to which s. 5 applies and where it found that no portion of the amount was a "retiring allowance" under s. 56(1)(a)(ii) of the *Act*. Rather, the Court was asked in the *Schwartz* case to apply the residual aspect of the other source rule in s. 3(a) to a breach of "employment contract" income source notwithstanding that the enumerated "other" income source known as a "retiring allowance" received for breach of an employment contract was found not to apply to the settlement. In effect, the Crown asked the Supreme Court in the *Schwartz* case to reach a conclusion that is untenable: give preference to a general provision (the s. 3(a) residual) over the detailed provisions that applied to such an income source (*i.e.*, the employment income source in ss. 5 and 6 and the retiring allowance provisions in subdivisions d and e to Division B of Part I).

Second, and from the narrow perspective of the *Savage* case, applying s. 3(a) of the *Act* to s. 5 employment income rather than the other source of income enunciated in s. 56(1)(n) would have negated the $500 offset clearly set out therein and otherwise available to Savage as an offset to her prize receipt. Again, the Crown was asking the Supreme Court to reach a result that is untenable: give preference in the general income computation provision (s. 3) to the detailed calculations (ss. 5 to 8) for an employment

---

[103] Subsequent to the *Savage* case, s. 56(1)(n) was amended to provide that it does not apply to amounts received in the course of "business" or by virtue of an "office or employment." See *Income Tax Act*, S.C. 1986, c. 6, s. 28(1). Thus, the finding in the *Savage* case could still be relevant in cases where a taxpayer's achievement prize is also income from "property" to which s. 9 of the *Act* would otherwise apply.

[104] *Supra* note 98 at 5416 [emphasis added].

[105] *Ibid.* Note: Dickson J. also states at 5416 that:

> I agree with counsel for Mrs. Savage that the opening words "Without restricting the generality of Section 3," in paragraph 56(1) would seem to have been inserted to defeat an argument of "*expressio unius est exclusio alterius*" [the maxim that the mention of one thing within a provision implies the exclusion of another thing not so mentioned], in order to relate income items contained in paragraph 56(1) to the arithmetical calculation set out in s. 3. Income can still be income from a source if it does not fall within s. 56. Moreover, s. 56 does not enlarge what is taxable under s. 3, it simply specifies. [Emphasis in original.]

source of income over the even more plainly and specifically applicable calculation for an achievement prize source of income (s. 56(1)(n)).[106]

It may be helpful to compare the Crown's argument in the *Savage* case to the following: would anyone suggest that the Crown could apply the residual aspects of s. 3(a) to the portion of an enumerated source of income for which the detailed calculations in the *Act* clearly provides a deduction? For example, to $2,000 in circumstances where a taxpayer is permitted a deduction for that amount in computing the taxpayer's employment income under ss. 5 to 8 (*e.g.*, $62,000 less that $2,000 because the amount is a professional fee to which s. 8(1)(i)(i) applies)?

It is submitted that the *Savage* case represents an appropriate application of the plain meaning interpretative approach since it is based on the purpose underlying both the employment income calculation in ss. 5 to 8 and the prize income calculation in s. 56(1)(n) of the *Act* and gives preference under s. 3 to the source that more plainly and specifically applies to "achievement prizes" and which permits a $500 offset. In this regard, reference should also be made to the limitations in s. 248(28) of the *Act* (former s. 4(4) in Division B of Part I of the *Act*), which among other things states:

> (28) Unless a contrary intention is evident, no provision of this Act shall be read or construed
>
> > (a) to require the inclusion or permit the deduction, either directly or indirectly, in computing a taxpayer's income ... for a taxation year or in computing a taxpayer's income or loss for a taxation year from a particular source or from sources in a particular place, of any amount to the extent that the amount has already been directly or indirectly included or deducted, as the case may be, in computing such income ... or loss, for the year or any preceding taxation year; ...[107]

In other words, while Savage's $300 receipt was income from two separate sources to which the income computation rule in s. 3 of Part I of the *Act* applied, the $300 amount could not be included in her employment source once it was found to be within the meaning of the more plainly and specifically stated achievement prize source. This

---

[106] Restated, the Supreme Court in *Savage* refuses, in the case of a work-related achievement prize, to give s. 3(a) preference to the "enumerated" employment source listed therein (as more specifically detailed and computed under ss. 5 to 8) over the even more plainly and specifically applicable "other" prize source enumerated in s. 56(1)(n) and for which there is a special $500 offset rule.

[107] S.C. 1996, c. 21 (s. 60(3) applicable to taxation years that end after 19 July 1995). Former s. 4(4), at the time of *Savage*, read as follows:

> Unless a contrary intention is evident, no provision of this Part shall be read or construed to require the inclusion or to permit the deduction, in computing the income of a taxpayer for a taxation year or his income or loss for a taxation year from a particular source or from sources in a particular place, of any amount to the extent that that amount has been included or deducted, as the case may be, in computing such income or loss under, in accordance with or by virtue of any other provision of this Part.

Former s. 4(4) was amended by S.C. 1994, c. 7, s. 2 primarily to add references to "directly or indirectly" applicable to the 1990 and subsequent taxation years.

approach can cut for and against taxpayers (and the treasury) depending on the facts and law at issue in a given case.

With respect to relating the correctness of the *Atkins*[108] decision to the *Savage*[109] case, it should also be noted that the application of the purpose interpretative approach could have resulted in Atkins' dismissal settlement being an amount to which the retiring allowance source in s. 56(1)(a)(ii) applied (and for which there also existed at that time a registered pension fund and RRSP tax-deferral rollover mechanism in s. 60(j)). This article will not consider in detail the then-stated language of the various provisions.

It suffices for these purposes to mention that such a finding would have meant that Atkins' dismissal settlement was both income from an employment source (see above) and income from a retiring allowance source — with the subsequently decided *Savage* case standing for the proposition that preference under s. 3 should be given to the source that more plainly and specifically applies. The provision that is the more plainly and specifically applicable source would be the retiring allowance source. The then stated definition of "retiring allowance" in s. 248(1) of the *Act* applied to, among other things, "... an amount received ... in respect of a loss of employment."

In contrast, s. 6(3) of the *Act* is a deeming provision which converts amounts not already considered to be employment income into employment income and, while it is submitted that s. 5 should be read as applying to a wrongful dismissal award or settlement given the above purpose-based analysis of that provision, the statement in s. 5 is, in the case of a loss of employment, more general than the plainly and specifically applicable wording in the definition of "retiring allowance" quoted above. To rule otherwise would also undermine the purpose underlying the tax-deferral rollover mechanism provided to taxpayers in respect of their retiring allowances under s. 60 of the *Act*, which is to encourage such taxpayers to contribute a portion of their dismissal award to a tax-assisted retirement fund.

Also, it should be noted how the post-*Atkins* amendment of the definition of "retiring allowance" adds to the complexity of the language therein by indicating that an amount received in respect of a "loss of an office or employment" includes amounts whether received as, on account of, or in lieu of, payment of damages or pursuant to an order or judgment of a competent tribunal. All of which is unnecessary verbiage that has contributed to an ever-widening tax code that, as previously mentioned, Bowman suggests is the inevitable result of the plain meaning approach. The post-*Atkins* amendments also ensured that a fair and liberal interpretation of ss. 56 and 60 of subdivisions d and e to Division B of the *Act*, respectively, would not result in those provisions applying to Schwartz's wrongful dismissal award given the differing wording existing in s. 80.4 and the definition of "employment" in s. 248(1).

---

108 *Supra* note 83.

109 *Supra* note 98.

Nevertheless, it would have been inappropriate to permit the Crown to apply the residual aspect of the other source of income rule in s. 3(a) to the *Schwartz* breach of employment contract settlement given that the award was found not to be within the meaning of the definition of "retiring allowance," notwithstanding that the Crown was right when it maintained that the list of other income sources to which s. 3(a) applies is not limited to the other sources set out in s. 56. Rather, the Crown should have asked the Supreme Court to consider the correctness of the *Atkins*[110] decision and to find that the award was income from the enumerated employment source to which ss. 5 and 3 apply.

F. IS THIS TANGLED WEB CONTRIBUTING TO AN APPARENT UNDERMINING OF THE FAITH THAT CITIZENS HAVE IN THE STATE?

Schwartz, his tax advisers and the Crown all won their day in court. But did other taxpayers?

The pivotal point in the series of events leading up to the "uncertainty" associated with the *Schwartz* fact pattern is the application of the plain meaning approach to interpreting the law in the *Atkins* case.[111] The resulting amendments contributed to a tangled web in the law that the average taxpayer cannot hope to fathom. It is rough going even for lawyers. Not only do the resulting amendments add to the complexity of the tax law, thereby increasing its uncertainty in the minds of citizens, government, tax professionals and the judiciary, the average citizen appears left to face this uncertainty either alone, with the assistance of Revenue Canada's client services program, or (if they can afford it) advised by well-versed tax professionals.

It is also worth mentioning that the *Atkins* decision changed the dynamics of the political decision confronting the then-Minister of Finance from one of whether to recommend to Parliament that it amend the *Act* to provide "relief" to whether to recommend that Parliament tighten the law to close a perceived "loophole" in the law.

Prior to the *Atkins* decision, while retiring allowances were to be included in a taxpayer's income under s. 56(1)(a)(ii) of the *Act*, such amounts could be transferred without limit to an RRSP with a deduction from income being provided under then s. 60(j) of the *Act*.[112] Instead, the *Atkins* decision meant that affected employees would not have to include any portion of a wrongful dismissal award or settlement into their

---

110 *Supra* note 83. In *Schwartz* (S.C.C.), *supra* note 69 at 6107 and 6115, La Forest J. notes on two separate occasions that the Crown failed to ask the Court to consider whether the award was income from an office or employment. At 6115, La Forest J. states that:

> However, the correctness of *Atkins* is not at issue before us since the Minister, as I have explained, is not arguing that the amounts are taxable as income from employment.

111 See also note 90 for Mahoney J.'s *dicta* in *Manley* on the *Atkins* decision.

112 Note how that former provision, when read in conjunction with the definition of "premium" in s. 146(1)(f), *did not cap* rollover transfers of retiring allowances to RRSPs. Section 60(j.1) currently confines such a rollover to $2,000 for each pre-1996 year of non-pensionable employment service plus $1,500 for each pre-1989 year of pensionable employment service.

income. On the recommendation of the then-Minister of Finance, Parliament responded to this state of affairs in 1979 by requiring that "termination payments" be included in a taxpayer's income but this inclusion was limited to 50 percent of a taxpayer's salary, wages and other remuneration from an employment for the twelve months prior to the termination of the employment.[113]

While it is, therefore, inaccurate to state that it was the previously mentioned amendments in 1981 to s. 80.4 and the definition of "retiring allowance" in s. 248(1) and the enactment of s. 60(j.1) that responded to the *Atkins* decision, it is obvious that by 1981 the then tax treatment of settlement awards with respect to wrongful dismissal claims and termination payments was wholly inadequate. For example, the following is stated at 21 and 22 of the *1981 Budget Papers*:

> Retiring Allowances and Job Termination Payments
>
> A limit is proposed on the amount of a retirement allowance that can be received and reinvested tax-free in a registered retirement savings plan (RRSP). Under present law there is a limit of $60,000 per annum on the pension that can be funded out of tax-deductible contributions by employers and employees. This limit, however, can be *circumvented* for those senior executives who typically arrange to receive a large lump-sum payment upon retirement (called a retiring allowance), which they may then contribute tax-free to their RRSP. The employer obtains a tax deduction for the allowance over and above the deduction for pension plan contributions he has previously made, and the employee defers tax until funds are later withdrawn from his RRSP. *The amount of these retiring allowances has increased dramatically in recent years and in some instances amounts to several hundreds of thousands of dollars.*
>
> The amount of retiring allowance an employee will now be able to contribute tax-free to his RRSP will be limited to $3,500 for each year the employee was with the employer and was not covered by the employer's pension plan. This limit recognizes that had the employee been a pension plan member in those years his employer could have contributed $3,500 to the plan on his behalf.
>
> Since 1978, all job-termination payments amounting to less than six months' salary have been taxable, regardless of their form [see the commentary at *supra* note 113], whereas the tax status of larger payments has depended on whether they could be considered to be damages. *This has led higher-income individuals who receive large payments on termination of an employment to attempt to have them appear as damages for wrongful dismissal, and thus be tax-exempt. In fact the full amount of all job termination payments represents remuneration or a substitute for remuneration and should thus*

---

[113] See the 1979 enactments that: a) indicate that a "termination payment" is another source of income under s. 56(1)(a)(vii) (S.C. 1979, c. 5, s. 15(1)), and b) provide for the now repealed definition of a "termination payment" in s. 248(1) of the *Act* (S.C. 1979, c. 5, s. 66(8)). S.C. 1979, c. 5, s. 66(12) is applicable with respect to amounts received in respect of a termination after 16 November 1978 of an office or employment.

> *be taxable.* Effective for employees who terminate employment after November 12, 1981, *the entire amount of all job termination payments will be required to be included in income.*[114]

Is it possible that the citizenry might perceive the machinery of the state in a more favourable light if Parliament were providing on-going relief from taxation rather than an exercise that many perceive to be the closing of "loopholes" after a few well-advised taxpayers have escaped the tax net?

Fault does not lie with Parliament with respect to the *Schwartz* result because it is doubtful that it intended such an isolated and anomalous result to have arisen. Moreover, the foregoing analysis suggests that, since before the *1972 Act*, Parliament has intended for s. 3 to apply to "income" amounts received on the wrongful termination of an employment contract whether as a retiring allowance income source or as employment income.

Nor does fault lie with Revenue Canada; they did the job they are paid to do. Can counsel for the Crown be blamed, who at the Tax Court stage

> did not even argue that the letters constituted evidence as to apportionment contrary to Mr. Schwartz's testimony.[115]

As indicated above, the letters appear to constitute *some* evidence of the amount by which the $400,000 could be reduced (*i.e.*, the reimbursement of legal expenses and damages for professional embarrassment). Rather than being evidence supporting a deduction claim, the litigants and judiciary appear to have considered the letters from the perspective of whether they constituted some evidence of income.[116] Should taxpayers be expected to know what such an apportionment is or should be, let alone objectively state to the Crown or the Court what the "income" portion of the amount is or should be?

That is not to say that the judiciary should be blamed. It is the collective's independent arbitrator. It ensures that no one is above the law. Judges are competent men and women who are called upon to apply the law in a just and fair way to all persons given the circumstances. That is what the Crown, the rich and the poor and everyone in between deserves. No more no less.

---

[114] See Canada, Department of Finance, *Budget Papers*, "Supplementary Information and Notices of Ways and Means Motions on the Budget, November 12, 1981" as tabled in the House of Commons by the Honourable Allan J. MacEachen, then Deputy Prime Minister, Minister of Finance and Member of Parliament for Cape Breton Highlands-Canso (Nova Scotia) [emphasis added].

[115] *Schwartz* (S.C.C.), *supra* note 69 at 6114.

[116] *Ibid.* For example, La Forest J. stated for the Supreme Court at 6114 that:

> Logically, the Minister should not have the burden of presenting, in every case where the apportionment of a general award is at issue, specific evidence amounting to an explicit expression of the concerned parties' intention with respect to that question. However, there must be *some* evidence, in whatever form, from which the trial judge will be able to infer, on a balance of probabilities, which part of that general award was intended to compensate for specific types of damages. [Emphasis in original.]

Perhaps the person most at fault is the drafter (or drafters) of the amendments to s. 80.4, s. 60 and the definition of "retiring allowance" in s. 248(1) of the *Act*. Obviously, the drafter(s) inserted wording into one provision (s. 80.4) that raised questions about the meaning Parliament intended in another provision (the definition of "employment" in s. 248(1)). The judiciary should not be called upon to backstop poorly drafted tax legislation or shallow government policy objectives. However, and as was detailed above, whether there ever was a gap in the tax law applicable to wrongful dismissal awards and settlement amounts may depend upon whether the proposed explanation is accepted as to why the legislated purpose-based approach should be adopted as the primary rule of interpretation for taxation statutes. Not only has this approach been mandated by Parliament, it may be an important ingredient in restoring the faith that the citizenry has in the Canadian state.

While no one person is responsible for the uncertainty in the tax law, all persons are responsible.

G. RESPONSIBILITIES AND THE PROTECTION OF TAXPAYER RIGHTS

This article began by suggesting that the debate between the legislated purpose approach and the modern judicial plain meaning approach to interpreting tax legislation is, at its core, related to the challenge Canadian society faces in balancing the rights and responsibilities of all its members, including not only individuals but also corporations, government, the judiciary, the media and tax advisers. All too often, the focus of many groups in this democracy has been on protecting and creating special rights, such as propping up the remains of the views espoused in 1936 by the House of Lords in the *Duke of Westminster* case[117] — that taxpayers have a right to ignore both the purpose underlying tax legislation and the substance of particular transactions when structuring their affairs. The interpretative tool most often used to prop up the remains of those views is the plain meaning approach, including the reformulation of that approach within the modern judicial plain meaning approach (plain meaning unless the words are uncertain). This should not be surprising because the common thread is the view that plain meaning can exist to the exclusion of purpose, as enunciated in ss. 12 and 44(f) of the Canada *Interpretation Act*. Canadians have recently begun to question the appropriateness of interpretive approaches that ignore the purpose of an enactment and ask whether a better balance should exist between rights and responsibilities; the enactment of the general anti-avoidance rule in s. 245 of the *Act* in 1988 is part of that re-thinking and re-balancing.

Nevertheless, the fundamental importance of the need to strengthen the relationship existing between taxpayer rights and responsibilities within the broader Canadian tax system is not a new idea or proposal. For example, the commissioners who wrote the *Carter Report* believed Canadians agreed upon the following four interrelated fundamental objectives of taxation:

---

[117] *Supra* note 24.

(1) To maximize the current and future output of goods and services desired by Canadians.

(2) To ensure that this flow of goods and services is distributed *equitably* among individuals or groups.

(3) To *protect* the liberties and rights of individuals through the preservation of representative, responsible government and maintenance of the rule of law.

(4) To maintain and strengthen the Canadian federation.[118]

Canadians may agree in general terms in this regard,[119] but there is no doubt that the views of the citizenry differ on what is an *equitable* distribution of goods or services among the population. These many and varied views are, to use Sharlow's terminology, "value-laden" [120] and can lead to competing claims, disagreements and disharmony within a society. While this article raises questions about the effect that uncertainty in the tax law has on the *rights* of Canadian taxpayers, it does not intend to suggest that the government, tax professionals and the judiciary are manipulating taxpayers in this regard. As hard as it is for some taxpayers to accept, they experience the benefits of Canadian society only because their correlative responsibility for the price of taxation is met. From this perspective, it is quite likely that tax administrators, tax professionals and the judiciary view their roles as *protecting* taxpayers.

That is to say, the view that government officials have of their role in administering the tax system through audits is likely one of protecting all taxpayers from those who seek out unfair advantage to the detriment of the many. Tax professionals would, in turn, view their primary role as protecting particular taxpayers from the state. In arbitrating disputes arising in this regard, the judiciary would want to err on the side of taxpayers, with the issue of whether a taxpayer entered into an arrangement with a tax-avoidance motive being relevant for the purpose of judging the rights and responsibilities of that taxpayer under the tax law, given its purpose and substance in a free and democratic society.[121]

---

118 *Report of the Royal Commission on Taxation, Vol. 2: The Use of the Tax System to Achieve Economic and Social Objectives* (Ottawa: Queen's Printer, 1966) at 7 (Chairman: K.L. Carter) [emphasis added].

119 For an alternative view, see I.H. Asper, *The Benson Iceberg* (Toronto: Clarke, Irwin & Co., 1970).

120 Sharlow, *supra* note 4 and specifically note 51.

121 For the relevance of a taxpayer's tax-avoidance motive, see, for example, *Bronfman Trust* (*supra* note 57) and *Tonn* v. *M.N.R.*, 96 D.T.C. 6001 (F.C.A.). Dickson C.J.C. stated for the Supreme Court of Canada in *Bronfman Trust* (*supra* note 57 at 5067) that:

> Assessment of taxpayers' transactions with an eye to commercial and economic realities ... may help to *avoid the inequity of tax liability being dependent upon the taxpayer's sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction.* [Emphasis added.]

In *Tonn*, Linden J. of the Federal Court of Appeal stated at 6009 (Strayer and McDonald JJ. concurring) that:

> I have dwelt upon the issue of the origin of the "reasonable expectation of profit" test because a proper understanding of it is necessary to the resolution of this application. As a

This protector role is preferable for government tax officials, private tax practitioners and the judiciary because it holds out the possibility that societal rights and responsibilities can be balanced better with respect to the price of taxation. Adopting a purpose approach to interpreting tax legislation is just one of the elements necessary to achieving that balance. Just as non-compliance with tax laws should be rooted out and penalized over the short term, so too should society embolden those persons in its midst who advocate the changes that will be necessary before taxpayers can be led out of the "tangled web of uncertainty weaved by all of us."[122]

It is submitted here that the legislated purposive approach to the interpretation of tax law is one that, in the *long run*, will improve the lot of all Canadians, including tax advisers, administrators, drafters, the judiciary and, of course, those who are called upon to pay the price of civilization.[123]

---

common law formulation respecting *the purposes of the Act*, the *Moldowan* test is ideally suited to situations where a taxpayer is *attempting to avoid tax liability by an inappropriate structuring of his or her affairs*. [Emphasis added.]

122 John Miller argues that tax law should provide general rules of application with severe penalties for those who violate its provisions. See J.A. Miller, "Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation" (1993) 68 Wash. L. Rev. 1. That article is reviewed by A.M. McGovern in (1993) 41 Can. Tax J. 844. In addition, some practitioners are beginning to suggest that the judiciary's interpretative role should extend to taking an active role in ensuring that there is a rational and coherent application of the tax law (which, among other things, tends to be "backward" looking at a time when the sophisticated nature of the global commercial economy is testing the very limits of the principles underlying that law). See J.S. Wilkie, "Looking Forward into the Past: Financial Innovation and the Basic Limits of Income Taxation" (1995) 43 Can. Tax J. 1144 at 1164-66.

123 Adapted from a statement of Mr. Justice Oliver Wendell Holmes of the Supreme Court of the United States, in dissent in *Compania General de Tobacos* v. *Collector of Internal Revenue*, 275 U.S. 87 at 100 (1927). He said: "Taxes are what we pay for civilized society."