EATLP – National report for Canada on Separation of Powers in relation to taxation

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Introduction – the Canadian framework

Canada is a parliamentary democracy with "a Constitution similar in Principle to that of the United Kingdom".[1] Canada is a federal state, with jurisdiction to tax accorded to both the federal and provincial (and territorial)[2] governments by the constitution. In this article, the discussion of the various powers of different levels of government, and of the roles of ministries and agencies within government, will be limited to direct taxes, and specifically the individual income tax and corporate profits tax. These are by far the most important taxes levied by Canadian governments,[3] although the federal goods and services tax ("GST", a value-added tax), federal excise taxes, and provincial and territorial sales taxes are also important sources of government revenue. Inheritance and wealth taxes as such do not exist in Canada. Capital taxes are imposed by a few provinces on corporate capital, at very low rates and sometimes as a form of minimum corporate tax. There are also numerous other taxes, both direct and indirect, at the sub-national level on specific types of transaction or property, such as property transfer taxes on registration of real property transactions, hotel room taxes, medical and hospital insurance taxes, municipal property taxes on real property, and carbon taxes, not all of which exist in all provinces and vary greatly in the way they are imposed and collected.

Constitutional jurisdiction over taxation of income of individuals and corporate profits

[1] Preamble to the Constitution Act, 1867, formerly the *British North America Act* (of the UK Parliament). Canada's head of state is Queen Elizabeth II; her Governor-General for Canada acts in the Queen's absence. Following a general federal election , the Governor-General invites the leader of the political party holding the greatest number of seats in the House of Commons to form Her Majesty's government, officially referred to as the Governor-General in Council led by the prime minister. The provincial executive branches of government are formed in essentially the same way.

[2] The Yukon Territory, the Northwest Territories and Nunavut do not have the constitutional status of provinces within the federation, but exercise powers devolved from the federal government. Each of the territories imposes an income tax on essentially the same legislative template as the provinces, as described below. Further discussion of the distinctions between territorial and provincial status and taxation powers are beyond the scope of this paper.

[3] Personal income tax contributes 46.6%, and corporate income tax 16.8% of total federal budgetary revenues, the two most important sources.

The Canadian constitution grants residual power to the federal government over all matters not exclusively reserved to the provinces. The ten provinces have sovereign legislative authority within the legislative areas reserved to them. The federal government has general power "for the raising of Money by any Mode or System of Taxation".[4] The provinces have exclusive legislative authority for "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes".[5] The result is that both federal and provincial governments have, and exercise, legislative authority to impose direct taxes, which include income and corporate profits taxes. (In Canada, "income tax" refers to both income tax on individuals and the taxation of corporations on their profits, and includes taxation of capital gains.) The federal income tax system is contained in the *Income Tax Act*, and as explained below, provincial income tax is largely harmonized with the federal tax, and collected and administered by federal authorities. This paper will therefore confine itself to discussion of the separation of powers in relation to federal, and to a lesser extent provincial, income taxes.

It should also be noted that some recent land claims settlement agreements with First Nations provide for taxation by First Nations governments, including the imposition of income taxes on First Nations territory. Under the Yukon First Nations self-government and land claims settlement agreements among the First Nations, the Yukon Territory and Canada, the federal government has ceded its tax "room" to a number of First Nations governments. The federal Canada Revenue Agency collects income tax owing by residents of First Nations territory, called "Settlement Land" and remits 95% of it to the First Nations government.[6] In British Columbia, the Nisga'a Final Agreement provides for direct taxation by the Nisga'a Lisims Government to raise revenue for Nisga'a Nation or Nisga'a village purposes. This income taxation has not yet been implemented.[7]

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[4] Constitution Act, 1867 subsection 91(3).
[5] Constitution Act, 1867, subsection 92(2).
[6] *Yukon First Nations Self-Government Act*, S.C. 1994, c. 35, and *First Nations (Yukon) Self Government Act*, S.Y. 1993, c. 5.
[7] Property, including income of Indians situated on Indian reserves is exempt from taxation by either level of government under the federal *Indian Act*. The modern land claims settlement agreements provide that the *Indian Act* no longer applies to the First Nations people and territory covered by the agreement. It should be noted that progress in implementing other forms of taxation, and specifically the GST and certain excise taxes on First Nations territory has advanced more than income taxation.

Historically, the federal government has exercised the more significant role in defining the income tax base, and administering, enforcing and collecting both federal and provincial income taxes. The first federal income tax was imposed in 1917 under the *Income War Tax Act*,[8] and was intended to provide a temporary source of additional revenue for the federal government for its military efforts during the 1914 – 1918 war in Europe. However, the IWTA was not repealed after the war ended, and during the 1920s and 1930s all the provinces came to impose provincial income and corporate profits taxes, on various bases and at various rates, as well.[9]

The necessity at both levels of government to raise revenue to combat the economic depression of the 1930s gave way in 1941 to the federal government's greater requirements to finance the war effort. The provinces agreed to cede income tax jurisdiction temporarily to the federal government under a system of "tax rental agreements", which were replaced in 1962 by a first generation of tax collection agreements. The TCAs were (and are) bilateral intergovernmental agreements according to which the federal government is the sole collector, administrator and enforcer of income taxes on behalf of the provinces (other than Quebec, and in the case of corporations, Alberta).[10]

The TCAs created a harmonized national income tax base by requiring "agreeing provinces" to adopt the federal definition of income for tax purposes. Canadians resident outside Quebec therefore file a single tax return with an annexed provincial schedule calculating provincial tax liability. (Quebec residents file a separate provincial return with the Quebec's separate tax authorities.) In exchange for the provinces' agreement to harmonize their tax bases, the federal tax authority, the Canada Revenue Agency collects, administers and enforces provincial as well as

[8] The *Income War Tax Act* became notable for the degree of discretion accorded the Minister of National Revenue to determine tax consequences and liabilities, and the lack of a functioning and accessible process of appeal to an independent judicial authority. See Lefebvre, MacGregor and Olsen, Income Tax Litigation, (1995), vol. 43, no. 5 *Canadian Tax Journal*, at pp. 1861-1865. The process of reform to ensure full application of the rule of law began with the new *Income Tax Act* of 1948.
[9] Often referred to in Canadian tax literature as the "tax jungle".
[10] The history and operation of the tax collection agreements are explored in detail in Munir A. Sheikh and Michel Carreau, "A Federal Perspective on the Role and Operation of the Tax Collection Agreements" (1999) vol. 47, no. 4 *Canadian Tax Journal* 845-60 and Canada, Department of Finance, Federal Administration of Provincial Taxes: New Directions (Ottawa: Department of Finance, 2000).

federal income tax law, without charging the provinces for the service, remits the amount of provincial tax to the appropriate provincial government's revenue department. This results in cost-effective and efficient collection of tax, and streamlines the administrative process. The provincial income tax statutes adopt by reference the federal law. Under the second generation of TCAs in force since 2000 each province determines its own tax rates for both individuals and corporations which are applied to the provincial tax base.[11] The provinces also usually provide for tax credits that mirror the federal ones, and may also provide for additional incentives or benefits that the federal government does not. A national formulary apportionment system, based on payroll and gross revenue, applies to allocate income among the provinces where a business is carried on by a taxpayer in more than one province.

This system has resulted in a dominant legislative and administrative role for the federal government in relation to income tax. Amendments to the definition of the tax base, administration and collection measures, and the setting of federal rates and brackets occur through the federal budgetary and legislative process. The provincial legislatures exercise budgetary and legislative authority primarily over their tax rates and brackets. Both levels of government provide progressive tax rates for individuals, preferential rates for small Canadian corporations, basic exemptions for personal and family situation and tax credits that promote certain activities or behaviours according to the policies of the provincial government in power.[12]

There are three federal ministries that play significant, complementary roles in the tax system. The federal department of finance ("Finance") is under the political responsibility of the minister of finance, an elected member of Parliament and the

[11] As noted, Quebec maintains a separate income tax system, with its own administration and collection. However, the tax base as defined in Quebec's tax legislation is not widely divergent from the federal income tax base, and of course Quebec residents are subject to the federal system as well. Alberta's separate corporate tax administration is also very similar to the federal system. All provinces apply the same test for provincial residence of individuals, and for determining the existence permanent establishments of corporations.

[12] A recent example is the introduction of a carbon tax in 2008 by the British Columbia government. A reduction in income tax for both individuals and corporations at the same time is intended to result in a revenue-neutral shift to promote greener technologies and lower consumption of greenhouse gas producing fuels.

second most senior member of the executive. Finance is responsible for tax policy, federal budgets and the drafting of amendments to the *Income Tax Act*.[13]

The Department of National Revenue has political responsibility for tax administration, collection and enforcement. The Canada Revenue Agency ("CRA") is a quasi-independent[14] agency that actually carries out the functions of administration and collection of federal taxes, as well as provincial income tax on behalf of the provinces and territories (and the participating Yukon First Nations).[15] The CRA is the governmental organ that is most properly referred to as the "tax authorities" and is the competent authority for international tax administration.

The CRA is governed by a board of management consisting of fifteen members appointed by the Governor in Council. The provinces and territories nominate eleven of the fifteen members. The board's chairman is the Commissioner and Chief Executive Officer of the CRA, a senior civil servant. The Appeals Directorate of the CRA also hears and rules on a taxpayer's initial administrative appeal (called an "objection") of a tax assessment. The Department of Justice Tax Section provides legal advice and representation to the CRA in tax appeals.

The federal legislative process

The constitution requires "money bills" for spending public revenue or imposing taxes (and in particular for amending the *Income Tax Act*) to be introduced in the House of Commons,[16] the lower house of directly elected members of parliament, rather than in the Senate, an appointed body. The Supreme Court of Canada has characterized this

[13] R.S.C. 1985 (5th Supp.) c. 1 as amended. In this article this statute may be referred to as the "Act".
[14] The reason for creating the CRA in 1999 was to separate it from the political and bureaucratic structures and processes of the government, so that taxpayers would be assured of political neutrality in their tax affairs.
[15] The reason for creating the CRA under a separate statute in 1999 was to separate it and its functions from the political and bureaucratic structures and processes of the government, so that taxpayers would be assured of political neutrality in their tax affairs. The agency was originally called the Canada Customs and Revenue Agency; the customs function was transferred to the Canada Border Services Agency in 2003. See Rob Wright, "The Canada Customs and Revenue Agency: Structure and Objectives," *Report of Proceedings of Fifty-First Tax Conference*, 1999 Tax Conference (Toronto: Canadian Tax Foundation, 2000), 19:1-4. (Mr. Wright was the first CRA Commissioner and CEO). See also Alan Nymark, "Strategic Priorities for the CCRA," *Report of Proceedings of Fifty-Fifth Tax Conference*, 2003 Tax Conference (Toronto: Canadian Tax Foundation, 2004), 6:1-6.
[16] *Constitution Act* 1867, s. 53.

as an expression of the constitutional principle of "no taxation without representation".[17] All votes on money bills are, by constitutional convention, votes of confidence, so that defeat of a government-sponsored revenue bill results in the government falling, and new national elections.

Annual budgets are normally presented to Parliament by the minister of finance in February or March, and tax bills may be introduced in the House at any time in a parliamentary session. The budget is subject to policy analysis in the form of pre-budget consultations conducted by the House of Commons Standing Committee on Finance,[18] (SCF) in the weeks leading up the budget. Anyone may make submissions to the SCF, and its sessions are open to the public and media, and are televised and broadcast on the internet. The budget is subject to vigorous debate in Parliament, and once adopted, the tax measures contained in it are implemented by means of one or more normal tax bills. Money bills are introduced by the government in the House of Commons, and are referred to the SCF normally following second reading. The SCF will study the bill clause by clause, may hear witnesses including experts, receive briefs from the public, including advocacy groups, and may propose amendments to the bill before it goes back to the House for third reading and the final vote. Again there is often intense debate in the House before passage of the bill, and in the case of a minority government, the possibility that the tax bill will be defeated and the government will therefore fall. The bill then proceeds to the Senate for a similar process of debate, committee review and adoption by vote[19] before receiving Royal Assent from the Governor-General, bringing it into force.

There is extensive case law, dating from decisions of the Judicial Committee of the Privy Council in the 19th century and continuing unabated in the 21st century, which set out and apply the constitutional requirements for valid provincial and federal tax laws and in particular the division of powers between federal and provincial

[17] *Re Eurig Estate* [1998] 2 S.C.R. 565 (Supreme Court of Canada).
[18] This is a permanent committee with membership of twelve MPs from both government and opposition parties in rough proportion to the election results, chaired by an MP from the governing party.
[19] The leading view is that the Senate may reject, but may not amend a money bill. See Driedger, Elmer A. "Money Bills and the Senate" (1968), 3 *Ottawa L. Rev.* 25.

governments.[20] More recently, the constraints placed on tax authorities by the Canadian Charter of Rights and Freedoms (the "Charter")[21] have been the subject of numerous judicial decisions. Lawyers, accountants, economists and others, both scholars and practitioners, have created a large body of literature analyzing and criticizing and commenting on the constitutional requirements of the exercise of the taxing power, tax policy and tax laws.[22]

The Act is an extremely detailed and complex enactment, with precise provisions defining the tax base, the taxpayer, the tax consequences of transactions, reporting and payment requirements and other matters. There are numerous deeming provisions, that dictate a tax result that would not otherwise apply. In Canada, the legal form of a transaction is normally the basis for determining its tax consequences, unless the legal form does not reflect the real transaction, and is a mere sham or artifice. Further, the courts have indicated that in general taxpayers may arrange their affairs so as to minimize their tax liabilities, so long as they correctly report their tax position under Canada's self-assessment system. In no instance does the Act allow the CRA to apply its discretion conclusively to determine a tax result (other than to grant discretionary relief as discussed below). The precision and detail in the drafting of the Act removes a great deal of interpretational ambiguity. The fundamental structure and central concepts of the current Act have been in place since a major reform was undertaken and a new Act adopted in 1972. Judicial interpretation of most areas of income tax law is generally well-developed. It is largely where innovative or unusual transactions have been undertaken that interpretational issues still arise.

There are numerous specific anti-avoidance provisions in the Act, including provisions that direct that the form or legal effect of certain transactions or arrangements may be disregarded for tax purposes. The Act also imposes a test of

[20] See for example the iconic work, by La Forest, G. V. *The Allocation of Taxing Power Under the Canadian Constitution*, 2nd ed. Toronto: Canadian Tax Foundation, 1981.
[21] The Charter was adopted with other amendments to the constitution in 1982. It drew a degree of inspiration from the European Convention on Human Rights, but there are very significant differences as well. Anyone subject to Canadian federal or provincial law may challenge the compatibility of that law with the Charter. If the law is incompatible, it is not applied, and may be declared void.
[22] The leading institution in taxation in Canada is the Canadian Tax Foundation, founded in 1945 (www.ctf.ca). The great majority of tax lawyers, accountants and economists, as well as scholars are members of the foundation. It publishes the Canadian Tax Journal, and holds high level annual conferences of experts nationally and regionally. Papers from the conferences are published by the foundation. There are many other public policy institutions that contribute to the discussion on tax issues.

"reasonableness" in some instances, particularly in relation to amounts claimed as deductions. This allows the CRA to challenge amount claimed by the taxpayer as excessive, but the determination of reasonableness is ultimately for the Tax Court.

In 1988 Parliament enacted the general anti-avoidance rule, or "GAAR"[23] which allows the CRA to reassess "as is reasonable in the circumstances" to deny any tax benefit from a transaction or series of transactions that is motivated by tax avoidance rather than *bona fide* business, investment or family purposes. The transaction or series must also reasonably be considered to result directly or indirectly in a misuse of a provision of the Act, the Regulations,[24] a tax treaty or certain other enactments, or an abuse having regard to the provisions of the latter taken as a whole. In summary, the taxpayer may be reassessed if his transaction was undertaken primarily for tax avoidance purposes and is abusive of the technical provisions or overall purpose of the Act or certain other enactments. The GAAR is most likely to be relied on by the CRA to reassess a taxpayer where a complex or unusually structured transaction or series yields a tax result that seems contrary to the intention or purpose of the Act.

The Canadian tax system relies on annual self-assessment by taxpayers. In reviewing a taxpayer's self-assessment of tax liability, the CRA has a certain margin of discretion as to whether to challenge or accept the taxpayer's reporting or characterization of receipts and disbursements, claims for deductions and credits, etc., and is not bound to audit or reassess every taxpayer who is in the same situation. If the CRA does decide to audit and then reassess a taxpayer, the latter has extensive statutory rights to administrative and judicial review.[25]

The first level of appeal, referred to as an objection, is to an Appeals Officer in the Appeals Directorate of the CRA. The objection process is usually not successful,[26] but accords the taxpayer an opportunity to discover more fully the factual and legal

[23] *Income Tax Act* s. 245.
[24] Regulations are "hard law", adopted by the Governor in Council under authority delegated by the Act.
[25] See for a fuller description of the audit and reassessment process, Alexandra K. Brown and Roger Taylor, "A Practical Guide to the Audit and Audit Issues," Report of Proceedings of Fifty-Ninth Tax Conference, 2007 Tax Conference (Toronto: Canadian Tax Foundation, 2008), 17:1-10.
[26] The CRA revealed that Canada-wide, the rate of full success by taxpayers at the objection stage was 16% in response to a question at the annual Quebec tax conference and reported in technical interpretation document 2006-0196041C6.

basis of the reassessment and how it might be overturned. It is not clear whether the Appeals Officer has jurisdiction to determine the constitutional validity of a statutory provision; to our knowledge this has never occurred. The Appeals Directorate is obviously not fully independent of the CRA or of government.

All of the courts and of Canada are fully independent of political interference in the discharge of their duties. The judges of the Tax Court of Canada are senior tax lawyers, many of whom were in private practice representing taxpayers, both corporate and individual for many years, although some have been in government service prior to appointment. Some judges are appointed based on their perceived political views and the degree to which their views accord with the government's policies, there is no concern expressed in legal literature regarding the independence of the judiciary from government, although there is of course sometimes intense criticism of judicial attitudes and rulings.

Following the objection process, the next level of appeal is to the Tax Court of Canada, a court established by federal statute.[27] The TCC has jurisdiction to determine that a law is inconsistent with the Constitution, including the Charter, and is invalid to the extent of the inconsistency.[28] Further appeals lie to the Federal Court of Appeal and Supreme Court of Canada, both of which also have inherent jurisdiction to declare legislation to be constitutionally invalid. The federal and provincial governments are bound by such declarations.

The strictness of the application of the rule of law in resolving tax disputes is exemplified by the inability of the CRA, represented by the Department of Justice, to settle a tax appeal other than by application of legal principles. In other words, it is not open to the CRA to settle an appeal out of court by negotiating a mutually acceptable compromise as to the amount the taxpayer should pay, but only by

[27] The Tax Court of Canada was first established in 1983, and has had exclusive original jurisdiction in tax appeals since 1991. This marks the final stage of evolution of Canadian tax law from a system subject to extensive ministerial discretion to one governed by law alone, and adjudicated by courts that are fully independent of the tax administration and any political interference.

[28] *Nova Scotia (Workers' Compensation Board) v. Martin* [2003] 2 S.C.R. 504; applied to the Tax Court in *Canada (Attorney General) v. Campbell*, 2005 FCA 420 at paragraph 23. The jurisdiction of the Tax Court to award damages or grant another remedy has not yet been fully explored.

negotiating a mutually acceptable resolution of the legal issues, with the actual amount to be paid determined by the way the legal issues are resolved.[29]

The common law approach to statutory interpretation applied by the courts in Canada leaves very little scope for a finding that a provision is legally indeterminate. The courts strive to find meaning in statutory language, and apply numerous interpretational maxims to avoid absurdity or vagueness. The Supreme Court of Canada has ruled that a broad textual, contextual and purposive approach to statutory interpretation is appropriate.[30] In the case of the *Income Tax Act*, the detailed and precise drafting style leads primarily to a textual interpretation. Where there remains ambiguity, the context, and ultimately the purpose of the legislation is to be analyzed to arrive at an interpretation that resolves the dispute. In extreme cases, where the latter process does not point to a result, there may be applied a residual presumption in favour of the taxpayer.[31] It is for Parliament to amend ambiguous statutory language.

Legal indeterminacy or vagueness of a legislative provision can be the basis of a judicial declaration that the provision is unconstitutional, in that it infringes the right to life, liberty and security of the person, and the right not to be deprived thereof except in accordance with the principles of fundamental justice, fundamental rights protected by s. 7 of the Charter. A further argument can be made that vague legislation violates the rule of law, a fundamental principle underlying the Canadian constitution as a whole and expressly confirmed in the preamble to the Charter. The Supreme Court of Canada ha ruled that vague laws have the potential to violate requirements of the principles of fundamental justice that citizens be provided with fair notice of prohibited conduct, and that their be adequate safeguards against selective and arbitrary law enforcement. The test of unconstitutional legal

[29] *Galway v. M.N.R.*, [1974] C.T.C. 454, 74 D.T.C. 6355 (F.C.A.).
[30] *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54.

[31] *Johns-Manville Canada Limited v. The Queen*, [1985] 2 SCR 46 and *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)* 2006 S.C.J. No. 20; 2006 SCC 20.

indeterminacy is strict however, requiring that the law must so lack precision that it does not give sufficient guidance for legal debate.[32]

The GAAR itself was challenged as unconstitutionally vague in *Gregory v. The Queen*.[33] However, the Federal Court of Appeal ruled that the constitutional issue could not be decided simply by evaluating the words of legislation; the test of vagueness was whether a court could effectively apply the GAAR to the facts disclosed by the evidence. The courts were able to find that the GAAR could be interpreted and applied to the facts as proven, and it was therefore not unconstitutionally indeterminate.[34] No tax provision has ever been held to be invalid on the basis that it is too vague. The courts have the final word, and so far have been able to interpret the Act and apply it in every case, occasionally resorting to the residual presumption in favour of the taxpayer.

Soft Law

The CRA issues administrative guidance in the form of interpretation bulletins which indicate the CRA's assessing policy and internal approach to interpretation of the Act and regulations. It also issues information circulars, which are more practical guides to compliance, and technical interpretations, which are published[35] responses to specific questions of interpretation posed by individuals and their tax advisors. The CRA publishes Income Tax Technical News, a periodical describing, among other matters, changes in policy for the benefit of tax advisors and specialists, and provides extensive plain language guides and instructions for completing forms. None of these administrative positions are binding on either the taxpayer or the CRA. The TCC, FCA and SCC generally regard interpretation bulletins as helpful aids to resolving a tax dispute, but by no means binding on the court. Some judges are more willing than others to prevent the CRA from reassessing contrary to its published policy to the

[32] *R. v Nova Scotia Pharmaceutical Society* [1992] 2 S.C.R. 606; *Ontario v. Canadian Pacific Ltd.*, [1995] 2 S.C.R. 1031.
[33] 2000 DTC 6561 (FCA).
[34] This case was ultimately decided by the Supreme Court of Canada under the name *Mathew v. Canada*, [2005] 2 S.C.R. 643, 2005 SCC 55; the transactions concerned were found to offend the GAAR and accordingly the constitutional challenge to the GAAR was unsuccessful.
[35] The technical interpretations are obtained under the Federal Information and Privacy Act, which provides for public access to government information. All indications of the identity of any taxpayer are redacted, and the documents are published in full and in edited form by commercial publishers.

detriment of a taxpayer who has relied on a published administrative interpretation, but as a matter of law the CRA may do this, and it is the law that governs. There is no principle of reciprocal observation of the interpretation of tax law by the CRA and the courts; the rulings of the courts are binding on the CRA.

The CRA offers a service of providing binding advance rulings (for a fee) as to the tax consequences of a proposed transaction. The requesting taxpayer must disclose the names of transacting parties and the details of the proposed transactions; the ruling is binding on the CRA provided the actual transaction follows the proposal in all relevant details. The advance ruling process is commonly used for large transactions such as the issue of publicly traded securities to provide certainty, although it is also used where an innovative transaction is contemplated to test the anticipated tax consequences and the potential for reassessment. The CRA has recently sought to challenge the binding nature of an advance tax ruling by taxpayers, and was met with the following words from the Chief Justice of the Tax Court:

> If the respondent [CRA] is now seeking to establish that advance rulings can be repudiated by the Minister after decades of reliance by taxpayers upon them, this proposition, which would startle most practitioners, should be tested in a full trial and not a preliminary motion. This preliminary motion is certainly not the time or place to discuss the complex issues arising out of the Minister's remarkable position. *The rulings process, which was created by Revenue Canada and has been enormously beneficial to taxpayers in creating certainty in predicting the tax consequences of commercial transactions, constitutes a fundamental cornerstone of Canadian tax administration*. The idea that a motions judge could, on the basis of a one hour argument without evidence, demolish one of the essential underpinnings of our system is, quite frankly, appalling. (Emphasis added)[36]

Given that the rulings of the courts are binding on the CRA, the CRA must take these into account in deciding whether to reassess a taxpayer and defend that reassessment in the courts. The CRA will sometimes select a "test case" to reasses in order to obtain a judicial ruling on an interpretive or other issue of law that is either new, or has begun to arise frequently. Occasionally the CRA will comment on a ruling that is adverse to its position, to the effect either that it considers that the result applies only to the specific facts of the case, or that it does not accept the court's conclusions.

[36] *Sentinel Hill Productions (1999) Corporation et al v The Queen*, 2007 TCC 472 at paragraph 12. This ruling is under appeal.

These kinds of statements have no binding effect, but are of interest to tax advisors, as they indicate that the CRA is willing to test the issue again on different facts, or to adjust its legal arguments to try to win a new case.

The CRA cannot and does not circumvent the law as pronounced by the domestic courts. However, where a court has made a ruling that is contrary to the policy favoured by the CRA and Finance, it is common for Finance to propose an amendment to the Act to ensure that the outcome will be reversed in future cases. The amendment is usually made effective as of the date that Finance publishes draft amending legislation, which may be months, or even years, before the amending legislation actually comes into force. Retroactive effect of tax law is therefore common, and is valid provided the intention of Parliament that the law apply retroactively is clear. However, there are some questionable examples of the use of retroactive legislation. The most recent and perhaps most egregious is the 2005 amendment to the GAAR to include the abuse of tax treaties in avoidance transactions, some 17 years after the original provision was enacted. The constitutional doctrine of the supremacy of Parliament would allow such retroactive laws to be enforced in principle, although it can be anticipated that there will be challenges based on s. 7 of the Charter.[37]

In recent years Finance has adopted a practice of releasing draft legislation amending the Act at various times, and not just in connection with the budget process. It has also frequently asked for comment on such draft legislation from tax lawyers and accountants and other interested parties, with the objective of refining the proposed amendments to apply more specifically to the situations that are intended to be targeted. When it releases draft tax legislation, Finance also provides "explanatory notes" that describe the effect the amendments are intended to have. The courts use the explanatory notes as an indication of the intention of Parliament, so that they have

[37] In *MIL (Investments) S.A. v. The Queen* 2006 TCC 460, the court characterized this retroactive legislation as "legal but undesirable". The Federal Court of Appeal upheld the ruling that the use of the tax treaty did not offend the GAAR, but without specific comment on the desirability or legality of the retroactive legislation.

a potentially very significant influence on the outcome of a tax case where the language of the legislation is otherwise ambiguous.[38]

Another technique used by Finance, particularly where draft legislation has been released but changes in response to public submissions are anticipated, is to issue and publish a "comfort letter" indicating that it intends to issue a revised version of the proposed legislation that will have a particular effect or application desired by the taxpayer requesting confirmation of the way the legislation is intended to apply. These letters are regarded as binding at least as a practical matter, though their effect as a matter of law has not been tested.

Avenues of discretionary relief from taxes, penalties and interest

Where a taxpayer is liable as a matter of law for an amount of tax, an administrative penalty or interest on unpaid taxes there are a number of discretionary reliefs that may be applied for. Under the *Financial Administration Act*,[39] the federal government (Governor in Council) may remit (forgive) such amounts where the enforcement of the law is unreasonable or unjust or it is otherwise in the public interest to remit the tax or penalty. Remission orders are not commonly granted, but are reserved for cases where there is clear hardship due to an unusual or unanticipated, though valid, application of the law.

Another avenue of discretionary relief is the so-called "Fairness Package" which provides the Minister of National Revenue (who delegates it to a competent person in the CRA) with the discretion to waive penalties and interest for late-filed returns or overdue taxes in cases of hardship. Illness, accident, family breakdown, natural disaster and other extreme adverse situations affecting the taxpayer's ability to comply with the Income Tax Act are taken into account. If the CRA official does not exercise his or her discretion in favour of the taxpayer, there is a right of review of the decision by the director of a district office or tax centre, and the decision of the latter is reviewable by the Federal Court (Trial Division).

[38] The Supreme Court of Canada relied heavily on the explanatory notes in interpreting the GAAR in *Canada Trustco*, note 30.
[39] R.S.C. 1985, c. F-11, s. 23(2).

A new office of the Taxpayers' Ombudsman began operations in February 2008. Its mandate is to assist taxpayers to deal with administrative difficulties in dealing with the CRA, by mediating between CRA officials and taxpayers in relation to service complaints.[40] At a high level, both Finance and the CRA are subject to review by the Auditor-General, an independent official who reviews the performance of federal departments and agencies, and reports to Parliament.[41]

Legal pluralism

Canada has entered into bilateral tax agreements with approximately 90 other States, including all the EU Member States except Greece. As a dualist theory country and a federal state, Canada can only give binding legal force to tax treaties by Act of Parliament. The practice is to enact a statute declaring the appended tax treaty to have the force of law in Canada, and that in the event of any inconsistency between any provision of the tax treaty and the law of Canada, the provision of the treaty is to take precedence to the extent of the inconsistency. The EC Treaty does not affect the Canadian legal or tax system.

Canada's tax treaties do not apply to provincial income tax laws. However, the provinces usually provide tax treatment consistent with federal treatment of foreign source income that is subject to provincial taxation. For example, British Columbia provides a foreign tax credit to individuals who earn income from non-Canadian sources that mirrors the federal foreign tax credit,[42] even though it has no treaty obligation to mitigate juridical double taxation in this way.

Taxpayers may directly enforce in the courts the provisions of a tax treaty that has been brought into force in Canada. The courts give precedence to tax treaties over inconsistent provisions of the *Income Tax Act*, and interpret them as relieving in

[40] See the information provided on-line at http://www.taxpayersrights.gc.ca/mndt-eng.html , accessed February 18, 2008.
[41] See the Auditor General's report of November 2004, c. 6: "CRA: Resolving Disputes and Encouraging Voluntary Disclosure" at http://www.oag-bvg.gc.ca/internet/English/parl_oag_200411_06_e_14910.html#ch6hd3a , accessed February 18, 2008.
[42] S. 4.71, *Income Tax Act*, RSBC 1996, c. 215 as amended.

nature. However, the *Income Tax Conventions Interpretation Act* ("ITCIA")[43] provides for certain express legislative overrides of the Act bringing a tax treaty into force in Canada, and consequently of the treaty. The courts will give precedence to the interpretation provided for in the ITCIA over the that provided in the tax treaty where the ITCIA so directs.

The courts apply the Vienna Convention on the Law of Treaties where they consider it helpful to interpret a tax treaty. They also refer to the OECD Model Convention and Commentary,[44] and in the case of the Canada-US Treaty, to the Technical Interpretation prepared by the US Treasury, which is explicitly adopted by Finance as conforming to its view of the correct interpretation of the Treaty. The Canadian tax courts also accept evidence of the rulings made by foreign courts in respect of tax treaty provisions and treat them as worthy of respect, though not as binding on them.

Secondary law, or regulations made under the authority of a statute are equally as binding as primary law, and are subject to review for constitutional validity by the courts in the same way. Soft law is not recognized as legally binding by the courts although it is frequently referred to for assistance in interpreting tax provisions and tax treaties. The writings of respected scholars and practitioners are also frequently relied on by the courts.

[43] R.S.C. 1985, c. I-4 as amended. The ITCIA was originally enacted to reverse a 1985 decision of the Supreme Court that gave effect to a static interpretation of tax treaties based on the provisions of the Income Tax Act that were in force at the time the Treaty was concluded, substituting the preferred ambulatory approach. It now contains a number of provisions that operate "notwithstanding" the provisions of a tax treaty or the statute giving it the force of law in Canada.

[44] It appears that Canadian courts' practice is to refer to the Model and Commentary that was in place at the time the particular tax treaty was negotiated and concluded, rather than subsequent versions. However, there has not been a clear statement from an appellate court on whether this is the correct approach. The leading decision on interpretation of tax treaties is *The Queen v. Crown Forest Industries Limited* [1995] 2 SCR 802.