CANADIAN TAX JOURNAL

REVUE FISCALE CANADIENNE

PEER-REVIEWED ARTICLES

The Death of the Tariff: A Review of the Tax Court's Discretionary Approach to Costs Awards

Derrick Hosanna and Erica Hennessey

Unresolved Controversies in Suing for Negligence of Tax Officials: Canadian and Australasian Insights and a Primer for Policy Makers' Consideration

John Bevacqua

POLICY FORUM

Editors' Introduction—Election Platform Costing by the Parliamentary Budget Officer

Alan Macnaughton and Kevin Milligan

Assessing Party Platforms for Fiscal Credibility in the 2019 Federal Election

Mostafa Askari and Kevin Page

Independent Platform Costing—Balancing the Interests of the Public and Parties

Scott Cameron

Public Costing of Party Platforms—Learning from International Experience

Jennifer Robson and Mark Jarvis

SYMPOSIUM

A Tax Policy Legacy: Tim Edgar's Contributions to Tax Scholarship and Tax Legislation

Richard Krever

GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand

Thaddeus Hwong and Jinyan Li

General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's "Building a Better GAAR"

David G. Duff

Ahead by a Century: Tim Edgar, Machine-Learning, and the Future of Anti-Avoidance

Benjamin Alarie

(Continued on inside front cover)

(Continued from outside front cover)

FEATURES

Current Cases: (FCA) Canada v. Alta Energy Luxembourg SARL;
(FCA) Louie v. Canada; (FCA) Markou v. Canada

*Ryan Walker, Maressa Singh, and
Lauzanne Bernard Normand*

Personal Tax Planning / Planification fiscale personnelle :

Pack Your Suitcase! The Baggage of Canada's Departure Tax /
Faites votre valise! Le bagage de l'impôt de départ du Canada

*Sonia Gandhi, Megan Dalton,
and Yooham Jung*

Selected US Tax Developments: The Unbearable Absurdity of the
US Tax Rules for Withholding on Dispositions of Partnership Interests

Michael J. Miller

Current Tax Reading

Robin Boadway and Kim Brooks

■ CANADIAN TAX JOURNAL EDITORIAL BOARD / COMITÉ DE RÉDACTION DE LA REVUE FISCALE CANADIENNE

■ Editors/Rédacteurs en chef

Alan Macnaughton
University of Waterloo

Kevin Milligan (on leave)
University of British Columbia

Daniel Sandler
EY Law LLP

■ Practitioners/Fiscalistes

Brian J. Arnold
Tax Consultant, Toronto

Thomas A. Bauer
Bennett Jones LLP, Toronto

Stephen W. Bowman
Bennett Jones LLP, Toronto

C. Anne Calverley
Calgary

R. Ian Crosbie
Davies Ward Phillips & Vineberg LLP, Toronto

Cy M. Fien
Fillmore Riley LLP, Winnipeg

James P. Fuller
Fenwick & West LLP, Mountain View, CA

Edwin C. Harris
McInnes Cooper, Halifax

William I. Innes
Toronto

Brent Perry
Felesky Flynn LLP, Calgary

Scott Jeffery
KPMG LLP, Vancouver

Edwin G. Kroft
Bennett Jones LLP, Vancouver

Janice McCart
Blake Cassels & Graydon LLP, Toronto

Matias Milet
Osler Hoskin & Harcourt LLP, Toronto

W. Jack Millar
Millar Kreklewetz LLP, Toronto

Michael J. O'Connor
Sunlife Financial Inc., Toronto

François Vincent
KPMG Law LLP, Chicago

■ University Faculty/Universitaires

Reuven Avi-Yonah
University of Michigan

Richard M. Bird
University of Toronto

Robin W. Boadway
Queen's University

Neil Brooks
York University

Arthur Cockfield
Queen's University

Graeme Cooper
University of Sydney

Bev G. Dahlby
University of Calgary

David G. Duff
University of British Columbia

Judith Freedman
Oxford University

Vijay Jog
Carleton University

Jonathan R. Kesselman
Simon Fraser University

Kenneth J. Klassen
University of Waterloo

Gilles N. Larin
Université de Sherbrooke

Amin Mawani
York University

Jack Mintz
University of Calgary

Suzanne Paquette
Université Laval

Abigail Payne
University of Melbourne

Diane M. Ring
Boston College

Michael R. Veall
McMaster University

Join tomorrow's tax leaders

MASTER OF TAXATION

REACH BEYOND

In addition to strong technical competencies, the MTax program prepares graduates for roles as high performing members of the tax community.

Next class starts in September – apply now!

EXPERT FACULTY > UNPARALLELED LEARNING EXPERIENCE

learn ... develop ... experience

All classes held in downtown Toronto

WATERLOO EMPOWERS STUDENTS
TO GO BEYOND. LEARN MORE.

The MTax advantage.

mtax.ca

UNIVERSITY OF
WATERLOO

C016411

www.ctf.ca/www.fcf-ctf.ca

ROBERT (BOB) E. BEAM

1935-2020

The Canadian Tax Foundation was saddened to learn of the passing, on April 13, 2020, of Bob Beam. A chartered accountant by training, Bob was a dedicated educator for 40 years, teaching tax at Ryerson and Waterloo universities and—as co-author of the classic treatise *Introduction to Federal Income Taxation in Canada*, now in its 40th edition—elucidating tax concepts for generations of tax professionals. He was also a long-time consultant for Ernst & Young and gave to the tax community in many ways, generous in sharing his time with many professional organizations, including the Foundation. He was a regular contributor to the *Canadian Tax Journal*, publishing many articles and serving as co-editor of the journal's Personal Tax Planning feature from 1994 to 1998. We are grateful to have had the benefit of Bob's insights for many years, and we offer our condolences to his family and friends.

ROBERT (BOB) E. BEAM

1935-2020

La Fondation canadienne de fiscalité a le regret de vous annoncer le décès de Bob Beam, survenu le 13 avril dernier. Comptable agréé de formation, Bob a été un professeur dévoué de fiscalité aux universités Ryerson et Waterloo pendant 40 ans. Il a été co-auteur de l'ouvrage classique *Introduction to Federal Income Taxation in Canada*, maintenant rendu à sa 40^e édition, élucidant les concepts fiscaux pour des générations de professionnels en fiscalité. Pendant de nombreuses années, il a été consultant pour Ernst & Young et il a contribué à la communauté fiscale de diverses façons, généreux de son temps auprès de plusieurs organisations professionnelles y compris la Fondation. Il a été un collaborateur régulier à la *Revue fiscale canadienne*, écrit plusieurs articles et a été co-rédacteur de 1994 à 1998 à la chronique *Planification fiscale personnelle* de la Revue. Nous sommes reconnaissants d'avoir bénéficié des connaissances de Bob pour plusieurs d'années, et nous offrons nos plus sincères condoléances à sa famille et à ses amis.

CALL FOR BOOK PROPOSALS

The Canadian Tax Foundation, an independent, not-for-profit research and educational organization, is seeking proposals for books in the areas of taxation and public finance.

Since its inception in 1945, the Foundation has published many books and articles on a wide range of subjects within its areas of interest. The Foundation seeks proposals for research projects that will

- result in a book on a single topic of interest in the area of taxation or public finance;
- be undertaken by an experienced researcher who has expertise in an area of taxation or public finance; and
- be carried out within a time frame that is reasonable, given the nature of the project.

Projects selected by the Foundation may qualify for its full or partial financial support of the research and for its underwriting of the publication costs. The Foundation retains the absolute right at its sole discretion to choose whether to support a given proposal or to publish a project.

Interested parties should send a brief written outline of a proposal, for initial consideration by the Foundation, to:

Heather Evans
Executive Director and Chief Executive Officer
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8
hevans@ctf.ca

For further information, please contact the director, as indicated above, or the co-chairs of the Canadian Tax Foundation Research Committee:

Hugh Woolley
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

APPEL DE PROPOSITIONS DE LIVRES

La Fondation canadienne de fiscalité (FCF) / Canadian Tax Foundation, un organisme sans but lucratif indépendant de recherche et à caractère éducatif, souhaite recevoir des propositions de livres dans les domaines de la fiscalité et des finances publiques.

Depuis sa fondation en 1945, la FCF a publié de nombreux livres et articles sur divers sujets dans ses champs d'intérêt. La FCF souhaite obtenir des propositions de projets de recherche qui :

- mèneront à la rédaction d'un livre sur un sujet unique d'intérêt en fiscalité ou en finances publiques;
- seront dirigés par un chercheur chevronné ayant une expertise dans un domaine de la fiscalité ou des finances publiques;
- seront effectués dans un délai raisonnable, compte tenu de la nature du projet.

Les projets qui seront sélectionnés par la FCF pourront être partiellement ou totalement admissibles à une aide financière pour la recherche et les frais de publication. La FCF se réserve le droit absolu, et à sa seule discrétion, d'appuyer une proposition particulière ou de publier un projet.

Toute personne intéressée doit faire parvenir un bref sommaire de la proposition pour examen initial par la FCF à :

Heather Evans
Directrice exécutive et chef de la direction
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8
hevans@ctf.ca

Pour plus d'information, veuillez communiquer avec le directeur, tel qu'il est mentionné plus haut, ou avec les co-présidentes du comité de recherche de la Fondation canadienne de fiscalité :

Hugh Woolley
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

■ RECENT AND UPCOMING EVENTS*

■ ACTIVITÉS RÉCENTES ET À VENIR*

Given the ongoing COVID-19 situation, we have made the decision, after considerable consultation, not to proceed with any in-person events for our 2020 fall conference program. We remain committed, however, to the professional development of our members and to serving the tax community.

We are pleased to announce The Foundation Conferences: Building Your Tax Expertise—a unique collection of four virtual events that will be delivered in the fall of 2020 and will cater to all tax professionals.

Étant donné la situation COVID-19 qui perdure, nous avons pris la décision, après de nombreuses consultations, de ne pas tenir d'événements en personne pour notre programme de conférences à l'automne 2020. Toutefois, nous demeurons engagés à l'égard du développement professionnel de nos membres et à servir la communauté fiscale.

Nous sommes heureux d'annoncer Les conférences de la Fondation : Bâtir votre expertise fiscale — une collection unique de quatre événements virtuels qui seront offerts à l'automne 2020 et qui répondront aux besoins de tous les fiscalistes.

YOUNG PRACTITIONER FOCUS / FOCUS SUR LES JEUNES FISCALISTES

September 9, 2020

THE DEFINITIVE GUIDE TO OWNER-MANAGER TAXATION / LE GUIDE COMPLET SUR LA FISCALITÉ DES PROPRIÉTAIRES EXPLOITANTS

September 21-22, 2020

LEADING TAX THOUGHT / MAÎTRE À PENSER EN FISCALITÉ

October 26-27, 2020

FISCALITÉ DES ENTREPRISES ET DÉVELOPPEMENTS RÉCENTS / TAXATION OF BUSINESSES AND RECENT DEVELOPMENTS

Le 4 novembre 2020

Disclaimer. The material contained in this publication is not intended to be advice on any particular matter. No subscriber or other reader should act on the basis of any matter contained in this publication without considering appropriate professional advice. The publisher, and the authors and editors, expressly disclaim all and any liability to any person, whether a purchaser of this publication or not, in respect of anything and of the consequences of anything done or omitted to be done by any such person in reliance upon the contents of this publication. Opinions expressed by individual writers are not necessarily endorsed by the Canadian Tax Foundation and its members.

Photocopying and reprinting. Permission to photocopy or reprint any part of this publication for distribution must be applied for in writing; e-mail: permissions@ctf.ca.

Advertising. Inquiries relating to advertisements should be directed to Christine Escalante, e-mail: cescalante@ctf.ca.

Exonération de responsabilité. Le contenu de cette publication ne doit être interprété d'aucune façon comme un avis ou une opinion. L'abonné ou le lecteur ne devrait pas fonder ses décisions sur le contenu de cette publication sans envisager une consultation professionnelle appropriée. L'éditeur et les auteurs réfutent toute responsabilité envers toute personne, qu'elle soit abonnée ou non, relativement à toute conséquence résultant d'actes ou omissions faits en fonction du contenu de la présente publication. Les opinions exprimées par les auteurs particuliers ne sont pas nécessairement appuyées par la Fondation canadienne de fiscalité et ses membres.

Photocopie et réimpression. L'autorisation de photocopier ou de réimprimer toute portion de cette publication à des fins de distribution devra être obtenue en adressant une demande écrite à permissions@ctf.ca.

Annonces publicitaires. Toutes demandes concernant les annonces publicitaires devront être adressées à Christine Escalante, courriel : cescalante@ctf.ca.

Canadian Tax Journal
Published four times per year
Price: \$75 per copy (plus applicable taxes)
Subscription rate: \$343.75 per year (plus applicable taxes)
(HST registration no. R-106867260)

Canadian Tax Foundation
145 Wellington Street West
Suite 1400
Toronto, Canada M5J 1H8
Telephone: 416-599-0283
Toll Free: 1-877-733-0283
Facsimile: 416-599-9283
Internet: www.ctf.ca

2020, vol. 68, no. 2
(Issued July 2020)

ISSN 0008-5111

Printed in Canada
6,200 07-20

Revue fiscale canadienne
Publiée quatre fois l'an
Prix : 75 \$ l'exemplaire (taxes en sus)
Abonnement : 343,75 \$ par an (taxes en sus)
(Numéro d'enregistrement de TVH :
R-106867260)

La Fondation canadienne de fiscalité
1250, boul. René-Lévesque ouest
Bureau 2935
Montréal (Québec) H3B 4W8
Téléphone : 514-939-6323
Télécopieur : 514-939-7353
Internet : www.fcf-ctf.ca

2020, vol. 68, n° 2
(publication : juillet 2020)

ISSN 0008-5111

Imprimée au Canada
6,200 07-20

Canadian Tax Journal

Revue fiscale canadienne

PEER-REVIEWED ARTICLES

- 409 **The Death of the Tariff: A Review of the Tax Court's Discretionary Approach to Costs Awards**
DERRICK HOSANNA AND
ERICA HENNESSEY
- 439 **Unresolved Controversies in Suing for Negligence of Tax Officials: Canadian and Australasian Insights and a Primer for Policy Makers' Consideration**
JOHN BEVACQUA

POLICY FORUM

- 477 **Editors' Introduction—Election Platform Costing by the Parliamentary Budget Officer**
ALAN MACNAUGHTON AND
KEVIN MILLIGAN
- 481 **Assessing Party Platforms for Fiscal Credibility in the 2019 Federal Election**
MOSTAFA ASKARI AND KEVIN PAGE
- 491 **Independent Platform Costing—Balancing the Interests of the Public and Parties**
SCOTT CAMERON
- 505 **Public Costing of Party Platforms—Learning from International Experience**
JENNIFER ROBSON AND
MARK JARVIS

SYMPOSIUM

- 517 **A Tax Policy Legacy: Tim Edgar's Contributions to Tax Scholarship and Tax Legislation**
RICHARD KREVER
- 539 **GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand**
THADDEUS HWONG AND JINYAN LI
- 579 **General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's "Building a Better GAAR"**
DAVID G. DUFF
- 613 **Ahead by a Century: Tim Edgar, Machine-Learning, and the Future of Anti-Avoidance**
BENJAMIN ALARIE

FEATURES

- 631 Current Cases:** (FCA) Canada v. Alta Energy
Luxembourg SARL; (FCA) Louie v. Canada;
(FCA) Markou v. Canada
RYAN WALKER, MARESSA SINGH, AND
LAUZANNE BERNARD NORMAND
- 661 Personal Tax Planning:** Pack Your Suitcase!
The Baggage of Canada's Departure Tax
SONIA GANDHI, MEGAN DALTON,
AND YOOHAM JUNG
- 687 Planification fiscale personnelle :** Faites votre valise!
Le bagage de l'impôt de départ du Canada
SONIA GANDHI, MEGAN DALTON
ET YOOHAM JUNG
- 717 Selected US Tax Developments:** The Unbearable Absurdity
of the US Tax Rules for Withholding on Dispositions of
Partnership Interests
MICHAEL J. MILLER
- 731 Current Tax Reading**
ROBIN BOADWAY AND KIM BROOKS

■ CANADIAN TAX JOURNAL

The *Canadian Tax Journal* publishes research in, and informed comment on, taxation and public finance, with particular relevance to Canada. To this end, the journal invites interested parties to submit manuscripts for possible publication as peer-reviewed articles, and it especially welcomes work that contributes to the analysis, design, and implementation of tax policies.

Articles may be written in English or French and should present an original analysis of the topic. Submitted work, or any substantial part or version thereof, must not have been previously published, either in print or online, and it must not be submitted or scheduled for publication elsewhere. The journal welcomes shorter submissions (from 4,000 to 8,000 words) focused on specific topics as well as longer submissions (to a maximum of 20,000 words) that analyze issues in depth.

Submitted articles are subject to a double-blind peer review; authors' identities are not known to reviewers, and reviewers' identities are not known to authors. (Non-peer-reviewed contributions may appear elsewhere in the journal.) Final decisions on publication of articles are made by the editors, Alan Macnaughton, Daniel Sandler, and Kevin Milligan, on the advice of reviewers. Many reviewers are drawn from the editorial board (listed on the inside front cover of this journal), although ad hoc reviewers are also consulted. Submissions may be (1) accepted outright; (2) accepted if recommended revisions are made; (3) revised by the authors, as requested by the editors on the advice of reviewers, and resubmitted for further review; or (4) rejected with reasons. The time from submission to the first editorial decision is usually two months or less.

Prospective contributors should submit a copy of the manuscript to the journal's editorial department. The preferred method of submission is by e-mail with an attached Word document. E-mail inquiries are welcome: write to CTFeditorial@ctf.ca. Contributors are responsible for providing complete and accurate citations to sources, a detailed abstract (200 to 400 words), and up to six keywords for indexing purposes.

The full text of many articles that have appeared in the *Canadian Tax Journal* since 1991 can be found on the Canadian Tax Foundation's website: www.ctf.ca. Additionally, the journal in its entirety appears in the Canadian Tax Foundation's *TaxFind*, which is updated regularly.

The *Canadian Tax Journal* is indexed in EconLit, ABI Inform, LegalTrac, Index to Canadian Legal Literature, CCH Canadian's Canadian Income Tax Research Index, Carswell's Income Tax References, Accounting and Law Index, Current Law Index, Canadian Index, Canadian Periodicals Index, Index to Canadian Legal Periodical Literature, Index to Legal Periodicals and Books, and PAIS International in Print.

■ REVUE FISCALE CANADIENNE

La *Revue fiscale canadienne* publie des recherches et des commentaires éclairés sur la fiscalité et les finances publiques, particulièrement pertinents pour le Canada. À cette fin, la revue invite les personnes intéressées à soumettre des articles en vue d'une éventuelle publication en tant qu'articles revus par des pairs, et elle accueille tout particulièrement les travaux qui contribuent à l'analyse, à la conception et à la mise en oeuvre des politiques fiscales.

Les articles peuvent être rédigés en anglais ou en français et doivent présenter une analyse originale du sujet. Les articles soumis, ou toute partie substantielle ou version des articles, ne doivent pas avoir été publiés antérieurement en format papier ou électronique, et ne doivent pas être soumis ou prévus pour publication ailleurs. Vous pouvez soumettre pour publication, dans la revue fiscale, des articles plus courts (4 000 à 8 000 mots) sur des sujets particuliers ainsi que des articles plus longs (maximum de 20 000 mots) analysant des sujets en profondeur.

Les articles soumis sont sujets à une double revue à l'aveugle par des pairs; l'identité des auteurs n'est pas connue des réviseurs et celle des réviseurs n'est pas connue des auteurs (certains articles non soumis à cette révision par des pairs peuvent paraître ailleurs dans la revue.) La décision finale de publier ou non un article est celle des rédacteurs en chef Alan Macnaughton, Daniel Sandler et Kevin Milligan, à la recommandation des réviseurs. Bien que certains réviseurs *ad hoc* soient aussi consultés, la majorité des réviseurs sont choisis parmi les membres du Comité de rédaction (énumérés à l'endos de la page couverture de la revue). Les articles soumis peuvent être 1) acceptés d'emblée; 2) acceptés après modifications; 3) modifiés par les auteurs tel que demandé par les rédacteurs en chef sur l'avis des réviseurs, et resoumis à une nouvelle révision; ou 4) rejetés avec raisons. Le temps écoulé entre la soumission d'un article et la première décision éditoriale est habituellement de deux mois ou moins.

Les aspirants contributeurs doivent soumettre un exemplaire de l'article proposé au service éditorial. Il est préférable que la soumission se fasse par courriel, avec une pièce jointe en Word. Les demandes de renseignements par courriel sont les bienvenues. Elles doivent être adressées à CTFeditorial@ctf.ca. Les contributeurs doivent soumettre l'ensemble de leurs sources, un précis détaillé de leurs articles (entre 200 et 400 mots), et jusqu'à six mots clés aux fins d'indexation.

On peut trouver le texte intégral de nombreux articles publiés dans la *Revue fiscale canadienne* depuis 1991 sur le site Internet de la Fondation : www.fcf-ctf.ca. De plus, la revue dans son entier se trouve dans *TaxFind*, qui est mis à jour régulièrement.

La *Revue fiscale canadienne* est indexée sous EconLit, ABI Inform, LegalTrac, Index to Canadian Legal Literature, Canadian Income Tax Research Index de CCH Canadian, Income Tax References de Carswell, Accounting and Law Index, Current Law Index, Canadian Index, Canadian Periodicals Index, Index to Canadian Legal Periodical Literature, Index to Legal Periodicals and Books, et PAIS International in Print.

■ CANADIAN TAX FOUNDATION

The Canadian Tax Foundation is Canada's leading source of insight on tax issues. The Foundation promotes understanding of the Canadian tax system through analysis, research, and debate, and provides perspective and impartial recommendations concerning its equity, efficiency, and application.

The Canadian Tax Foundation is an independent tax research organization and a registered charity with over 12,000 individual and corporate members in Canada and abroad. For more than 70 years, it has fostered a better understanding of the Canadian tax system and assisted in the development of that system through its research projects, conferences, publications, and representations to government.

Members find the Foundation to be a valuable resource both for the scope and depth of the tax information it provides and for its services, which support their everyday work in the taxation field.

Government policy makers and administrators have long respected the Foundation for its objectivity, its focus on current tax issues, its concern for improvement of the Canadian tax system, and its significant contribution to tax and fiscal policy.

MEMBERSHIP

Membership in the Foundation is open to all who are interested in its work. Membership fees are \$399.00 a year, except that special member rates apply as follows: (a) \$199.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) \$199.00 for persons on full-time teaching staff of colleges, universities, or other educational institutions; (c) \$40.00 for students in full-time attendance at a recognized educational institution; and (d) \$171.00 for persons who have reached the age of 65 and are no longer actively working in tax. Memberships are for a period of 12 months dating from the receipt of application with the appropriate payment.

Applications for membership are available from the membership administrator for the Canadian Tax Foundation: facsimile: 416-599-9283; Internet: www.ctf.ca; e-mail: ctfmembership@ctf.ca.

■ FONDATION CANADIENNE DE FISCALITÉ

La Fondation canadienne de fiscalité est un organisme indépendant de recherche sur la fiscalité inscrit sous le régime des œuvres de charité. Elle compte environ 12 000 membres au Canada et à l'étranger. Depuis plus de 70 ans, la FCF favorise une meilleure compréhension du système fiscal canadien et aide au développement de ce système par le biais de ses projets de recherche, conférences, publications et représentations auprès des gouvernements.

Les membres considèrent l'étendue et le détail de l'information offerte par la FCF comme une importante ressource. Ils apprécient également les autres services de la FCF qui facilitent leur travail quotidien dans le domaine de la fiscalité.

Les décideurs et administrateurs gouvernementaux respectent depuis longtemps l'objectivité de la FCF, son attention aux questions fiscales de l'heure, sa préoccupation envers l'amélioration du système fiscal canadien et son importante contribution au développement des politiques fiscales.

ADHÉSION

Toute personne intéressée aux travaux de la FCF peut en devenir membre. Les droits d'adhésion sont de 399,00 \$ par année, à l'exception des tarifs spéciaux suivants : a) 199,00 \$ pour les personnes faisant carrière en comptabilité ou en droit pendant les trois premières années suivant leur admission à la profession; b) 199,00 \$ pour le personnel enseignant à temps plein dans un collège, une université ou une autre maison d'enseignement; c) 40,00 \$ pour les étudiants fréquentant à temps plein une maison d'enseignement reconnue; et d) 171,00 \$ pour les personnes qui ont 65 ans et plus et qui ne travaillent plus activement en fiscalité. La période d'adhésion est de 12 mois, à compter de la réception de la demande accompagnée du paiement approprié.

Il est possible de se procurer les demandes d'adhésion auprès de l'administratrice responsable de l'adhésion à la FCF : télécopieur : 514-939-7353; Internet : www.fcf-ctf.ca; courriel : adminmtl@ctf.ca.

■ BOARD OF GOVERNORS/CONSEIL DES GOUVERNEURS

Elected December 1, 2019/Élu le 1^{er} décembre 2019

Albert Anelli, QC ^{1*}	Ted Gallivan, ON ³	Elizabeth Murphy, ON ³
Cheryl Bailey, ON ¹	Rachel Gervais, ON ^{1*}	Anu Nijhawan, AB ²
Jeffery Blucher, NS ²	Siobhan Goguen, AB ²	Heather O'Hagan, ON ³
Eoin Brady, ON ¹	Kay Gray, BC ¹	John Oakey, NS ¹
Mark Brender, QC ^{2*}	Ken Hauser, BC ²	Mitchell Sherman, ON ²
Alycia Calvert, ON ^{1*}	Soraya Jamal, BC ²	Michael Smith, AB ¹
Marlene Cepparo, ON ^{1*}	Timothy Kirby, AB ²	Martin Sorensen, ON ^{2*}
Grace Chow, ON ¹	Dean Landry, ON ^{1*}	John Tobin, ON ²
Allison Christians, QC ³	Rick McLean, ON ¹	Dave Walsh, ON ¹
Michael Coburn, BC ²	Stefanie Morand, ON ²	Hugh Woolley, BC ¹
Marie-Claire Dy, BC ²	Michael Munoz, AB ³	Barbara Worndl, ON ^{2*}
Olivier Fournier, QC ²		

* Executive Committee of the Board of Governors

Comité de direction du conseil des gouverneurs

¹ Nominee of the Chartered Professional Accountants of Canada

² Nominee of the Canadian Bar Association

³ Non-sponsor

■ OFFICERS/MEMBRES DE LA DIRECTION

Chair/ <i>Présidente du conseil</i>	Alycia Calvert
Vice-Chair and Chair of the Executive Committee/ <i>Vice-présidente du conseil et présidente du comité de direction</i>	Barbara Worndl
Second Vice-Chair/ <i>Deuxième vice-présidente</i>	Marlene Cepparo
Past Chair/ <i>Président sortant du conseil</i>	Mark Brender
Executive Director and Chief Executive Officer/ <i>Directrice exécutive et chef de la direction</i>	Heather Evans
Director, Membership Development and Community Relations/ <i>Directeur, Développement du programme de l'adhésion et relations avec la communauté</i>	Wayne Adams
Regional Director, Quebec/ <i>Directrice régionale du Bureau du Québec</i>	Lucie Bélanger
Director of Finance and Treasurer/ <i>Directrice financière et trésorière</i>	Shelly Ali

■ STAFF/PERSONNEL

Events and Web Manager/ <i>Directrice des événements et du site Web</i>	Roda Ibrahim
Librarian/ <i>Bibliothécaire</i>	Judy Singh
Managing Editor/ <i>Directeur de la rédaction</i>	Michael Gaughan

■ CANADIAN TAX FOUNDATION PUBLICATIONS

The Foundation's publications comprise a range of forms and delivery formats. A number of the regularly issued publications are distributed without charge to Foundation members: the *Canadian Tax Journal* (4 issues), *Perspectives on Tax Law & Policy* (4 issues, delivered electronically), *Tax for the Owner-Manager* (4 issues, delivered electronically), *Canadian Tax Focus* (4 issues, delivered electronically), and the annual conference report. Monographs and books may be purchased on the Foundation's website at www.ctf.ca.

CANADIAN TAX JOURNAL — issued quarterly to members via www.ctf.ca (Non-Members \$75 per copy, \$343.75 per year).

NEWSLETTERS

Perspectives on Tax Law & Policy — issued quarterly to members via www.ctf.ca.

Tax for the Owner-Manager — issued quarterly to members via www.ctf.ca.

Canadian Tax Focus — issued quarterly; available to members and non-members via www.ctf.ca.

Canadian Tax Highlights — archives (2000-2019) available to members via www.ctf.ca.

CONFERENCE REPORTS — Reports of the proceedings of annual tax conferences (Members \$40; Non-Members \$95). Latest issue: 2018 (Members \$40; Non-Members \$350).

— *Tax Dispute Resolution, Compliance, and Administration in Canada: Proceedings of the June 2012 Conference* (Members \$30; Non-Members \$195)

— Collections of papers delivered at regional and special tax conferences (British Columbia, Prairie Provinces, Ontario, and Atlantic Provinces) are available in USB format (Members \$445; Non-Members \$495).

FINANCES OF THE NATION — Review of expenditures and revenues and some budgets of the federal, provincial, and local governments of Canada. PDFs for the years 2002-2012 are available on the CTF website at no cost. In 2014, "Finances of the Nation" began to appear as a feature in issues of the *Canadian Tax Journal*.

MONOGRAPHS

2020. *Taxation of Private Corporations and Their Shareholders*, 5th edition, Rachel Gervais, John Sorensen, David Stevens, and Dave Walsh, eds. (Members and Non-Members \$170; Students \$70)

2019. *Funding the Canadian City*, Enid Slack, Lisa Philipps, Lindsay M. Tedds, and Heather L. Evans, eds. (\$40 each)

2018. *Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville*, Brian J. Arnold, ed. (Members \$60; Non-Members \$90)

2018. *Reforming the Corporate Tax in a Changing World*, School of Public Policy of the University of Calgary (Members \$30; Non-Members \$50)

2017. *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act*, Jinyan Li, J. Scott Wilkie, and Larry F. Chapman, eds. (Members \$60; Non-Members \$90)

2016. *Reform of the Personal Income Tax in Canada*, School of Public Policy of the University of Calgary (Members \$35; Non-Members \$50)

2016. *Canadian Taxation of Trusts*, Elie S. Roth, Tim Youdan, Chris Anderson, and Kim Brown (Members \$150; Non-Members \$200; Students \$50)

2016. *User Fees in Canada: A Municipal Design and Implementation Guide*, Catherine Althaus and Lindsay M. Tedds (\$40 each)

2015. *Timing and Income Taxation*, 2d edition, Brian J. Arnold, Colin Campbell, Michael Hiltz, Richard Marcovitz, Shawn D. Porter, and James R. Wilson (Members \$25; Non-Members \$125; Students \$25)

2015. *Effective Writing for Tax Professionals*, Kate Hawkins and Thomas E. McDonnell, QC (Members \$35; Non-Members \$40)

2014. *After Twenty Years: The Future of the Goods and Services Tax*, School of Public Policy of the University of Calgary (Members \$25; Non-Members \$35)

2013. *Essays on Tax Treaties: A Tribute to David A. Ward*, Guglielmo Maisto, Angelo Nikolakakis, and John M. Ulmer, eds. (\$100 each)
2012. *Tax Policy in Canada*, Heather Kerr, Ken McKenzie, and Jack Mintz, eds. (Members \$75; Non-Members \$100; Students \$50)
2011. *Canadian Tax Foundation Style Guide*, 5th edition (Members \$35; Non-Members \$40)
2011. *International Financial Reporting Standards: Their Adoption in Canada*, Jason Doucet, Andrée Lavigne, Caroline Nadeau, Jocelyn Patenaude, and Dave Santerre (Members \$30; Non-Members \$40)
2011. *Tax Expenditures: State of the Art — Selected Proceedings of the Osgoode 2009 Conference*, Lisa Philipps, Neil Brooks, and Jinyan Li, eds. (Members \$45; Non-Members \$55; Students \$30)
2010. *Taxation of Private Corporations and Their Shareholders*, 4th edition (Members \$75; Non-Members \$100; Students \$25)
- TAX PROFESSIONAL SERIES (Please specify title and author when ordering.)
2003. *The Taxation of Business Profits Under Tax Treaties*, Brian J. Arnold, Jacques Sasseville, and Eric M. Zolt, eds. (softcover edition, \$75)
2003. *International Taxation in the Age of Electronic Commerce: A Comparative Study*, Jinyan Li. Co-published with International Fiscal Association (Canadian Branch) (Members \$95; Non-Members \$145; Students \$45)
1999. *Countering Tax Treaty Abuses: A Canadian Perspective on an International Issue*, Nathalie Goyette (\$75 each)
- CANADIAN TAX PAPER SERIES (Please specify publication number when ordering.)
- No. 112: 2009. *Effective Responses to Aggressive Tax Planning: What Canada Can Learn from Other Jurisdictions*, Gilles N. Larin and Robert Duong, with a contribution from Marie Jacques
- No. 111: 2009. *Reforming Canada's International Tax System: Toward Coherence and Simplicity*, Brian J. Arnold (Members \$100; Non-Members \$125)
- No. 110: 2006. *Financing Education and Training in Canada*, 2d edition, Douglas Auld and Harry Kitchen
- No. 109: 2004. *The Canadian Federal-Provincial Equalization Regime: An Assessment*, Alex S. MacNevin
- No. 108: 2004. *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States*, Daniel Sandler
- No. 107: 2002. *Municipal Revenue and Expenditure Issues in Canada*, Harry M. Kitchen (Members \$20; Non-Members \$40)
- No. 106: 2002. *Taxes and the Canadian Underground Economy*, David E.A. Giles and Lindsay M. Tedds
- No. 105: 2000. *The Income Tax Treatment of Financial Instruments: Theory and Practice*, Tim Edgar
- No. 104: 1999. *Rationality in Public Policy: Retrospect and Prospect, A Tribute to Douglas G. Hartle*, Richard M. Bird, Michael J. Trebilcock, and Thomas A. Wilson, eds.
- No. 103: 1999. *Canadian Tax Policy*, 3d edition, Robin W. Boadway and Harry M. Kitchen
- No. 102: 1997. *Financing the Canadian Federation, 1867 to 1995: Setting the Stage*, David B. Perry
- No. 101: 1997. *General Payroll Taxes: Economics, Politics, and Design*, Jonathan R. Kesselman
- No. 100: 1995. *Growth of Government Spending in Alberta*, Paul Boothe
- No. 99: 1995. *Financing Education and Training in Canada*, Harry Kitchen and Douglas Auld
- SPECIAL STUDIES IN TAXATION AND PUBLIC FINANCE (Please specify publication number when ordering.)
- No. 2: 2000. *Gambling and Governments in Canada, 1969-1998: How Much? Who Plays? What Payoff?* François Vaillancourt and Alexandre Roy
- No. 1: 1998. *Federal-Provincial Tax Sharing and Centralized Tax Collection in Canada*, Ernest H. Smith

■ LES PUBLICATIONS DE LA FONDATION CANADIENNE DE FISCALITÉ

Les publications de la Fondation existent sous différentes formes et elles sont disponibles de diverses façons. Certaines de ces publications régulières sont distribuées gratuitement aux membres de la Fondation : la *Revue fiscale canadienne* (4 numéros), *Perspectives en fiscalité et en politique fiscale* (4 numéros, offerts électroniquement), *Actualités fiscales pour les propriétaires exploitants* (4 numéros, offerts électroniquement), *Canadian Tax Focus* (4 numéros, offerts électroniquement) et le Rapport de la conférence annuelle. Les livres et monographies peuvent être achetés sur le site Web de la Fondation www.fcf-ctf.ca.

REVUE FISCALE CANADIENNE — parution trimestrielle aux membres sur www.fcf-ctf.ca
(Non-membres 75 \$ par numéro, 343,75 \$ par année).

BULLETINS

Perspectives en fiscalité et en politique fiscale — parution trimestrielle disponible aux membres sur www.fcf-ctf.ca.

Actualités fiscales pour les propriétaires exploitants — parution trimestrielle disponible aux membres sur www.fcf-ctf.ca.

Canadian Tax Focus — parution trimestrielle disponible aux membres et non-membres sur www.fcf-ctf.ca.

Faits saillants en fiscalité canadienne — archives (2000-2019) accessibles aux membres sur www.fcf-ctf.ca.

RAPPORTS DES CONFÉRENCES — comptes rendus des conférences annuelles sur la fiscalité (Membres 40 \$; Non-membres 95 \$). Dernière édition : 2018 (Membres 40 \$; Non-membres 350 \$).

— *Tax Dispute Resolution, Compliance, and Administration in Canada: Proceedings of the June 2012 Conference* (Membres 30 \$; Non-membres 195 \$)

— Collections contenant les travaux présentés aux conférences régionales sur la fiscalité, soit British Columbia, Prairie Provinces, Ontario et Atlantic Provinces, sont disponibles en format USB (Membres 445 \$; Non-membres 495 \$).

FINANCES OF THE NATION — Analyse des recettes et dépenses, et quelques budgets, des gouvernements fédéral, provinciaux et locaux au Canada. Les copies PDF pour les années 2002-2012 sont disponibles sur le site Web de la FCF pour téléchargement gratuit. Dans le numéro 62:3 (2014), « *Finances of the Nation* » est apparu dans les éditions de la *Revue fiscale canadienne* à titre de nouvelle rubrique.

MONOGRAPHIES

2020. *Taxation of Private Corporations and Their Shareholders*, 5^e édition, Rachel Gervais, John Sorensen, David Stevens et Dave Walsh, éd. (Membres et Non-membres 170 \$; Étudiants 70 \$)

2019. *Funding the Canadian City*, Enid Slack, Lisa Philipps, Lindsay M. Tedds et Heather L. Evans, éd. (\$40 chacun)

2018. *Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville*, Brian J. Arnold, éd. (Membres 60 \$; Non-membres 90 \$)

2018. *Reforming the Corporate Tax in a Changing World*, l'École de politique publique de l'Université de Calgary (Membres 30 \$; Non-membres 50 \$)

2017. *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act*, Jinyan Li, J. Scott Wilkie et Larry F. Chapman, éd. (Membres 60 \$; Non-membres 90 \$)

2016. *Reform of the Personal Income Tax in Canada*, l'École de politique publique de l'Université de Calgary (Membres 35 \$; Non-membres 50 \$)

2016. *Canadian Taxation of Trusts*, Elie S. Roth, Tim Youdan, Chris Anderson et Kim Brown (Membres 150 \$; Non-membres 200 \$; Étudiants 50 \$)

2016. *User Fees in Canada: A Municipal Design and Implementation Guide*, Catherine Althaus et Lindsay M. Tedds (40 \$ chacun)

2015. *Timing and Income Taxation*, 2^{ième} édition, Brian J. Arnold, Colin Campbell, Michael Hiltz, Richard Marcovitz, Shawn D. Porter et James R. Wilson (Membres 25 \$; Non-membres 125 \$; Étudiants 25 \$)
2015. *Effective Writing for Tax Professionals*, Kate Hawkins et Thomas E. McDonnell, QC (Membres 35 \$; Non-membres 40 \$)
2014. *After Twenty Years: The Future of the Goods and Services Tax*, l'École de politique publique de l'Université de Calgary (Membres 25 \$; Non-membres 35 \$)
2013. *Essays on Tax Treaties: A Tribute to David A. Ward*, Guglielmo Maisto, Angelo Nikolakakis et John M. Ulmer, éd. (100 \$ chacun)
2012. *Tax Policy in Canada*, Heather Kerr, Ken McKenzie et Jack Mintz, éd. (Membres 75 \$; Non-membres 100 \$; Étudiants 50 \$)
2011. *Canadian Tax Foundation Style Guide*, 5^{ième} édition (Membres 35 \$; Non-membres 40 \$)
2011. *International Financial Reporting Standards: Their Adoption in Canada*, Jason Doucet, Andrée Lavigne, Caroline Nadeau, Jocelyn Patenaude et Dave Santerre (Membres 30 \$; Non-membres 40 \$)
2011. *Tax Expenditures: State of the Art — Selected Proceedings of the Osgoode 2009 Conference*, Lisa Philipps, Neil Brooks et Jinyan Li, éd. (Membres 45 \$; Non-membres 55 \$; Étudiants 30 \$)
2010. *Taxation of Private Corporations and Their Shareholders*, 4^{ième} édition (Membres 75 \$; Non-membres 100 \$; Étudiants 25 \$)
- COLLECTION TAX PROFESSIONAL (Prière d'indiquer le titre et le nom de l'auteur sur votre commande.)
2003. *The Taxation of Business Profits Under Tax Treaties*, Brian J. Arnold, Jacques Sasseville et Eric M. Zolt, éd. (édition brochée, 75 \$)
2003. *International Taxation in the Age of Electronic Commerce: A Comparative Study*, Jinyan Li. Publié en collaboration avec l'Association fiscale internationale (chapitre canadien). (Membres 95 \$; Non-membres 145 \$; Étudiants 45 \$)
1999. *Contrer l'abus des conventions fiscales : Point de vue canadien sur une question internationale*, Nathalie Goyette (75 \$ chacun)
- CANADIAN TAX PAPER SERIES (Prière d'indiquer le numéro de la publication.)
- N° 112 : 2009. *Des réponses efficaces aux planifications fiscales agressives : leçons à retenir des autres juridictions*, Gilles N. Larin et Robert Duong, avec la contribution de Marie Jacques
- N° 111 : 2009. *Reforming Canada's International Tax System: Toward Coherence and Simplicity*, Brian J. Arnold (Membres 100 \$; Non-membres 125 \$)
- N° 110 : 2006. *Financing Education and Training in Canada*, 2^{ième} édition, Douglas Auld et Harry Kitchen
- N° 109 : 2004. *The Canadian Federal-Provincial Equalization Regime: An Assessment*, Alex S. MacNevin
- N° 108 : 2004. *Venture Capital and Tax Incentives: A Comparative Study of Canada and the United States*, Daniel Sandler
- N° 107 : 2002. *Municipal Revenue and Expenditure Issues in Canada*, Harry M. Kitchen (Membres 20 \$; Non-membres 40 \$)
- N° 106 : 2002. *Taxes and the Canadian Underground Economy*, David E.A. Giles et Lindsay M. Tedds
- N° 105 : 2000. *The Income Tax Treatment of Financial Instruments: Theory and Practice*, Tim Edgar
- N° 104 : 1999. *Rationality in Public Policy: Retrospect and Prospect, A Tribute to Douglas G. Hartle*, Richard M. Bird, Michael J. Trebilcock et Thomas A. Wilson, éd.
- N° 103 : 1999. *Canadian Tax Policy*, 3^e édition, Robin W. Boadway et Harry M. Kitchen
- N° 101 : 1997. *General Payroll Taxes: Economics, Politics, and Design*, Jonathan R. Kesselman
- N° 102 : 1997. *Financing the Canadian Federation, 1867 to 1995: Setting the Stage*, David B. Perry
- N° 100 : 1995. *Growth of Government Spending in Alberta*, Paul Boothe
- N° 99 : 1995. *Financing Education and Training in Canada*, Harry Kitchen et Douglas Auld
- SPECIAL STUDIES IN TAXATION AND PUBLIC FINANCE SERIES (Prière d'indiquer le numéro de la publication.)
- N° 2 : 2000. *Gambling and Governments in Canada, 1969-1998: How Much? Who Plays? What Payoff?* François Vaillancourt et Alexandre Roy
- N° 1 : 1998. *Federal-Provincial Tax Sharing and Centralized Tax Collection in Canada*, Ernest H. Smith

The Death of the Tariff: A Review of the Tax Court's Discretionary Approach to Costs Awards

Derrick Hosanna and Erica Hennessey*

PRÉCIS

L'attribution des dépens dans les litiges civils généraux avait traditionnellement pour but d'indemniser la partie qui avait eu gain de cause des dépens et autres frais engagés pour défendre une allégation non prouvée ou faire valoir un droit légal. Toutefois, les tribunaux canadiens ont reconnu que la conception traditionnelle des dépens est dépassée, et que l'attribution des dépens sert davantage et de façon plus importante à promouvoir l'administration efficace et ordonnée de la justice.

L'attribution des dépens à la Cour canadienne de l'impôt a généralement suivi une évolution similaire, mais à un rythme plus lent. Historiquement, les dépens étaient accordés uniquement en conformité au tarif annexé aux Règles de la Cour canadienne de l'impôt (procédure générale), sauf en cas de « conduite répréhensible, scandaleuse ou outrageante ». Plus récemment, cependant, les juges de la Cour de l'impôt ont exprimé des inquiétudes quant à l'inadéquation du tarif. Ces préoccupations ont conduit la Cour à adopter une méthode raisonnée à l'égard des dépens, similaire à celle utilisée dans les litiges civils généraux modernes, en appliquant les facteurs donnés énoncés à la règle 147(3) (« les facteurs de la règle 147(3) ») plutôt que de se fier uniquement au tarif.

Cet article passe en revue la jurisprudence récente relative à l'attribution des dépens à la Cour de l'impôt, en mettant particulièrement l'accent sur la manière dont les facteurs de la règle 147(3) ont été interprétés et sur la manière dont l'application de ces facteurs pourrait évoluer pour promouvoir davantage les nouveaux objectifs de l'attribution des dépens reconnus dans le cadre des litiges civils généraux. Les auteurs font valoir que les dépens accordés par la Cour de l'impôt pourraient être utilisés plus efficacement pour promouvoir une administration efficace et ordonnée de la justice en 1) prenant en considération les caractéristiques uniques d'un litige fiscal, et 2) en mettant davantage l'accent sur les objectifs de l'attribution des dépens dans les litiges civils généraux.

* Derrick Hosanna is of Bennett Jones LLP, Calgary (e-mail: hosannad@bennettjones.com); Erica Hennessey is of Felesky Flynn LLP, Calgary (e-mail: chennessy@felesky.com). The authors would like to thank Ken S. Skingle of Felesky Flynn LLP for his comments on earlier drafts of this article. Any errors are our own.

ABSTRACT

The traditional objective of a costs award in general civil litigation was to indemnify the successful party for the legal and other costs incurred to defend an unproven claim or pursue a valid legal right. However, Canadian courts have recognized that the traditional view of costs is outdated and that an additional and more important use of costs awards is promotion of the efficient and orderly administration of justice.

Costs awards at the Tax Court of Canada have generally followed a similar path of development, but at a slower pace. Historically, costs were awarded only in accordance with the tariff annexed to the Tax Court of Canada Rules (General Procedure) unless “reprehensible, scandalous, or outrageous conduct” was present. More recently, however, Tax Court judges have expressed concerns about the inadequacy of the tariff. These concerns have led the court to adopt a “principled” approach to costs, similar to that used in modern general civil litigation, by applying specific factors set out in rule 147(3) (“the 147(3) factors”) rather than relying solely on the tariff.

This article reviews the recent jurisprudence relating to costs awards at the Tax Court, with a particular focus on the manner in which the 147(3) factors have been interpreted and how the application of those factors could evolve to further promote the new objectives of costs awards recognized in general civil litigation. The authors argue that costs awards by the Tax Court could be used more effectively to promote the efficient and orderly administration of justice by (1) taking into consideration the unique features of a tax dispute, and (2) placing additional emphasis on the purposes of costs awards adopted in general civil litigation.

KEYWORDS: COSTS ■ AWARDS ■ TAX COURT OF CANADA ■ TAX LITIGATION ■ CIVIL LITIGATION ■ JURISPRUDENCE

CONTENTS

Introduction	411
The New Approach to Costs Awards	412
The 147(3) Factors	413
The Result of the Proceeding (Rule 147(3)(a))	413
Interpretation of the Factor	413
Alignment with the New Approach	415
The Amounts in Issue (Rule 147(3)(b))	415
Interpretation of the Factor	415
Alignment with the New Approach	417
The Importance of the Issues (Rule 147(3)(c))	417
Interpretation of the Factor	417
Alignment with the New Approach	419
Any Offer of Settlement Made in Writing (Rule 147(3)(d))	419
Interpretation of the Factor	419
Alignment with the New Approach	421
The Volume of Work (Rule 147(3)(e))	421
Interpretation of the Factor	421
Alignment with the New Approach	423
The Complexity of the Issues (Rule 147(3)(f))	423
Interpretation of the Factor	423
Alignment with the New Approach	425

The Conduct of Any Party That Unnecessarily Affected the Duration of the Proceeding (Rule 147(3)(g))	425
Interpretation of the Factor	425
Alignment with the New Approach	428
The Denial or the Neglect or Refusal of Any Party To Admit Anything That Should Have Been Admitted (Rule 147(3)(h))	429
Interpretation of the Factor	429
Alignment with the New Approach	429
Whether Any Stage in the Proceeding Was Improper, Vexatious, or Unnecessary, or Taken Through Negligence, Mistake, or Excessive Caution (Rule 147(3)(i))	430
Interpretation of the Factor	430
Alignment with the New Approach	430
Whether the Expense of Having an Expert Witness Was Justified (Rule 147(3)(i.1))	431
Interpretation of the Factor	431
Alignment with the New Approach	431
Any Other Matter Relevant to Costs (Rule 147(3)(j))	431
Interpretation of the Factor	431
Alignment with the New Approach	434
Summary of the Court's Recent Approach to Costs Awards	434
The Use of Costs Awards To Move Toward a More Efficient Tax Dispute Resolution System	435
A Better Approach	435
Recognizing the Uniqueness of Tax Litigation	435
Emphasizing the New Purposes of Costs Awards	437

INTRODUCTION

Traditionally, in a general civil litigation context, costs have been awarded only to partially indemnify a party for legal and other costs incurred to defend an unproven claim or pursue a valid legal right.¹ However, more recently, Canadian courts have recognized that the traditional view of costs is outdated.² Instead, in addition to the partial indemnification objective, courts now use costs as a means to influence the way the parties conduct themselves and to promote efficient administration of the justice system by, for example, encouraging settlement and deterring abuse of the court's process.³ Modern jurisprudence has recognized that courts generally have broad discretion in awarding costs and that various factors militate in favour of increased awards to achieve these new objectives.

Costs awards at the Tax Court of Canada have generally followed a similar path of development, but at a slower pace. Historically, the Tax Court took a rigid approach to awarding costs. In general, costs were awarded only in accordance with

1 See, for example, *British Columbia (Minister of Forests) v. Okanagan Indian Band*, 2003 SCR 71, at paragraphs 19-20; and *Somers v. Fournier*, 2002 CanLII 45001 (ONCA), at paragraphs 16-17.

2 *Okanagan*, supra note 1, at paragraphs 22-26.

3 *Ibid.*, at paragraph 25; and *Somers*, supra note 1, at paragraph 16.

the tariff annexed to the Tax Court of Canada Rules (General Procedure)⁴ unless “reprehensible, scandalous, or outrageous conduct”⁵ was present. More recently, however, Tax Court judges have expressed concerns about the inadequacy of the tariff. These concerns have led the court to adopt an approach to costs similar to that used in modern general civil litigation. In *Velcro*, Rossiter ACJ made it clear that exceptional circumstances are not required to justify a deviation from the tariff.⁶ Rather, he emphasized the court’s broad authority to award costs, and observed that such awards should be made on a principled basis after consideration of the 11 factors set out in rule 147(3) (“the 147(3) factors”).⁷ The tariff is merely a reference point, and the court is under no obligation to refer to it in awarding costs.⁸

With the adoption of this new approach to awarding costs by the Tax Court, the manner in which the 147(3) factors are interpreted and taken into account has become increasingly important. While costs awards are generally fact-dependent, a review of the recent costs awards jurisprudence provides useful guidance on the court’s application of the 147(3) factors and the weight given to those factors.

Despite the development of the Tax Court awarding costs on a principled basis, tax practitioners should consider whether the court’s approach could evolve to further promote the new objectives of costs awards articulated by the Supreme Court of Canada⁹ (discussed in the next section). An approach that recognizes the unique aspects of tax litigation could promote the more efficient resolution of tax disputes.¹⁰

THE NEW APPROACH TO COSTS AWARDS

The traditional objective of a costs award was to indemnify the successful party for the legal and other costs incurred to defend an unproven claim or pursue a valid legal right. In *Okanagan*, the Supreme Court of Canada recognized that the objective of costs awards is no longer focused solely on the indemnification of the successful party, and in some circumstances it is not even the primary purpose.¹¹ Instead, courts now use costs awards more broadly as an “instrument of policy” to

4 SOR/90-688a, as amended (herein referred to as “the rules”), schedule II. Unless otherwise stated, references to rules in this article are to these rules.

5 See *Velcro Canada Inc. v. The Queen*, 2012 TCC 273, at paragraph 6, citing *Young v. Young*, [1993] 4 SCR 3. See also *IPAX Canada Ltd. v. The Queen*, 2011 TCC 50.

6 *Velcro*, supra note 5, at paragraph 6.

7 *Ibid.*, at paragraphs 8-9.

8 *Ibid.*, at paragraph 10.

9 For example, using costs awards to further encourage settlement and to discourage unreasonable conduct.

10 See the discussion below under the heading “The Use of Costs Awards To Move Toward a More Efficient Tax Dispute Resolution System.”

11 *Okanagan*, supra note 1, at paragraph 22.

promote the “efficient and orderly administration of justice.”¹² In particular, costs awards may be used to encourage settlement and to discourage conduct that is unreasonable or vexatious, or that increases the duration and cost of the litigation process.¹³

The use of costs awards is not limited to achieving the new purposes emphasized in *Okanagan*. Canadian jurisprudence has held that the principles articulated in *Okanagan* are not confined to the specific situations referred to in that case and are merely illustrative of the modern approach to costs.¹⁴ In view of this judicial acknowledgment, the new approach to costs is likely to further evolve to advance and encourage the efficient and orderly administration of justice. In the general civil litigation context, arguably there is now an emphasis on using costs as a means to facilitate access to justice by awarding interim costs,¹⁵ taking into consideration any significant disparity of financial resources between the parties,¹⁶ and generally trying to discourage the commencement or continuance of doubtful cases or defences.¹⁷ In the Tax Court context, it is reasonable to expect that the court will continue, or should evolve, to recognize similar policy objectives and also other considerations that exist only in the realm of tax litigation.

THE 147(3) FACTORS

Rule 147(3) sets out 11 factors that the court may consider in awarding costs. In this section, we provide an overview of how each of the 147(3) factors has been interpreted and applied by Tax Court judges in determining whether an award of costs in excess of the tariff is warranted. We also discuss how each factor can be applied to promote the efficient and orderly administration of justice in a tax litigation context.

The Result of the Proceeding (Rule 147(3)(a))

Interpretation of the Factor

In circumstances where a party to a Tax Court proceeding is wholly successful, it would be reasonable to assume that rule 147(3)(a) generally should weigh in favour of an increased award of costs. However, complete success by a party, in and of itself, is not a guarantee of an increased costs award.¹⁸ Some jurisprudence has viewed the

12 Ibid., at paragraph 25.

13 Ibid., at paragraphs 22-25.

14 *Sawridge Band v. Canada*, 2006 FC 656, at paragraph 58.

15 See, for example, *Okanagan*, supra note 1.

16 See, for example, *Currie v. Taylor*, 2013 BCSC 1071, at paragraphs 65-67.

17 See, for example, *Catalyst Paper Corporation v. Companhia de Navegação Norsul*, 2009 BCCA 16, at paragraph 16.

18 See, for example, *Walsh v. The Queen*, 2010 TCC 125, at paragraph 5.

result of the proceeding as justifying an increased award of costs only if the possibility existed that a party might have had mixed success in the proceeding. That is, if the proceeding involved only one issue that was black or white, such that there was no opportunity for partial success, the fact that a party succeeded on that issue should not justify an increased costs award. However, if a proceeding involved a number of different issues and a party has mixed results, the degree of the party's overall success will be relevant in awarding costs.¹⁹

Other jurisprudence has instead viewed success in the proceeding "more as a gatekeeping factor than a significant reason itself for increased costs."²⁰ In other words, success at trial generally is a prerequisite for a litigant to be entitled to costs, but it is the application of the other 147(3) factors that will determine the quantum of the costs award. Accordingly, when a litigant is wholly successful, a closer examination of the other factors in rule 147(3) is required to determine whether an award in excess of the tariff is justified.²¹

There can be circumstances where the other 147(3) factors may outweigh a litigant's success at trial and lead the court to conclude that no costs will be awarded. For example, in *Benedict*,²² the court refused to award costs to the taxpayer, even though he had been wholly successful at trial, on the basis that the matter in dispute might have been settled without a hearing if the taxpayer had provided supporting documentation in a timely manner, rather than shortly before the hearing commenced.²³

Given the complexities of tax law and the fact-driven nature of most tax appeals, it is common for multiple issues to be before the court. As a result, parties are often only partially successful at trial. Case law has considered the threshold of what constitutes "success" and the related costs award consequences. In particular, jurisprudence related to rule 147(3)(a) has held that success should not be determined on the basis of the outcome of each individual issue or argument, and costs

19 See, for example, *2078970 Ontario Inc. v. The Queen*, 2018 TCC 214, at paragraphs 9-11. The approach articulated in *2078970 Ontario* was supported in *Loblaw Financial Holdings Inc. v. The Queen*, 2018 TCC 263, at paragraph 7, and *Cameco Corporation v. The Queen*, 2019 TCC 92, at paragraph 11; under appeal to the Federal Court of Appeal.

20 *Daishowa-Marubeni International Ltd. v. The Queen*, 2013 TCC 275, at paragraph 7. This decision was made by the Tax Court following the Supreme Court of Canada's direction that the taxpayer was entitled to costs throughout the appeals proceedings from the lowest court up to and including the highest court, where the taxpayer was wholly successful.

21 *Daishowa-Marubeni*, supra note 20, at paragraph 7.

22 *Benedict v. The Queen*, 2012 TCC 174.

23 *Ibid.*, at paragraph 24. See also *Heaney v. The Queen*, 2011 TCC 429, where a taxpayer was awarded no costs despite being partially successful. The Tax Court was critical of the taxpayer's decision to call a witness who purported to remember a payment to the Canada Revenue Agency (CRA) that clearly had never been made. The court held that such conduct unnecessarily prolonged the trial and added complexity to the appeal.

should not be allocated on such bases.²⁴ Rather, in the context of partial success, it is the outcome of the proceeding as it relates to the overall amount in issue that determines whether and how costs will be awarded.²⁵ If the success of the proceeding is divided, such that one party did not obtain a better outcome than the other relative to the overall amount in issue, an award of costs may not be warranted absent compelling factors in favour of an award.²⁶

Alignment with the New Approach

The concept of indemnifying the successful party to a proceeding has traditionally been viewed as the most fundamental principle in the awarding of costs.²⁷ As the Tax Court's approach to costs awards evolves, it is possible that the indemnification objective may be given less weight in favour of other more "modern" objectives, such as discouraging unreasonable conduct. However, in our view, the result of the proceeding should remain as the gatekeeper to an award of costs, meaning that this factor should determine a litigant's entitlement to costs, but it should not affect the quantum of the award. Rather, the amount of the award should be determined on the basis of the other 147(3) factors. In this way, the Tax Court's approach to costs may be augmented without jeopardizing the traditional objective of indemnifying the successful party.

The Amounts in Issue (Rule 147(3)(b))

Interpretation of the Factor

There appear to be several conflicting interpretations of the amounts in issue factor in the jurisprudence. In some cases, this is considered to be a leading factor in determining costs awards because the amounts in issue often affect the time and resources that a party will dedicate to a tax dispute. In particular, where the amounts in issue are large, the legal issues and facts are often complex and may result in lengthier

24 In *Kruger Incorporated v. The Queen*, 2016 TCC 14; rev'd 2016 FCA 186, the Tax Court recognized that there was no rule that prohibited the court from distributing costs between the parties on the basis of the outcome of particular arguments; the court therefore awarded costs to each party on a distributive basis reflecting each party's degree of success. However, the taxpayer was wholly successful on appeal and was awarded costs in respect of both court hearings. The decision of the Federal Court of Appeal in effect reversed the prior distributive costs award; however, the court did not comment on the Tax Court's distributive approach.

25 See, for example, *Rio Tinto Alcan Inc. v. The Queen*, 2016 TCC 258, at paragraph 8; *Henco Industries Limited v. The Queen*, 2014 TCC 278, at paragraph 4; *Klemen v. The Queen*, 2014 TCC 369, at paragraphs 9-11; *Otteson v. The Queen*, 2014 TCC 362, at paragraphs 14-15; *SWS Communication Inc. v. The Queen*, 2012 TCC 114; and *General Electric Capital Canada Inc. v. The Queen*, 2010 TCC 490, at paragraph 31.

26 See, for example, *Pirart v. The Queen*, 2016 TCC 291.

27 Mark Orkin, *The Law of Costs*, 2d ed., vol. 1 (Aurora, ON: Canada Law Book) (looseleaf), at 2-62.6.

proceedings, thus justifying an increased award.²⁸ On the other hand, at least one Tax Court decision has held that the amounts in issue are merely one factor to be considered among all of the factors in rule 147(3).²⁹

The jurisprudence to date is unclear on how this factor should be interpreted and applied. Some decisions have awarded increased costs solely on the basis of the amounts in issue,³⁰ whereas other decisions have held that the amounts in issue must be contextualized.³¹ For example, in *Daishowa*,³² Miller J held that the \$14 million of tax in issue did not justify an award of increased costs when it was placed in context. That context included the following facts: (1) the amount of tax in issue was approximately 6 percent of the proceeds of the transaction in issue at trial; (2) the tax consequences resulting from the transaction were minimal; and (3) the appellant operated a multimillion-dollar business.³³ In arriving at his conclusion, Miller J expressed his reservations about the application of the amounts in issue factor to large corporations: “So, what is a significant amount in this regard—a small business facing a \$100,000 tax bill that could bankrupt it, or a large multi-national organization, bringing a case based on principle, regardless of the numbers?”³⁴

Counsel in at least one case subsequent to *Daishowa* has attempted to rely on Miller J’s comments on rule 147(3)(b) to argue that a large corporate taxpayer should not be entitled to increased costs. In *Invesco*, the Crown, citing *Daishowa*, asked Campbell J to take judicial notice of the fact that the amount of goods and services tax (GST), interest, and penalties in issue (a total of approximately \$24 million) was nominal compared to the overall revenue and assets of the appellant and, as a result, increased costs were not justified.³⁵ Relying in part on the interpretation of rule 147(3)(b) in *Daishowa*, he concluded that this factor only slightly favoured increased costs to the taxpayer after the amounts in issue were considered in context. However, he appears to have tempered the *Daishowa* observation about the application of rule 147(3)(b) to large corporations with the following statement: “I do not believe that the size of the corporation alone can be used to completely undermine the significance of an assessment of almost \$25,000,000 in GST and approximately

28 See, for example, *Kruger*, supra note 24 (TCC), at paragraphs 14–15.

29 *Otteson*, supra note 25.

30 See, for example, *Repsol Canada Ltd. v. The Queen*, 2015 TCC 154, at paragraph 13; *Standard Life Assurance Company of Canada v. The Queen*, 2015 TCC 138, at paragraph 16; and *General Electric*, supra note 25, at paragraph 32.

31 See, for example, *Alta Energy Luxembourg SARL v. The Queen*, 2018 TCC 235, at paragraphs 16–18, where the court stated that the amount in issue must be contextualized, but that it is not appropriate to contextualize an amount by looking beyond the taxpayer to its investors or shareholders.

32 *Daishowa*, supra note 20.

33 *Ibid.*, at paragraph 8.

34 *Ibid.*

35 *Invesco Canada Ltd. v. The Queen*, 2015 TCC 92, at paragraph 10.

\$10,000,000 in interest and penalties.”³⁶ Additionally, Campbell J made it clear that if the amounts in issue are of particular importance to a taxpayer, insofar as they influence the manner in which it may conduct its business in the future, then increased costs could be justified under other factors in rule 147(3).³⁷

On the basis of the current jurisprudence, it is unclear how the amounts in issue factor should be interpreted and applied in any given circumstance. Given the conflicting views outlined above, there is an opportunity for a winning party to argue in favour of an increased costs award either solely on the basis of the amount in issue or on the basis of contextualization of the amount in issue relative to the party's business or circumstances. However, it is arguable that where a large amount is in issue, the more reasonable approach is for the analysis to focus more on other 147(3) factors that are likely to be inherent in such a case. For example, generally a case where a large amount is in issue is likely to involve a greater volume of work than a case where a smaller amount is in dispute. Accordingly, in our view, a submission on costs should not focus too heavily on the amounts in issue in attempting to justify an increased costs award, but instead this factor should be used to inform or complement the application of other 147(3) factors.

Alignment with the New Approach

While the amount in issue in a particular case may support an argument for an increased costs award, placing too much emphasis on this factor may risk alienating the consideration of other 147(3) factors and may undermine the new objectives of costs awards.³⁸ The amounts in issue should help to inform the application of other 147(3) factors but should not dictate the quantum of a costs award. For example, in a circumstance where the disputed amounts are relatively insignificant, a significant costs award against the losing party should not be precluded if that party engaged in unreasonable conduct. In that regard, costs awards can be a useful policy tool to discourage inappropriate conduct and deter parties from advancing dubious claims.

The Importance of the Issues (Rule 147(3)(c))

Interpretation of the Factor

It is reasonable to assume that a taxpayer who appeals a reassessment to the Tax Court would consider the issues before the court to be of significant importance. However, the court has indicated that a broader perspective is required to determine the application of this factor.³⁹ In particular, the resolution of the issues must

36 Ibid., at paragraph 11.

37 Ibid.

38 C. Hunter, “Costs Immunity: Banishing the ‘Bane’ of Costs from Public Interest Litigation” (2013), *The Advocate*, vol. 7, part 1, at 199. Martin Twigg, “Costs Immunity: Banishing the ‘Bane’ of Costs from Public Interest Litigation” (2013) 36:1 *Dalhousie Law Journal* 193–238, at 199.

39 *Grimes v. The Queen*, 2017 TCC 113, at paragraph 28; and *Klemen*, supra note 25, at paragraph 18.

have some significance to “the development of tax law, to the public interest or to a broad number of people”⁴⁰ for this factor to favour an increased costs award. Where a court considers for the first time the interpretation of a particular provision,⁴¹ a case from a higher court,⁴² or the application of a legal test in a novel context,⁴³ an increased costs award may be justified. Similarly, a high level of interest in a case among stakeholders in a particular industry⁴⁴ or members of the national or international tax community⁴⁵ could favour an increased award. For example, in *General Electric*, Hogan J considered the fact that the trial decision was the subject of a large number of articles published in Canada and around the world to be an indication of the importance of the transfer-pricing issues addressed in the case.⁴⁶

Other indicators that an issue may be sufficiently important to justify an increased costs award have been held to include the following:

1. The matter in dispute gave the court an opportunity to provide guidance on when an uncommon result may be obtained, such as determining whether an amount is a non-taxable receipt.⁴⁷
2. The case was concerned with the interpretation of contracts.⁴⁸
3. The issue warranted a considerable investment of time by counsel in preparing the case.⁴⁹
4. Novel arguments presented for the court’s consideration were viewed as having precedential value for other similar cases.⁵⁰

40 *Wolsey v. The Queen*, 2017 TCC 34, at paragraph 6. See also *MacDonald v. The Queen*, 2018 TCC 55; rev’d on a substantive issue 2018 FCA 128, leave to appeal to the Supreme Court of Canada granted March 21, 2019. As the Tax Court observed in *MacDonald*, “[i]mportance is not viewed from the perspective of the Appellant but from a legal point of view”: *ibid.* (TCC), at paragraph 76.

41 *Standard Life*, *supra* note 30, at paragraph 16; and *General Electric*, *supra* note 25, at paragraph 32.

42 *Invesco*, *supra* note 35, at paragraph 15; and *Velcro*, *supra* note 5, at paragraph 24.

43 *Velcro*, *supra* note 5, at paragraph 24.

44 See, for example, *CIT Group Securities (Canada) Inc. v. The Queen*, 2017 TCC 86, at paragraph 12; *Invesco*, *supra* note 35, at paragraph 14; *Standard Life*, *supra* note 30, at paragraph 16; and *Daisbowa*, *supra* note 20, at paragraph 15.

45 *Velcro*, *supra* note 5, at paragraph 24.

46 *General Electric*, *supra* note 25, at paragraph 32.

47 See, for example, *Henco*, *supra* note 25, at paragraph 9. In *Henco*, the court weighed the fact, *inter alia*, that it is rare for a receipt to qualify as a non-taxable receipt as an indication that the issue in question was important.

48 *Ibid.*, at paragraph 10.

49 *Ibid.*, at paragraph 11.

50 *Otteson*, *supra* note 25, at paragraph 21.

5. The case involved the application of the general anti-avoidance rule (GAAR).⁵¹

Not surprisingly, a decision that is based primarily on findings of fact generally should not be considered to weigh in favour of an increased costs award.⁵² Similarly, the need to use a textual, contextual, and purposive interpretation to understand complicated provisions of the Income Tax Act,⁵³ in and of itself, should not increase the importance of an issue before the court, because “it is the role of [the] Court to interpret complex legislation.”⁵⁴

Alignment with the New Approach

Consideration of the importance of the issue may present the Tax Court with an opportunity to apply broader principles of access to justice. Where the issue is of significance to Canadian taxpayers as whole, the court should consider moving beyond traditional principles in the awarding of costs. This approach has been recognized as important in other litigation contexts, including civil public interest litigation.⁵⁵ The decision on the awarding of costs can be used to ensure that a particular taxpayer does not bear the entire financial burden of litigating an issue of acknowledged societal interest, and can provide some comfort to other taxpayers who may otherwise be deterred from pursuing their claim. The court could rely on this factor, in appropriate circumstances, to award much higher costs to a successful taxpayer or to limit an award of costs against an unsuccessful taxpayer.⁵⁶

Any Offer of Settlement Made in Writing (Rule 147(3)(d))

Interpretation of the Factor

Settlement offers play a large role in how costs are awarded. The prospect of settling a tax appeal prior to trial, and consequently reducing the related legal fees, encourages parties to “evaluate the strength of their respective cases and to consider settlement at an early stage.”⁵⁷ Rules 147(3.1) through (8) (“the settlement

51 *Spruce Credit Union v. The Queen*, 2014 TCC 42, at paragraph 38. GAAR is contained in section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the ITA”).

52 *ACSIS EHR (Electronic Health Record) Inc. v. The Queen*, 2016 TCC 50, at paragraph 13.

53 ITA, *supra* note 51.

54 *Repsol*, *supra* note 30, at paragraph 13.

55 *Okanagan*, *supra* note 1, at paragraphs 27-28.

56 In *B. (R.) v. Children's Aid Society of Metropolitan Toronto*, [1995] 1 SCR 315, the Supreme Court of Canada recognized that costs could be ordered against the successful party. This decision was cited with approval in *Okanagan*, *supra* note 1, at paragraph 30.

57 *Ike Enterprises Inc. v. The Queen*, 2017 TCC 160, at paragraph 15.

rules”) essentially⁵⁸ establish a default entitlement of substantial indemnity (defined as 80 percent of solicitor and client costs)⁵⁹ after the date of a settlement offer where the party who has made the offer goes on to obtain a judgment as favourable as, or more favourable than, the terms of the offer. Settlement offers are also considered to be important in the awarding of costs apart from the application of the settlement rules. Generally, settlement offers are given considerable weight in determining to whom and in what quantum costs should be awarded.

Although a settlement offer is one of the more important factors,⁶⁰ it remains only one among many, and it cannot be considered in isolation. Nevertheless, a settlement offer can be the focal point of a costs award.⁶¹ In addition to emphasizing the importance of encouraging settlements, the Tax Court has held that

1. a settlement offer that cannot be agreed to and that contains conditions that are not under appeal should not affect a costs award;⁶²
2. the absence of a settlement offer may operate as a negative factor and result in a lower costs award than may otherwise be granted;⁶³ and
3. a settlement offer must contain an element of compromise.⁶⁴

Where the settlement rules do not apply, a settlement offer can still be recognized and relied on by the court in awarding costs in excess of the tariff. If a settlement offer is made but is not equal to or better than the result at trial, the court may nevertheless award increased costs to the successful party.⁶⁵ Further, where the settlement rules are triggered, this factor may remain relevant in determining the costs that should be awarded for the time leading up to the date of the settlement offer.⁶⁶ That view, however, can be contrasted with Miller J’s comments in *Repsol* noting that this factor is not relevant where there is a settlement that qualifies for the settlement rules.⁶⁷ Thus, it is not yet clear how this factor interacts with the settlement rules, but it should remain relevant given the court’s broad discretion in awarding costs.

58 A detailed discussion of the settlement rules is beyond the scope of this article.

59 Rule 147(3.5).

60 *Barrington Lane Developments Limited v. The Queen*, 2010 TCC 476, at paragraph 13; and *Daishowa*, supra note 20, at paragraph 18.

61 *Potash Corporation of Saskatchewan Inc. v. Canada*, 2012 TCC 235, at paragraph 53.

62 *Pirart*, supra note 26, at paragraphs 15-23. The settlement offer at issue in this case was made on the Thursday prior to the commencement of the trial on the following Monday.

63 *Rio Tinto*, supra note 25, at paragraph 19. The court acknowledged that this finding did not fall strictly within the settlement rules, which determine the costs consequences where a settlement offer is rejected.

64 *McKenzie v. The Queen*, 2012 TCC 329, at paragraph 11.

65 *Klemen*, supra note 25, at paragraphs 20-23.

66 See, for example, *Standard Life*, supra note 30, at paragraph 16.

67 *Repsol*, supra note 30, at paragraph 13.

Alignment with the New Approach

When the settlement rules were introduced, rule 147(3)(d) was not removed; accordingly, it is reasonable to assume that this factor continues to be significant and should be given weight when it is appropriate to do so. Despite Miller J's comments in *Repsol*, a settlement offer should be a relevant consideration in determining the quantum of a costs award up to the date of the settlement offer (after which the settlement rules may apply). The existence of an offer should weigh in favour of a higher costs award amount for the pre-settlement offer period.

Further, even settlement offers that do not qualify for the settlement rules should play a role in determining costs. Where a settlement offer is made and the offeror ultimately obtains a judgment less favourable than the terms of the offer, in certain circumstances the offer should be taken into account. Consider a situation where the offeror is the successful party at trial but receives a costs award that is slightly less than the proposed settlement amount. Perhaps the difference is such that the resources required to take the matter to trial are not justified. This is a more flexible approach that recognizes the resources and other inputs required for tax litigation in the context of the offer and the outcome. Assume, for example, that the Canada Revenue Agency (CRA) assesses the taxpayer for \$1,000 and the taxpayer makes an offer to settle for \$100. The Crown does not accept the offer, and the dispute proceeds to trial. At trial, the taxpayer is found liable for \$125. In this circumstance, the settlement offer would not result in a substantial indemnity settlement under the settlement rules. However, the offer is much closer to the final result than the amount originally assessed by the CRA. Although the taxpayer will not be entitled to a substantial indemnity, arguably she should not be limited to costs in accordance with the tariff. Such a situation illustrates why settlement offers that fall outside the settlement rules should be relevant in awarding costs. Assessing the merits of a settlement offer is not a science, and where there is a successful outcome relative to the reassessment under appeal, the offeror should, absent other mitigating factors, receive a higher costs award.

The Volume of Work (Rule 147(3)(e))

Interpretation of the Factor

Determining the amount of work that counsel has undertaken in preparing for and engaging in the conduct of the trial is largely a subjective and individualized process.⁶⁸ There is no regular standard by which a court can assess a party's level of work. However, there is a limit to the volume of work that one side can expect the other to pay for.⁶⁹

In determining whether this factor justifies an increased costs award, the jurisprudence indicates that the court generally gauges the volume of work that was

68 As noted in *Henco*, supra note 25, at paragraph 13, measuring the volume of work is "more art than science."

69 *Daishowa*, supra note 20, at paragraph 22.

“necessary” in the context of the other 147(3) factors⁷⁰ as well as additional considerations, including the following:

1. the number of issues before the court;⁷¹
2. the novelty of the arguments made at trial;⁷²
3. the number of documents and authorities produced at trial;⁷³
4. the number of taxation periods at issue;⁷⁴
5. the need to translate documents;⁷⁵
6. the use of and need for experts;⁷⁶
7. the interpretation of foreign law;⁷⁷
8. the need to research economic policy and legislative history;⁷⁸ and
9. a significant increase in the volume of work owing to the Crown’s reliance on an allegation of sham.⁷⁹

The particular reason or reasons for an increased volume of work can validate or neutralize the weight given to this factor in determining whether increased costs are justified. For example, in *Klemen*, the volume of work was held not to weigh in favour of increased costs because the amount of work required was increased by the taxpayer’s lack of documentation and poor communication with his counsel.⁸⁰ Similarly, in *Ford Motor Company*, the Crown’s failure to file written submissions, as it had committed to do in a case management conference, caused the taxpayer to be prepared to address all possible arguments that could have resulted from a notice of motion, regardless of the likelihood that those arguments would be raised.⁸¹ The court held that this failure on the part of the Crown lengthened the proceeding and weighed in favour of increased costs.⁸²

70 See, for example, *Grimes*, supra note 39, at paragraphs 32-38; *Repsol*, supra note 30, at paragraph 13; and *Vélcro*, supra note 5, at paragraph 24.

71 *Standard Life*, supra note 30, at paragraph 16.

72 *Otteson*, supra note 25, at paragraph 24.

73 *Standard Life*, supra note 30, at paragraph 16; and *Invesco*, supra note 35, at paragraph 17.

74 *Invesco*, supra note 35, at paragraph 17.

75 *Sommerer v. The Queen*, 2011 TCC 212, as referenced in *Daishowa*, supra note 20, at paragraph 23.

76 *Grimes*, supra note 39, at paragraph 34; *Repsol*, supra note 30, at paragraph 13; and *Sommerer*, supra note 75.

77 *Sommerer*, supra note 75, as referenced in *Daishowa*, supra note 20, at paragraph 23.

78 *Repsol*, supra note 30, at paragraph 13.

79 *Cameco*, supra note 19, at paragraph 26.

80 *Klemen*, supra note 25, at paragraph 25.

81 *Ford Motor Company of Canada Limited v. The Queen*, 2015 TCC 185, at paragraphs 18-19.

82 *Ibid.*, at paragraph 19.

However, where the reason for an increased workload is the result of general litigation tactics employed by one side, it is unlikely that such considerations will weigh in favour of increased costs. In *Henco*, the taxpayer argued that the volume of work was significant as a result of the Crown “not agreeing to allow extrinsic evidence, not conducting a more in depth audit, refusing to produce certain documents and refusing to admit press releases.”⁸³ Such factors were not given any weight in the court’s conclusion that the volume of work was considerable. Instead, the court stated that such tactics “are within the normal thrust and parry of litigation.”⁸⁴

Alignment with the New Approach

Rule 147(3)(e) cannot be considered in isolation. An increased volume of work logically increases the costs incurred by a litigant. However, placing too much weight on the volume of the workload could result in a litigant being rewarded for redundant or even unnecessary work. Additionally, not all work incurred by a party should favour a higher costs award. Putting undue weight on this factor could result in the court spending more time trying to discern how much of counsel’s work was necessary and not redundant. Such an exercise could impose an additional burden on a judicial system that is already under strain. Ultimately, a particularly large volume of work should inform a costs award, but the decision should be balanced by the court’s understanding of the amount of work that is reasonable in the circumstances.

The Complexity of the Issues (Rule 147(3)(f))

Interpretation of the Factor

Under the traditional approach, the Tax Court generally gave little, if any, consideration to the complexity of the issues as a factor in the awarding of costs. As Bowman J stated in *Continental Bank of Canada*, complexity and specialization are generally present in any tax litigation.⁸⁵ Therefore, there appeared to be no justification for awarding increased costs on this basis.

As noted above, the Tax Court no longer takes such a rigid approach in awarding costs. It now recognizes the impact that the complexity of an issue can have on the costs incurred by a party.⁸⁶ This factor acknowledges that complex appeals often involve more documentation, a longer discovery process, and more time to prepare for trial than is typical in simpler tax cases.⁸⁷

83 *Henco*, supra note 25, at paragraph 14.

84 *Ibid.*

85 *Continental Bank of Canada v. The Queen*, [1994] T.C.J. no. 863, at paragraph 9.

86 *Blackburn Radio Inc. v. The Queen*, 2013 TCC 98, at paragraphs 14–15.

87 See, for example, *Invesco*, supra note 35, at paragraph 17.

Because tax appeals are often fact-driven, it can be difficult to predict how the Tax Court will characterize the complexity of an issue in a particular circumstance. However, several general principles can be distilled from the jurisprudence. For example, although an issue may be novel or unique, that characterization, in and of itself, does not necessarily mean that the issue is complex.⁸⁸ Nevertheless, in the absence of prior precedential decisions on an issue, the court may be inclined to find that the issue is complex.⁸⁹ In most cases, the court will look to a number of considerations to determine the complexity of the issue. Issues may be characterized as complex where they require the court to consider the evidence of experts from a variety of specialized fields,⁹⁰ the evolution of an area of law⁹¹ or economic policy,⁹² or an interpretation of certain legislation that requires a textual, contextual, and purposive analysis.⁹³ Moreover, even when the issues may not be complex, an increased award of costs may be justified in circumstances where the facts are complex. For example, in *Velcro*, determining the true beneficial owner of certain royalty payments was a relatively straightforward issue; however, the court gave some weight to this factor because the case involved various complex agreements, all of which contained provisions that could affect the determination of who was the beneficial owner of the royalties.⁹⁴

In recent years, the court has commented on the general degree of complexity of a number of issues, including the following:

1. Capital versus income is not unduly complicated.⁹⁵
2. The family farm partnership rules⁹⁶ involve some complexity, even considered in the context of straightforward facts.⁹⁷
3. The characterization of a payment and the determination of the related income tax consequences, such as the deductibility of a dividend, are quite complex.⁹⁸

88 *H.B. Barton Trucking Ltd. v. The Queen*, 2009 TCC 472, at paragraph 7; and *Jolly Farmer Products Inc. v. The Queen*, 2008 TCC 693.

89 *General Electric*, supra note 25, at paragraph 34.

90 *Ibid.*, at paragraph 34.

91 *Spruce Credit Union*, supra note 51, at paragraph 45.

92 *Repsol*, supra note 30, at paragraph 13.

93 *Standard Life*, supra note 30, at paragraph 16.

94 *Velcro*, supra note 5, at paragraphs 24 and 28.

95 *Henco*, supra note 25, at paragraph 7.

96 ITA subsections 110.6(1), (2), and (3).

97 *Otteson*, supra note 25, at paragraphs 25-26.

98 *Spruce Credit Union*, supra note 51, at paragraph 45. The additional complexity of this issue was partly attributable to the Crown's argument that an amount legally declared and paid as a dividend was not a dividend for the purposes of the ITA.

4. The interpretation of the regulations governing certain capital cost allowance classes can be complex.⁹⁹
5. The interpretation of transfer-pricing provisions of the ITA (which had not previously been interpreted) and their application to highly factual circumstances (which resulted in 65 days of evidence and involved the reports and testimony of eight expert witnesses) have been characterized as being complex.¹⁰⁰

Alignment with the New Approach

Complexity of the issues should continue to be given significant weight in awarding costs. Defining complexity will be difficult and subjective unless there is a clearer conceptualization from the Tax Court as to what constitutes a complex legal issue. Until then, complexity will be, to some extent, in the eye of the beholder (notably, the judge hearing the case). It does, however, seem clear that this factor should take into account both complex issues of legal interpretation and complex facts.

The Conduct of Any Party That Unnecessarily Affected the Duration of the Proceeding (Rule 147(3)(g))

Interpretation of the Factor

Within the overall trend of awarding costs in excess of the tariff on the basis of the 147(3) factors, a general theme appears to have emerged in recent years, as evidenced by cases in which the Tax Court has placed significant weight on the conduct of the parties.¹⁰¹ The court has specifically acknowledged that costs are “an important tool in the hands of the court to influence the way the parties conduct themselves and to prevent abuse of the court’s process.”¹⁰² However, the court has also acknowledged that a party’s conduct should be clearly unreasonable before this factor is taken into account in the awarding of costs.¹⁰³

While the determination of what is clearly unreasonable depends on the context and the facts of each case, the jurisprudence that has considered this factor has provided some helpful guidance as to what may or may not cross the threshold of reasonability. For example, raising an argument at trial that the court ultimately determines to be unsuccessful generally should not equate to unreasonable conduct, nor should the failure to concede an issue, in and of itself, be unreasonable.¹⁰⁴

⁹⁹ *Repsol*, supra note 30, at paragraph 13.

¹⁰⁰ *Cameco*, supra note 19, at paragraph 28.

¹⁰¹ See, for example, *Ford Motor Company*, supra note 81; and *Standard Life*, supra note 30.

¹⁰² See *Elbadawi v. The Queen*, 2014 TCC 363, at paragraph 9, quoting Orkin, supra note 27, at 2-1; and *Douglas Zeller and Leon Paroian Trustees of the Estate of Margorie Zeller v. The Queen*, 2009 TCC 135, at paragraph 8.

¹⁰³ *Henco*, supra note 25, at paragraph 20.

¹⁰⁴ *Repsol*, supra note 30, at paragraph 13; *Invesco*, supra note 35, at paragraph 19; and *Klemen*, supra note 25, at paragraphs 30-31.

Similarly, “procedural wrangling and [common] litigation tactics,”¹⁰⁵ such as bringing a motion at trial,¹⁰⁶ refusing to settle a motion at trial, or refusing to answer certain questions during discovery,¹⁰⁷ may not be viewed as unreasonable conduct resulting in unnecessary delay.

Conduct is, however, likely to cross the reasonability line when it involves deception, obstruction of the other party’s ability to argue its case, or an abuse of power. For example, in *Standard Life*,¹⁰⁸ the taxpayer engaged in window dressing in an attempt to put itself in the position to argue that it met the legal test for carrying on a business. The court held that such conduct is “reprehensible and should be discouraged,”¹⁰⁹ and weighed this factor in favour of increased costs. In *Bekesinski*,¹¹⁰ although the taxpayer was wholly successful, the court refused to award costs because the taxpayer’s counsel had cherry-picked several excerpts from a case to assert a blatantly incorrect proposition of law.

The court has also used costs awards to express its displeasure with an opportunistic and improper use of a provision against a taxpayer. In *Ford Motor Company*, the court relied, in part, on this factor to justify a costs award of approximately 63 percent of the taxpayer’s legal costs in successfully defending against the Crown’s motion to strike substantial portions of its amended notice of appeal pursuant to the specified corporation rules in the Excise Tax Act.¹¹¹ The court justified the costs award in stating that the Crown was attempting to “use the specified corporation rules opportunistically as a sword and not as the protective shield they were intended and designed to be.”¹¹²

It is well accepted that unreasonable conduct of the parties during a trial will be considered in awarding costs. Pre-trial conduct, on the other hand, may be taken into consideration only in exceptional circumstances when such conduct unduly and unnecessarily prolongs the trial.¹¹³ The determination of what qualifies as an exceptional circumstance is not altogether unclear.

105 *Golini v. The Queen*, 2016 TCC 247, at paragraph 22.

106 *CIT Group Securities*, supra note 44, at paragraph 22.

107 *Golini*, supra note 105, at paragraphs 21–22.

108 *Standard Life*, supra note 30.

109 *Ibid.*, at paragraph 16.

110 *Bekesinski v. The Queen*, 2014 TCC 245.

111 Subsection 301(1.2) of the Excise Tax Act, RSC 1985, c. E-15, as amended (herein referred to as “the ETA”), regarding the contents of a notice of objection. These rules are similar to the large corporation rules in ITA subsection 165(1.11).

112 *Ford Motor Company*, supra note 81, at paragraph 21.

113 See, for example, *E.F. Anthony Merchant v. The Queen*, 2001 FCA 19, at paragraph 7; aff’g 98 DTC 1734 (TCC); *Canada v. Landry*, 2010 FCA 135, at paragraph 24; and *Canada v. Martin*, 2015 FCA 95, at paragraph 18.

Certain cases provide clear examples of pre-trial conduct that qualifies as “exceptional.” For example, in *Merchant*,¹¹⁴ the taxpayer refused to cooperate with the CRA auditor and would not provide receipts for expenses. The court held the taxpayer obstructed the CRA’s ability to perform the tax audit to the point that the merit of the taxpayer’s claim could not be properly verified. The result of the taxpayer’s conduct was that a trial that should have lasted one day took seven days, because the court was forced to use much of its time in discussing factual determinations that could easily have been resolved at the audit stage. As a result, the taxpayer’s pre-trial conduct significantly affected the manner in which the trial proceeded.

In *Scavuzzo*,¹¹⁵ the court awarded approximately 50 percent of the taxpayer’s legal costs, in part, because the CRA had obtained a jeopardy order prior to trial, authorizing it to collect the amount in dispute,¹¹⁶ and had used an affidavit that failed to disclose a key material fact that was adverse to the CRA’s position. The court regarded the manner in which this order was obtained as “high handed and oppressive,”¹¹⁷ stating that “[t]here can be no excuse for putting this elderly sick man [the taxpayer] through hell.”¹¹⁸

In rare cases, such as *Salaision Lévesque*,¹¹⁹ it has been recognized that incorrect or imprecise tax audit work on the part of the CRA may be considered in awarding costs, particularly when a taxpayer has been cooperative in providing the CRA with all requested documentation. In *Salaision Lévesque*, the court observed that the quality of the CRA’s audit work must be impeccable because the CRA has significant human and financial resources, as well as the benefit of far-reaching enforcement powers, and the Crown clearly relies on the findings of the CRA auditor’s investigative work. The court went on to add:

114 *Merchant*, supra note 113.

115 *Scavuzzo v. The Queen*, 2006 TCC 90.

116 In a typical situation, an individual taxpayer does not have to pay an amount in dispute when a notice of objection has been filed (ITA subsection 225.1(2)). However, pursuant to ITA subsection 225.2(2), if the CRA believes that its ability to collect the outstanding amounts will be jeopardized by waiting until the matter is resolved, the CRA can apply to the Federal Court, or to a provincial superior court, without notice to the taxpayer, for authorization to take collection action prior to the resolution of the matter if the judge is satisfied that there are reasonable grounds for doing so.

117 *Scavuzzo*, supra note 115, at paragraph 6.

118 *Ibid.*, at paragraph 9.

119 *Salaision Lévesque inc. v. The Queen*, 2015 TCC 247. See also, for example, *Walsh*, supra note 18, at paragraphs 15–16; and *Myrdan Investments Inc. v. The Queen*, 2013 TCC 168. In *Myrdan*, the taxpayer went to some effort and expense to make documents relevant to the appeals available to the CRA auditor; however, the auditor chose not to review those materials, despite being aware of their existence, and did not respond to the taxpayer’s requests for guidance with respect to additional documents that could assist in the audit process.

With such authority and powers, it is essential and completely fundamental that the quality of the audit work be impeccable and above reproach. In other words, there is no reason or justification that can explain or support work that is incomplete, botched, or shaped by any kind of bias particularly since any reassessment may be the subject of severe penalties with interest.

A trial must not be a fishing expedition allowing auditors to validate their intuition and/or perception. A tax trial requires exorbitant fees and disbursements. That reality often results in dissuading a reasonable person with limited means from challenging a possibly unjustified assessment.¹²⁰

Although there is some precedent for the Tax Court to consider unreasonable conduct at the audit stage, this interpretation should be considered in light of the Federal Court of Appeal's decision in *Martin*.¹²¹ At trial, the Tax Court had awarded costs in excess of the tariff because it found that the CRA auditor had intentionally misled the taxpayer during an audit and had adopted inconsistent positions for different taxation years, and as a result of that conduct, the taxpayer had been forced to incur significant expenses to dispute the matter through the audit, objection, and trial stages.¹²² On appeal, the Federal Court of Appeal acknowledged that pre-trial conduct can be taken into consideration when such conduct unduly and unnecessarily prolongs the trial. However, the court stated that the discretion to consider pre-trial conduct must be exercised within the context of rule 147, which permits the Tax Court to determine the amount of costs of all parties to a "proceeding."¹²³ The term "proceeding" is specifically defined in rule 2 to mean "an appeal or reference." With the context of that definition in mind, the Federal Court of Appeal held that the Tax Court had erred in allowing costs incurred at the objection stage to influence the costs award at trial because such costs were not incurred as part of the proceeding.¹²⁴

While one might consider that the *Martin* decision narrows the scope of this factor when considering pre-trial conduct, it is unclear how the decision interacts with the other 147(3) factors that may be considered in awarding costs. In particular, rule 147(3)(j) permits the Tax Court to consider "any other matter relevant to the question of costs," and, as discussed in further detail below, the related jurisprudence does not limit what the court may consider under that factor.

Alignment with the New Approach

One can expect that conduct of the parties will continue to be a focal point in costs awards. The Tax Court, however, may wish to clarify where the line will be drawn—

120 *Salaisson Lévesque*, supra note 119, at paragraphs 25-26.

121 *Martin*, supra note 113.

122 *Martin v. The Queen*, 2014 TCC 50, at paragraphs 16 and 18.

123 *Martin*, supra note 113, at paragraph 20.

124 *Ibid.*, at paragraph 22.

for example, by more clearly articulating what constitutes unreasonable behaviour that will justify increased costs. Higher costs awards will not only sanction bad behaviour, but also serve as a deterrent that can be clearly understood by litigants and possibly have a positive influence on the conduct of the parties.

The Denial or the Neglect or Refusal of Any Party To Admit Anything That Should Have Been Admitted (Rule 147(3)(h))

Interpretation of the Factor

For rule 147(3)(h) to weigh in favour of increased costs, a party must have refused to admit something that was, at the time of the request to admit, clearly true.¹²⁵ For example, in *Wolsey*,¹²⁶ the court awarded costs against the taxpayer in excess of the tariff because the taxpayer denied receiving certain communications that he clearly had received. As a result, the Crown was forced to spend a significant amount of time at trial proving that the taxpayer had received such communications.

Unlike a question of fact, a failure to admit a matter that is a question of mixed fact and law generally should not be considered in determining whether this factor should weigh in favour of increased costs.¹²⁷

From a strategic perspective, a party may not want to admit a statement of fact where the court does not have the benefit of knowing the context in which it occurred. As stated in *RMM Canadian Enterprises*, generally speaking, once a fact is admitted, no additional evidence regarding that fact may be presented.¹²⁸ For that reason, a party may believe that it may be more effective to call evidence than to agree to a bare statement of the fact in question. That decision is at the discretion of each party and is not one with which the court desires to interfere unless “the decision is patently unreasonable or made for some improper purpose.”¹²⁹

Alignment with the New Approach

Given the potential for this factor to unfairly prejudice litigants, it follows that it should justify higher costs only where the failure to admit a fact is patently unreasonable. Reducing the threshold for this factor to influence a costs award may result in modifying a litigant's behaviour in a manner outside the policy rationale for costs. Litigants should continue to be guided by the pursuit of their best interests in the particular tax litigation and should not be expected to make unwarranted concessions out of concern that higher costs may be awarded against them.

125 *CIT Group Securities*, supra note 44, at paragraph 24.

126 *Wolsey*, supra note 40.

127 *CIT Group Securities*, supra note 44, at paragraph 24.

128 *RMM Canadian Enterprises Inc. et al. v. The Queen*, 97 DTC 420, at 421.

129 *Ibid.*

Whether Any Stage in the Proceeding Was Improper, Vexatious, or Unnecessary, or Taken Through Negligence, Mistake, or Excessive Caution (Rule 147(3)(i))

Interpretation of the Factor

What qualifies as an improper, vexatious, or unnecessary stage in a proceeding will often, but not always, overlap with other factors, such as the conduct of the parties. In *Ford Motor Company*, the Crown's failure to follow through on its commitments to file written submissions, and its opportunistic use of the specified corporation rules, were considered under the factors in rules 147(3)(c) to (g) and given significant weight in the court's award of increased costs against the Crown.¹³⁰

Generally speaking, it should be relatively straightforward to identify a stage in a proceeding that is improper, vexatious, or unnecessary. A failure by a party to properly assess the merits of its case, including its theory of the case and the presence or absence of requisite facts, has been held not to cross the threshold for this factor to apply.¹³¹ Filing voluminous submissions and raising "all arguments that counsel reasonably believes may be relevant to the issues"¹³² also does not cross the required threshold.

Conversely, actions that are of a more egregious nature, or that show a lack of respect for the opposing side, the court, or its processes, may qualify as improper, vexatious, or unnecessary. The Crown's indifference to compliance with its commitments from the case management conference in *Ford Motor Company* illustrates the kind of conduct that can trigger the application of this factor. Similarly, the taxpayer's conduct in *Elbadawi* demonstrates the type of egregious conduct that a court will consider as improper, vexatious, or unnecessary.¹³³ In that case, the taxpayer filed his notice of appeal late, missed deadlines to satisfy undertakings, adjourned a settlement conference, and filed a unilateral application for the time and place of hearing before rescheduling the conference. The court found that the taxpayer merely used the proceedings as a means by which he could gather facts to use in his statement of claim in a civil lawsuit against several CRA officials.

Alignment with the New Approach

In awarding costs, courts should consider promoting access to justice. Using costs to condemn improper, vexatious, or unnecessary actions could be an important tool to ensure that the court's resources are not wasted, thus freeing up time for hearing legitimate appeals. Ensuring access to the Tax Court in a timely manner

130 *Ford Motor Company*, supra note 81. See the discussion in the text above at notes 81-82 and 111-112.

131 *O'Dwyer v. The Queen*, 2014 TCC 90, at paragraphs 22 and 24.

132 *CIT Group Securities*, supra note 44, at paragraph 25.

133 *Elbadawi*, supra note 102, at paragraphs 22 and 26.

breaks down at least one barrier to making the judicial system accessible to taxpayers wishing to assert legitimate challenges of tax reassessments.

Whether the Expense of Having an Expert Witness Was Justified (Rule 147(3)(i.1))

Interpretation of the Factor

Expert fees may be considered in determining costs where the expert's testimony is justified. In order for the expert fees to be justified, the work created by the expert must be of value to the court. For example, value to the court should exist where the expert provides assistance that is necessary for the court to determine an outcome, generally because of the complexity of the issues under appeal.¹³⁴ However, even when experts add value to a proceeding, the court generally places constraints on how much weight this factor may be given in deciding whether to award increased costs. A successful party cannot expect the other party to contribute to its costs of calling an unjustifiable number of experts. Instead, the jurisprudence has held that the number of experts must be reasonable in the circumstances.¹³⁵ Likewise, expert fees must be reasonable. This does not mean that the fees have to be consistent with the initial amount quoted. However, where there is a duplication of efforts by several experts, such fees will be discounted in determining an award of costs.¹³⁶

Alignment with the New Approach

One possible simple approach to this factor would be for the court to include a lump sum for all of the reasonable costs incurred for all necessary expert witnesses. This would align with the Tax Court's approach to expert evidence—namely, that the role of the expert is to provide assistance to the court. Further, this would allow any unreasonable charges, such as first-class flights, to be discounted.¹³⁷

Any Other Matter Relevant to Costs (Rule 147(3)(j))

Interpretation of the Factor

Consistent with the court's broad discretion to award costs in excess of the tariff, the court may consider any other matter relevant to the question of costs in making this determination. While there does not appear to be any limit to other considerations that the court may take into account in awarding costs, provided that the particular consideration is relevant to the appeal before the court, the recent jurisprudence

134 *Grimes*, supra note 39, at paragraph 49.

135 *Ibid.*, at paragraph 50.

136 *CIT Group Securities*, supra note 44, at paragraphs 29 and 33.

137 See *Repsol*, supra note 30, at paragraph 20, where Miller J disallowed almost 80 percent of the cost claimed by the appellants (more than \$9,200) for a business-class flight for a witness called to give evidence at the trial.

illustrates the range and nature of matters that the court has taken into account under this factor.

In *Velcro*, the court recognized that this factor provides the court with broad discretion to consider any other facts that may be relevant to a costs award in a given case. In this regard, the court provided three examples of considerations that could be relevant:

1. the actual costs incurred by a litigant and their breakdown including the experience of counsel, rates charged, and time spent on the appeal;
2. the amount of costs an unsuccessful party could reasonably expect to pay in relation to the proceeding for which costs are being fixed; and
3. whether the expense incurred for an expert witness to give evidence was justified.¹³⁸

The breakdown of the actual costs incurred by a litigant can affect the quantum of costs awarded. In *Invesco*, the court took into account the fact that “the Bill of Costs contained legal fees for five counsel although only two were present in Court.”¹³⁹ While this is not an uncommon scenario, the Crown in *Invesco* relied on this fact to argue that there was likely a duplication of efforts that should not be part of a costs award.¹⁴⁰

An unsuccessful party should provide the court with an indication as to what costs it considers reasonable, and why they are reasonable, if it hopes to successfully argue that a costs award claimed by the opposing party otherwise would exceed the unsuccessful party’s expectations. Without this indication, the losing party will face greater risk of being subject to a higher costs award.¹⁴¹ As part of the indemnification purpose of costs, it is well recognized that, other than in exceptional cases, a losing party will have to pay not only its own costs but also a significant proportion of the opposing party’s costs.¹⁴²

138 *Velcro*, supra note 5, at paragraph 12. These examples identified in *Velcro* were also referred to by the court in *Mariano v. The Queen*, 2016 TCC 161, at paragraph 26. In *Mariano*, the appellant argued that because the appeal was brought under rule 146.1, even though the appellant was not successful at trial each party should bear its own costs. The court held that the fact that an appeal is a lead case (see rule 146.1) can be considered by a court under rule 147(3)(j). However, “in order to constitute special or sounds reasons not to follow the practice of costs following the result, the issues before the Court must transcend the interest of the litigants and be of public interest or there must be misconduct by the successful party”: *ibid.*, at paragraph 40.

139 *Invesco*, supra note 35, at paragraph 23.

140 *Ibid.*

141 *Mariano*, supra note 138, at paragraphs 43-49.

142 *155569 Canada Limited v. 248524 Alberta Ltd.*, 1999 ABQB 394, at paragraph 48 as cited in *Mariano*, supra note 138, at paragraph 46.

The significant power imbalance between litigants in a tax appeal has been considered under this factor. In *Walsb*, the court relied in part on the recognition of this power imbalance in *Jolly Farmer Products*¹⁴³ in its decision to award significant costs against the Crown.¹⁴⁴ In *Walsb*, the taxpayer had made his position clear from the outset of the tax dispute process, and he had provided the CRA with all of the documentation to support his claim. The CRA had performed its own investigation during the audit, and the Crown conducted discoveries once the matter proceeded to the notice of appeal stage. However, at trial, the credibility of the taxpayer and his accountant was not challenged, no new facts were discovered, and no novel arguments were made. As a result, the court held that much of the proceeding could have been avoided if the CRA had paid more attention to the taxpayer's file.¹⁴⁵

Further, a litigant should be able to demonstrate that the cost claimed is essential to the conduct of the proceedings. Recently, in *Jayco*,¹⁴⁶ the taxpayer argued that the interest that it paid on a letter of credit provided to secure its unpaid GST/HST (harmonized sales tax), arising from the assessment, should be recoverable under rule 147(3)(j). The court held that the interest expense was related to the GST/HST that the taxpayer owed and was not related to the taxpayer's appeal (for example, was not a cost of the proceedings before the court).¹⁴⁷ The court also held that the minister's exercise of discretion in respect of collection action¹⁴⁸ is not relevant in determining costs under rule 147(3)(j).¹⁴⁹

The court concluded that the interest could not be recovered as a disbursement because it was not directly connected and essential to the conduct of the proceedings:

The Rules are clear that disbursements will only be awarded if they are essential to the conduct of the proceedings. A party has to establish that the disbursements have arisen inherently and directly from the issues in the appeal. That is not the case here. The interest was not paid by Jayco to establish that the Minister's assessment was incorrect and therefore did not arise from the appeal filed before this Court.¹⁵⁰

143 *Jolly Farmer Products*, supra note 88.

144 *Walsb*, supra note 18, at paragraph 15.

145 *Ibid.*, at paragraph 16.

146 *Jayco, Inc. v. The Queen*, 2018 TCC 239.

147 *Ibid.*, at paragraphs 33-34.

148 For example, in this case, the minister required a letter of credit from the appellant rather than forgoing collection action.

149 *Jayco*, supra note 146, at paragraphs 37-41.

150 *Ibid.*, at paragraph 44.

The court found support for this conclusion in decisions of provincial courts of appeal holding that interest incurred on amounts borrowed to fund litigation is not a disbursement.¹⁵¹

Alignment with the New Approach

The power imbalance recognized in *Jolly Farmer Products* and *Walsh* should continue to inform costs awards, and arguably should do so more frequently. Costs remain one of the few tools available to constrain the CRA and influence the Crown's behaviour. The court should be mindful, as it was in *Jolly Farmer Products* and *Walsh*, that the Crown is not a private party and may have forced the taxpayer to go to court.

Awarding costs more aggressively against the Crown may be the only way to limit this power imbalance and put parties on a more level playing field. This concept is discussed in more detail below under the heading "Recognizing the Uniqueness of Tax Litigation."

SUMMARY OF THE COURT'S RECENT APPROACH TO COSTS AWARDS

The recent jurisprudence reveals a trend toward higher costs awards by the Tax Court.¹⁵² However, perhaps not surprisingly, some inconsistencies and exceptions in the developing case law remain. Because new approach to awards, while principled, remains fact-driven, it is not always possible to reconcile the court's costs awards decisions. The benefit of this new principled approach is that costs awards are no longer formulaic; as a result, the party that is entitled to costs has an opportunity, in appropriate circumstances, to receive a higher award than it would be allowed strictly according to the tariff. The tradeoff is that this individualized and discretionary approach, which requires an analysis of the 147(3) factors in light of the specific facts, results in some greater uncertainty for tax litigants as to the costs that they may be entitled to receive or obligated to pay.

The Tax Court is increasingly recognizing the complexities inherent in tax litigation and is now more often awarding higher costs to help alleviate the accompanying financial burden. Further, the proper use of the court's resources, in the litigating of tax appeals, is continually underscored as a focal point of costs awards, whether through the encouragement of settlement or the penalizing of a party's conduct where it unnecessarily lengthened or complicated the litigation process.

151 Ibid., at paragraph 46, relying on *MacKenzie v. Rogalasky*, 2014 BCCA 446, and *Do v. Sheffer*, 2010 ABQB 422.

152 For example, recently in *Cameco*, supra note 19, the Tax Court awarded the taxpayer \$10.25 million in costs plus disbursements. The quantum itself, relative to other costs awards, seems staggeringly high. However, in our view, the award in *Cameco* aligns with the new approach taken by the Tax Court in applying the 147(3) factors.

In pursuing an award of costs, an emphasis on these two elements is recommended when appropriate.

Ultimately, parties now can expect a greater likelihood of a costs award in excess of the tariff. However, parties to a tax appeal should be prepared to highlight the facts applicable in respect of each of the relevant 147(3) factors to support a departure from the tariff.

THE USE OF COSTS AWARDS TO MOVE TOWARD A MORE EFFICIENT TAX DISPUTE RESOLUTION SYSTEM

A Better Approach

The recent shift in costs awards at the Tax Court is a positive development in bringing the court's approach more closely into line with the progressive and modern policies applied in general civil litigation, as articulated by the Supreme Court of Canada. However, it is arguable that costs awards at the Tax Court could be used more effectively to promote the efficient and orderly administration of justice by (1) taking into consideration the unique features of a tax dispute, and (2) placing additional emphasis on the new purposes of costs awards adopted in general civil litigation.

Recognizing the Uniqueness of Tax Litigation

There are several unique aspects of a tax dispute in Canada that should shape the Tax Court's approach in future decisions on costs awards. For example, in contrast to general civil litigation, where the initiating party (for example, the plaintiff) must prove the facts of its case, the CRA has broad scope to assume facts in issuing an assessment or reassessment of a taxpayer.¹⁵³ The taxpayer must then disprove the assumptions of fact in order to defeat the assessment or reassessment. While this reverse onus allows Canada's self-assessment tax system to function properly, it can create a formidable hurdle for taxpayers, the financial consequences of which can be significant, particularly when a CRA auditor or appeals officer has adopted a patently unreasonable position.

Another unique aspect of tax litigation is that there is a significant disparity between the average taxpayer and the CRA in terms of knowledge of Canada's tax laws, availability of time and financial resources to dispute a tax matter, and the general effect of the outcome of the dispute. Despite the notorious complexities of Canada's tax legislation, every taxpayer is presumed to know the law in all of its exacting detail,¹⁵⁴ even though it is nearly impossible for the average taxpayer to satisfy this

153 The onus is on a taxpayer to disprove the CRA's assessment: *Johnson v. MNR* (1948), 3 DTC 1182.

154 See, for example, *VR Interactive Corp. v. Canada (Customs and Revenue Agency)*, 2005 FC 273, at paragraph 15; *Goar v. The Queen*, [1999] 1 CTC 2784 (TCC) (available on *Knotia*); and *Winsor v. The Queen*, 97 DTC 1510 (TCC), at 1510.

presumption.¹⁵⁵ In contrast, the CRA, as the government agency with the delegated authority to administer and enforce the ITA, the ETA, and the related regulations, has intricate and detailed knowledge of Canadian tax laws, and employs staff with expertise in specialized areas of the law. Because of this knowledge imbalance, taxpayers must often rely on tax advisers to assist them in complying with the law and to settle tax disputes with the CRA.¹⁵⁶ However, not every taxpayer is in a position to be represented by a tax adviser. This constraint can create opportunities for a misuse of power by the CRA and for a biased or prejudicial application of the law to such disadvantaged taxpayers. Additionally, the CRA's access to virtually unlimited financial and human resources¹⁵⁷ can create further inequities for taxpayers, particularly those with limited time and financial resources to dispute a tax matter through the CRA's administrative dispute resolution process and at the Tax Court if necessary.

Finally, the general effect of the outcome of a tax dispute can be disproportionate as between taxpayers and the CRA. For example, even if a taxpayer is successful in resolving a tax dispute with the CRA, arriving at that result may subject the taxpayer to significant stress, financial hardship, and the diversion of time, energy, and resources away from family or business-related activities. Representatives of the CRA are generally not subject to the same potentially negative personal or financial consequences, even if the basis of a tax reassessment is found to be without merit.¹⁵⁸

Collectively, the unique features of a tax dispute identified above result in a significant power imbalance between taxpayers and the CRA. As discussed above, this imbalance has been acknowledged by the Tax Court on several occasions. For example, in *Salaison Lévesque*, the court stated that, given the CRA's significant authority and power, tax audits carried out by the CRA must be accurate and cannot be substandard, notwithstanding that the reverse onus is on the taxpayer.¹⁵⁹ Likewise, in *Jolly Farmer Products*, the court acknowledged that the CRA can effectively force a taxpayer to go to court, even if the basis for the reassessment is without merit. In that regard, the court stated:

There are perhaps some arguments and some cases that the Canada Revenue Agency just should not pursue. The Crown is not a private party. By reassessing a taxpayer and

155 Even tax professionals may hesitate to claim detailed knowledge of all of the rules in Canada's various tax statutes and regulations, along with the case law relating to their application.

156 In *Guindon v. Canada*, 2015 SCC 41, at paragraph 1, the Supreme Court of Canada recognized the complexities of tax legislation and the need for taxpayers to rely on tax advisers to help them to comply with tax laws.

157 *Salaison Lévesque*, supra note 119, at paragraph 40.

158 All public monies of the government of Canada are held on deposit in the consolidated revenue fund managed by the minister of finance. Accordingly, litigants for the Crown arguably do not have any skin in the game in relation to the outcome of a tax proceeding.

159 See, for example, *Salaison Lévesque*, supra note 119, at paragraphs 25-26 (quoted in the text above at note 120); and *Walsh*, supra note 18, at paragraphs 15-16 (discussed in the text above at notes 144-145).

failing to resolve its objection, the Crown is forcing its citizen/taxpayers to take it to Court. If the Crown's position does not have a reasonable degree of sustainability, and is in fact entirely rejected, it is entirely appropriate that the Crown should be aware it is proceeding subject to the risk of a possibly increased award of costs against it if it is unsuccessful. The Crown is not a private party and tax litigation is not a dispute like others between two Canadians. This is the government effectively pursuing one of its citizens.¹⁶⁰

Emphasizing the New Purposes of Costs Awards

By taking into consideration the power imbalance present in tax disputes, the Tax Court may be able to better promote the efficient and orderly administration of justice. This may be accomplished if the court's approach to costs awards continues to evolve to focus more on the modern purpose of discouraging conduct that is unreasonable or vexatious, or that increases the duration and cost of litigation. In particular, an emphasis on pre-trial conduct in awarding costs could be an appropriate deterrent to the CRA's adopting unreasonable or meritless bases when issuing or confirming notices of assessment or reassessment against a taxpayer.¹⁶¹ Under the current tax dispute resolution system, there are minimal, or no, repercussions for the CRA when its officials engage in such conduct. It seems clear that this apparent immunity does not promote the efficient and orderly administration of justice. In *Salaisson Lévesque*, the court recognized the effect that costs awards can have in adding balance to the Canadian tax system. In that decision, the court stated:

The possibility of obtaining higher costs than those provided for in the tariff is an effective action that can re-establish the balance between the opposing forces in a tax dispute. That possibility may be a very helpful tool for sanctioning abuses of authority by tax authorities.¹⁶²

Arguably, costs awards will influence the pre-trial behaviour of the CRA and taxpayers only if the threshold of unreasonable conduct and the quantum of the related potential costs award deterrent are relatively clear and predictable. However, the current jurisprudence on whether pre-trial conduct can or should be taken into

160 *Jolly Farmer Products*, supra note 88, at paragraph 26.

161 In the general civil litigation context, costs awards have been recognized as an appropriate deterrent to doubtful cases proceeding to trial. For example, in *Catalyst Paper*, supra note 17, at paragraph 16, the BC Court of Appeal stated, "It seems to me that the trend of recent authorities is to the effect that the costs rules should be utilized to have a winnowing function in the litigation process. The costs rules require litigants to make careful assessments of the strength or lack thereof of their cases at commencement and throughout the course of litigation. The rules should discourage the continuance of doubtful cases or defences. This of course imposes burdens on counsel to carefully consider the strengths and weaknesses of particular fact situations. Such considerations should, among other things, encourage reasonable settlements."

162 *Salaisson Lévesque*, supra note 119, at paragraph 33.

account in awarding costs is ambiguous. The common-law test generally requires the existence of exceptional circumstances that unduly and unnecessarily prolong the trial before pre-trial conduct can be considered.¹⁶³ While the interpretation of what is exceptional is often uncertain, it is worth considering whether additional emphasis should be placed on the work of the CRA at the audit and objection stages of the dispute process. More often than not, imprecise tax audit work or the adoption of a meritless basis for issuing a reassessment will not be conduct that is considered to unduly and unnecessarily prolong a trial in the traditional sense, particularly in light of the *Martin* decision.¹⁶⁴ However, with the new purposes of costs awards in mind, there may be value in taking into consideration the fact that such conduct (for example, patently flawed tax audit work or positions) may be the very reason why a particular matter must proceed to trial; unreasonable tax audit conduct by the CRA arguably prolongs a trial that would not have been required had a reasonable approach been taken in the first place.

163 This principle was recently reiterated in *Grimes*, supra note 39, at paragraph 41, where the court relied on *Martin*, supra note 113, at paragraphs 18-21; *Merchant*, supra note 113, at paragraph 7; and *Landry*, supra note 113, at paragraph 25.

164 In *Martin*, supra note 113, the Federal Court of Appeal held that the Tax Court had erred in awarding costs in excess of the tariff to include expenses incurred at the objection stage, on the basis that the objection stage is not a “proceeding,” as defined in section 2 of the rules. See *ibid.*, at paragraphs 21-22, and the discussion of this case in the text above at note 121 and following.

Unresolved Controversies in Suing for Negligence of Tax Officials: Canadian and Australasian Insights and a Primer for Policy Makers' Consideration

John Bevacqua*

PRÉCIS

Il y a eu récemment au Canada de nombreuses affaires dans lesquelles les contribuables ont prétendu que des agents de l'Agence du revenu du Canada avaient fait preuve de négligence. Cette jurisprudence canadienne en rapide évolution constitue, à l'heure actuelle, la jurisprudence la plus étendue dans le monde de la common law sur la responsabilité délictuelle des agents du fisc. Elle expose également les différends fondamentaux non résolus qui entravent la clarté et la certitude juridiques des limites du droit des contribuables à poursuivre en justice des agents du fisc pour négligence. En comparant ces affaires avec des affaires en Australie et en Nouvelle-Zélande, cet article confirme que ces différends non résolus ne sont pas uniques au Canada. L'auteur propose une série d'options pour résoudre ces problèmes. Destinées à attirer l'attention des responsables des politiques et à susciter un débat, ces propositions sont tirées des approches judiciaires et législatives adoptées au Canada, en Australie et en Nouvelle-Zélande, et dans d'autres juridictions de common law en grande partie comparables.

ABSTRACT

There have been numerous recent Canadian cases in which taxpayers have alleged negligence by Canada Revenue Agency officials. This body of rapidly evolving Canadian case law constitutes, at present, the most extensive jurisprudence in the common-law world considering the tortious liability of tax officials. It also exposes fundamental unresolved controversies that inhibit legal clarity and certainty on the limits of the right of taxpayers to sue for the negligence of tax officials. Through comparison with cases in Australia and New Zealand, this article confirms that these unresolved controversies are not unique to Canada. The author proposes a range of options for addressing these issues. Intended as a primer for policy makers' attention and debate, these proposals are

* Of the Department of Business Law and Taxation, Monash University, Melbourne (e-mail: john.bevacqua@monash.edu). I thank the anonymous reviewers for their invaluable suggestions and contributions to the development of this article.

drawn from judicial and legislative approaches adopted in Canada, Australia, and New Zealand, and in other broadly comparable common-law jurisdictions.

KEYWORDS: NEGLIGENCE ■ TAX LITIGATION ■ TORTS ■ PUBLIC POLICY

CONTENTS

Introduction	440
Coexisting Common-Law and Public Duties	443
The Canadian Position	443
Australasian Approaches	447
Tax Audit and Investigation Duties	450
The Canadian Position	450
Australasian Approaches	454
Residual Policy Concerns	456
The Canadian Position	457
Australasian Approaches	459
Standard of Care	460
The Canadian Position	460
Australasian Approaches	462
A Primer for Policy Makers' Consideration	463
Coexisting Common-Law and Public Duties	463
Duties of Tax Officials in Carrying Out Audits	467
Residual Policy Concerns	470
Standard of Care	473
Conclusion	474

INTRODUCTION

There have been a number of recent Canadian cases in which taxpayers have alleged negligence by Canada Revenue Agency (CRA) officials. Most have failed to demonstrate reasonable prospects of success and have been summarily dismissed during the pleading stage of proceedings.¹ A few have been permitted to proceed beyond the pleading stage.² The most notable of these is the 2014 decision of the Supreme

1 Cases in which negligence claims have been struck out have included *783783 Alberta Ltd. v. Canada (Attorney General)*, 2010 ABCA 226; *Foote v. Canada (Attorney General)*, 2011 BCSC 1062; and *Canada v. Scheuer*, 2016 FCA 7. For a detailed analysis of the cases up to and including 2013, see John Bevacqua, "Suing Canadian Tax Officials for Negligence: An Assessment of Recent Developments" (2013) 61:4 *Canadian Tax Journal* 893-914.

2 Notable examples include *Leroux v. Canada Revenue Agency*, 2014 BCSC 720; *McCreight v. Canada (Attorney General)*, 2013 ONCA 483; and *Gordon v. Canada*, 2019 FC 853. In *McCreight*, the Ontario Court of Appeal overturned the decision of the Ontario Superior Court in *McCreight v. The Attorney General*, 2012 ONSC 1983, stating, *supra*, at paragraph 60, "[T]he motion judge erred in concluding that it was plain and obvious that the respondent CRA investigators did not owe a duty of care . . . and, therefore, the negligence claim had no reasonable prospect of success and should be struck." In *Gordon*, the Federal Court ultimately found, *supra*, at paragraph 244, that there was insufficient evidence of serious mistakes or

Court of British Columbia in *Leroux*,³ in which, although the taxpayer was ultimately unsuccessful, the existence of a duty of care owed by the CRA to taxpayers was affirmed.⁴

A number of cases have considered *Leroux* and provided further insights into the circumstances in which a negligence claim might lie against the CRA and its tax officers. This growing body of Canadian case law represents, at present, the most extensive jurisprudence in the common-law world considering the tortious conduct of tax officials. It is questionable, however, whether this continuing judicial attention has resulted in greater certainty or clarity either for Canadian taxpayers or for Canadian tax officials seeking to determine the precise nature and scope of any common-law duties of care owed to taxpayers.

The Canadian cases expose a number of fundamental recurring and unresolved issues arising in taxpayer negligence claims against tax officials. These are not unique to Canada. There are striking similarities between the issues that Canadian judges have encountered in dealing with taxpayer negligence claims arising from the conduct of tax officials and those encountered in other common-law countries—particularly in Australia and New Zealand.

errors of judgment made by the CRA to support a finding of negligence. However, Barnes J was satisfied that on the facts of the case a negligence standard of care could be applied (*ibid.*, at paragraph 157), and a cause of action framed in negligence was theoretically available to the plaintiffs (*ibid.*, at paragraph 166).

- 3 *Leroux*, supra note 2. At the preliminary hearing of the matter, Preston J described the facts in the case as “a series of Kafkaesque events”: *Leroux v. Canada Revenue Agency*, 2010 BCSC 865, at paragraph 2. The saga started in 1996 with an audit of the plaintiff’s business. CRA auditors seized business receipts and other records. The plaintiff alleged that, before those records could be copied, the tax officials either shredded, or simply lost, a significant proportion of them (although at the 2014 hearing Humphries J described this assertion as “not convincing”: *Leroux*, supra note 2, at paragraph 220). Nevertheless, the audit was completed, and the plaintiff was assessed as owing more than \$600,000 in taxes, interest, and penalties. A lengthy dispute ensued, and in subsequent Tax Court proceedings, a consent settlement of approximately \$57,000 was reached. After some payments and a “fairness application” to the minister of national revenue (*Leroux*, supra note 2, at paragraph 1), which resulted in the cancellation of all interest and penalties, the plaintiff was owed an income tax *refund* of about \$25,000. Unfortunately, in the meantime, the CRA had issued seizure and sale orders against his property to recover the initially assessed tax debt. As a result, the plaintiff’s mortgage holders foreclosed on his properties. Ultimately, the plaintiff lost his home and business, and was financially ruined.
- 4 See *Leroux*, supra note 2, at paragraph 309. The court’s conclusion is consistent with the BC Court of Appeal’s refusal to strike out the plaintiff’s claim in negligence: see *Leroux v. Canada Revenue Agency*, 2012 BCCA 63. This is not the first time that Canadian courts have recognized the potential of a cause of action in tort against the CRA. See, for example, *Canada Revenue Agency v. Tele-Mobile Company Partnership*, 2011 FCA 89, at paragraph 6, where the Federal Court of Appeal acknowledged (albeit without elaboration) the possibility that a taxpayer plaintiff could bring an action in tort to obtain compensation for damage caused by the CRA. See also *Neumann v. Canada (Attorney General)*, 2011 BCCA 313, a case recognizing the potential applicability of the tort of negligent investigation in the tax investigation context.

While there have been a number of comprehensive expositions of the law of negligence as it applies in tax cases in both Canada⁵ and Australasia,⁶ there has been little focus to date on the legal controversies that recur and remain unresolved across jurisdictions. Accordingly, the primary focus of this article will be on identifying these common unresolved controversies and suggesting options for addressing the legal uncertainties that they have created for taxpayers and tax officials alike. This necessarily requires an analysis of a range of negligence claims, including claims involving allegations of negligent misstatement and negligent investigation in various contexts, in search of high-level and cross-jurisdictionally relevant thematic commonalities.⁷

The analysis will reveal four core unresolved controversies that have been exposed to date in Canadian and Australasian cases. Prime among these is the question of whether and to what extent common-law duties of care can coexist with public duties of tax authorities and officials. A second issue is the nature and scope of any duties specifically owed by tax officials in carrying out tax audits and investigations. A third issue is the evidentiary weight and validity of residual policy concerns that are commonly raised as a bar to tortious claims arising out of taxpayers' allegations of negligence by tax officials. Finally, there is the unresolved question of the standard of care expected of tax officials to satisfy any common-law duties to taxpayers. The first four parts of this article will address these current unresolved controversies and the various judicial approaches to dealing with them.

In the fifth part of the article, possible solutions to the four key controversies are posited. The proposals extend not only to the judicial approaches to dealing with these matters but also to legislative avenues for assisting judges in adjudicating tort claims by taxpayers against tax officials in a coherent and consistent manner. These suggestions are not intended as a comprehensive blueprint for reform, but simply as a primer for much-needed consideration and debate among policy makers.⁸

5 See Bevacqua, *supra* note 1; and Amir A. Fazel, "Suing the Canada Revenue Agency in Tort" (2019) 67:3 *Canadian Tax Journal* 581-611, especially at 609-10.

6 See John Bevacqua, "A Detailed Assessment of the Potential for a Successful Negligence Claim Against the Commissioner of Taxation" (2008) 37:4 *Australian Tax Review* 241-60. The term "Australasia" is used for convenience in this article to refer collectively to Australia and New Zealand.

7 Hence, the analysis in this article is organized according to the "common controversy" themes that have emerged in the case law, rather than by a more traditional chronological tracing and exposition of the progress of the cases through the courts or by classification of the cases within the various categories of negligence claims to which they relate.

8 In this article, the reference to "policy makers" is intended to encapsulate not only the legislatures in each jurisdiction, but also the judiciary, tax authorities, and other tax system stakeholders who might be directly or indirectly involved in making or influencing the development of policies and procedures in the areas of taxation and tax administration.

COEXISTING COMMON-LAW AND PUBLIC DUTIES

A significant and recurring unresolved issue exposed in Canadian cases and corresponding judicial consideration of taxpayer negligence claims involving tax officials in other common-law jurisdictions is the question of whether tax officials owe coexisting common-law duties and public statutory duties. To a large extent, the answer in each case turns on the specific statutory scheme in the relevant jurisdiction. However, the general challenges that judges face in addressing this matter are broadly comparable.

The Canadian Position

In Canada, the issue of whether tax officials owe coexisting common-law duties and public duties has arisen in the context of applying the *Anns-Cooper* test⁹ for determining whether to impose a duty of care in novel scenarios. The *Anns-Cooper* test has two stages. As described by Fisher J in *Leighton v. Canada (Attorney General)*, these are “(1) whether the relationship between the parties justifies the imposition of a duty of care on the defendant; and (2) whether there are residual policy considerations that militate against recognizing a novel duty of care.”¹⁰

Prior to *Leroux*, all Canadian taxpayer negligence claims against the CRA failed to satisfy the first stage of the *Anns-Cooper* test.¹¹ The biggest obstacle had typically been demonstrating a sufficiently proximate relationship between the taxpayer and the CRA to warrant imposing a common-law duty of care.¹² This was largely due

9 Named after the Supreme Court of Canada’s interpretation, in *Cooper v. Hobart*, 2001 SCC 79, of the UK House of Lords’ approach to determining when a novel duty of care can be established, as set out in *Anns v. Merton London Borough Council*, [1977] UKHL 4.

10 2012 BCSC 961, at paragraph 50. In *Leroux*, supra note 2 at paragraphs 275-76, Humphries J elaborated on the two stages of the *Anns-Cooper* test as follows:

In the proximity inquiry, the legislative scheme is important . . . as it may foreclose a private law duty of care. If the legislation is not determinative, the relationship between the parties, both as described in the legislation and based on the facts of the case, will be examined to determine if proximity has been established.

If the circumstances justify the imposition of a *prima facie* duty of care, the inquiry then moves to broader residual policy concerns to see if those concerns justify the negation of the *prima facie* duty of care. At this stage, the burden, which has rested on the plaintiff to show the *prima facie* duty of care, shifts to the defendant.

11 Notable examples include *Leighton*, supra note 10; *Canus v. Canada Customs*, 2005 NSSC 283; *783783 Alberta*, supra note 1; and *McCreight*, supra note 2 (although this case did not ultimately proceed to a full trial on the negligence action).

12 Stage 1 of the *Anns-Cooper* test involves considering both proximity and foreseeability of harm. The latter usually poses little difficulty. *Leroux*, supra note 2, was no exception, with the CRA conceding that its actions could cause foreseeable harm to taxpayers such as the plaintiff. Hence, as in all the preceding tax cases, the court’s discussion of the application of the test centred on proximity and public policy (see *ibid.*, at paragraphs 271-309).

to the prevailing judicial view that the Income Tax Act¹³ (ITA) precludes the possibility that private-law duties to taxpayers could coexist with the CRA's public-law duties. Comments such as the following, by Hood J in *Canus*, had typically been favoured:

[A]ny duty owed by [the CRA auditor] was to the Minister of National Revenue whose duty is owed in turn to Parliament and to all taxpayers generally. Therefore, there is no duty of care owed to an individual taxpayer under the *Income Tax Act*.¹⁴

Prior to *Leroux*, few judges had been prepared to qualify this statement.¹⁵

In contrast, in *Leroux*, the BC Supreme Court concluded that CRA employees must conduct themselves as reasonably careful professionals, stating, "There is nothing in the statutory scheme of the *Income Tax Act* that would suggest otherwise."¹⁶ Further, CRA public tax collection duties do not conflict with "a duty to take reasonable care in assessing taxes, auditing taxpayers, and particularly in imposing penalties."¹⁷

The court justified this stance by concluding that the CRA is not a "regulator."¹⁸ In cases involving regulators, Canadian courts usually consider that the legislative scheme precludes the possibility of any private-law duties existing alongside the regulator's public duties. In effect, regulatory functions are considered to be immune policy-making functions.¹⁹ In *Leroux*, the court concluded that "the individual employees of CRA are not regulators. Their duties are operational."²⁰

13 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended.

14 *Canus*, supra note 11, at paragraph 87. Similar comments were made by Fisher J in *Leighton*, supra note 10, at paragraph 54.

15 For exceptions, see, for example, *Foote*, supra note 1, at paragraph 41; 783783 *Alberta*, supra note 1, at paragraph 45; and *City Centre Properties Inc. v. Canada* (1994), 70 FTR 222, at 239-40.

16 *Leroux*, supra note 2, at paragraph 303.

17 *Ibid.*, at paragraph 306.

18 *Ibid.*, at paragraph 280.

19 This approach accords with the Supreme Court of Canada's decision in *Cooper*, supra note 9. *Cooper* involved allegations of negligence against the registrar of mortgages for failing to oversee the conduct of a broker that it had licensed, and as a result causing the plaintiff investors to suffer economic losses. The Supreme Court held, *ibid.*, at paragraph 44, that the registrar did not owe the plaintiff investors a duty of care. The court held that, *as a regulator*, the registrar's duty was to the public as a whole, not to any individual investors.

20 *Leroux*, supra note 2, at paragraph 280. The reference to "operational" duties is an allusion to the policy/operational dichotomy—a traditional distinction between unassailable policy decisions of public bodies and operational activities of those bodies that are properly considered capable of giving rise to private-law duties of care. For commentary on the issues surrounding the application of the policy/operational distinction, see Paul Daly, "The Policy/Operational Distinction in Canadian Tort Law: *R. v. Imperial Tobacco Canada Ltd.*", 2011 SCC 42, [2011] 3 S.C.R. 45," *CanLII Connects*, October 28, 2014 (<http://canliiconnects.org/en/commentaries/30413>).

This classification of CRA statutory duties as “operational” rather than “regulatory” has received mixed support in subsequent cases. In *Ludmer v. Attorney General of Canada*,²¹ the Quebec Superior Court broadly followed *Leroux*, characterizing CRA audit functions as not constituting “true core policy acts”²² and hence as being capable of supporting coexisting common-law and public duties. As noted above, in *Leroux*, Humphries J described CRA employee duties as operational on the basis that the CRA is not a regulator endowed with core discretionary policy-making powers. The Quebec Superior Court took a similar stance in *Ludmer*, describing CRA functions as follows:

The CRA is not charged with exercising a legislative or regulatory power or setting tax policy—those are matters for the Finance Department. The CRA’s role is limited to collecting the tax that is due under the *ITA*.²³

The court elaborated, concluding that the CRA does not ordinarily exercise discretionary power; rather,

its mandate is to calculate the tax due, no more and no less. However, it may exercise discretionary powers when it decides, for example, to issue a demand for information.²⁴

In contrast, in *Grenon v. Canada Revenue Agency*,²⁵ the Alberta Court of Appeal did not rely on any distinction between regulators and non-regulatory bodies to determine the issue. Instead, the court determined that private-law duties cannot be

21 2018 QCCS 3381. *Ludmer* was a case decided according to the laws applicable in Quebec.

Hence, while the court accepted that *Leroux* stands as authority for the existence of a duty of care owed by the CRA to taxpayers (and thus this case is instructive for present purposes), the court dismissed reliance on that line of authority in *Ludmer*, characterizing it as pertaining to “common law notions of duty of care, proximity, foreseeability and public policy that have no application in Québec”: *Ludmer*, supra, at paragraph 141.

22 *Ludmer*, supra note 21, at paragraph 144, citing the Supreme Court of Canada’s characterization of the limits of Crown immunity from suit in *R v. Imperial Tobacco Canada Ltd.*, 2011 SCC 42, at paragraphs 87–90.

23 *Ludmer*, supra note 21, at paragraph 146.

24 *Ibid.*, at paragraph 147. This statement indicates an appreciation of some of the nuances of the distinction between policy and operational activities, albeit falling far short of the detailed consideration in *Carboun*, discussed below (see *infra* note 125 and the accompanying text).

25 2017 ABCA 96. The case involved an extensive audit of the plaintiff and associated trusts, which ultimately resulted in the issuance of tax assessments and penalties amounting to almost \$500 million. The plaintiff claimed that the CRA had breached its duty of care to him in carrying out the audit by demanding access to a large number of irrelevant, publicly available, or privileged documents; unreasonably requesting information; and issuing numerous settlement proposal letters without prior notice.

owed by the CRA to taxpayers because such duties are incompatible with the “inherently adverse” relationship between taxpayers and the CRA created by the ITA.²⁶

The reasoning in *Grenon* was applied by the Ontario Superior Court of Justice in *McCreight*.²⁷ A broadly similar approach to *McCreight* and *Grenon* was adopted by the Supreme Court of Nova Scotia in *Canus*, in which Hood J described the relationship between tax officials and taxpayers as one of “inherently opposing interests.”²⁸ Hood J elaborated, describing taxpayers as being motivated to minimize their taxes and tax officials as being charged with the responsibility of ensuring that all taxes legally owing are collected.²⁹

The argument is that these inherently opposing interests are created by the statutory scheme under the ITA.³⁰ Therefore, imposing a duty of care would contradict this statutory intent. This argument broadly echoes the reasoning in *City Centre Properties Inc. v. Canada*,³¹ in which the relationship between the CRA and taxpayers was characterized as a creditor-debtor relationship—a relationship intuitively incongruous with any common-law duties of care.³²

26 *Grenon*, supra note 25, at paragraph 25. This characterization of the relationship between CRA officers and taxpayers as “inherently adverse” echoes the comments in *Leighton*, supra note 10, at paragraph 54: “CRA and taxpayers have opposing interests. The relationship is not one where CRA auditors should be responsible for protecting taxpayers from losses arising from their assessments.”

27 *McCreight*, supra note 2. Specifically, Patterson J accepted that the CRA and its prosecutors were in an “inherently adversarial relationship with the subjects of the investigation . . . and therefore, this would be contrary to there being a proximity such that would create a duty of care”: *ibid.*, at paragraph 62.

28 *Canus*, supra note 11, at paragraph 73.

29 *Ibid.*

30 The inherently opposing interests argument advanced by Hood J simply reflects the fact that taxation is fundamentally a state-sanctioned harm imposed on citizens in the form of an “enforced contribution exacted pursuant to legislative authority”: *Gunby v. Yates*, 214 Ga. 17 (1958), at 19. Necessarily, therefore, in administering the provisions of taxation statutes, tax authorities will adversely affect the interests of individual taxpayers, and opposing interests will arise.

31 [1993] FCJ no. 1260.

32 According to McKay J in *City Centre Properties*, supra note 15, at 239-40, to accord taxpayers an ability either to challenge or to counteract an assessment by common-law action in negligence could only subvert the creditor-debtor relationship between the commissioner and the taxpayer. This reasoning has been cited both in New Zealand and in Australia to support the proposition that a duty of care cannot coexist with the duties that tax officers owe to the Crown. For New Zealand examples, see *Cb’elle Properties (NZ) Ltd v. Commissioner of Inland Revenue*, 2005 NZHC 190; and *L R McLean & Co Ltd v. Commissioner of Inland Revenue*, [1994] 16 NZTC 11. For an Australian example, see *Farah Custodians Pty Limited v. Commissioner of Taxation* (No 2), 2019 FCA 1076.

A more accommodating approach was taken by the Alberta Court of Appeal in 783783 *Alberta*.³³ In that case, the court was prepared to concede that “[t]he relationship between the tax assessors and any taxpayer is primarily to ensure that the taxpayer is fairly assessed. The tax assessors also have a general duty to the government they work for, and indirectly to the general public.”³⁴ This more accommodating approach is consistent with cases such as *Gordon*³⁵ and *Neumann*³⁶ in which, in the context of the tort of negligent investigation, judges have accepted that despite the adversarial nature of the relationship between the taxpayer and CRA auditors, a duty of care can arise.³⁷

In *Gordon*, Barnes J affirmed that there were “no identifiable conflicts between the existence of a private law duty of care and an over-arching public duty beyond those that were addressed and dismissed in *Hill*.”³⁸

Australasian Approaches

In Australia and New Zealand, despite the relatively small number of cases dealing with the issue, judicial attention has regularly turned to the question of whether tax authorities owe coexisting public and private duties to taxpayers. However, in both jurisdictions, courts have consistently rejected this possibility. In Australia, this approach has developed despite the views expressed by the Australian High Court almost a century ago in *Moreau v. Federal Commissioner of Taxation*, in which

33 783783 *Alberta*, supra note 1. This case concerned an error by the CRA in allowing a non-resident business competitor of the plaintiff to claim deductions that were available only to Canadian residents. The plaintiff alleged that this error resulted in the loss of its competitive advantage as a Canadian resident.

34 Ibid., at paragraph 45.

35 *Gordon*, supra note 2.

36 *Neumann*, supra note 4.

37 For further discussion of *Neumann* and *Gordon*, see infra notes 55 and 57-58, and the accompanying text. The adversarial nature of the relationship between tax officials carrying out criminal investigations and the taxpayers subjected to those investigations was conceded by the Supreme Court of Canada in *R v. Jarvis*, 2002 SCC 73, at paragraph 2, where the court observed that “there is an adversarial relationship that crystallizes between the taxpayer and the tax officials when the predominant purpose of an official’s inquiry is the determination of penal liability.”

38 *Gordon*, supra note 2, at paragraph 159. The reference to *Hill* is to the Supreme Court of Canada’s decision in *Hill v. Hamilton-Wentworth Regional Police Services Board*, 2007 SCC 41, where the court held that a duty of care can be imposed on police in cases of negligent criminal investigation of criminal suspects—effectively affirming the existence of a tort of negligent investigation. This case and its application in *Gordon* and other Canadian tax cases is discussed at length below; see infra notes 52-65 and the accompanying text. As far as the applicability of *Hamilton-Wentworth* is concerned, the approach of Barnes J echoes that of Hughes J in 2013, who dismissed the appeal by the defendants against the prothonotary determination refusing to strike out the plaintiffs’ negligence claim: *Gordon v. Canada*, 2013 FC 597, discussed further below in the text accompanying note 65.

the duties of the Australian commissioner of taxation were described as being “to administer the Act with solicitude for the Public Treasury *and with fairness to taxpayers*.”³⁹

In stark contrast, the approach of the New South Wales Supreme Court in *Harris v. Deputy Commissioner of Taxation* accurately encapsulates the more recent Australian judicial attitude:

There is no basis upon which to conclude that there is a tort liability in the Australian Taxation Office or its named officers towards a taxpayer arising out of the lawful exercise of functions under the Income Tax Assessment Act.⁴⁰

The approach in *Harris* is consistent with rare attempts to impose other private-law duties on Australian tax officials. For example, in *Lucas v. O'Reilly*, a case involving allegations of tortious breach of statutory duty by the Australian commissioner (also unsuccessfully pleaded in *Harris*), the Australian Federal Court cursorily rejected the taxpayer's submissions, stating:

If the cause of action relied upon by the plaintiff is based upon a breach of statutory duty, the plaintiff must show . . . that the statute creating the duty confers upon him a right of action in respect of any breach. . . . However, it is, I think, clear that the defendant owes the plaintiff no such duty. The duty of the Commissioner is owed to the Crown.⁴¹

The judicial reasoning is strikingly similar in Australian cases seeking to make out equitable estoppel claims against the commissioner in order to prevent the commissioner from resiling from previous approaches or representations made to taxpayers. For example, in *AGC (Investments) Ltd. v. Federal Commissioner of Taxation*,⁴² Hill J dismissed the taxpayer's estoppel action against the commissioner seeking to prevent the commissioner from assessing profits from investment activities of the taxpayer that the commissioner had been aware of for many years and had never previously sought to assess. Hill J reasoned that “[t]he *Income Tax Assessment Act* imposes obligations on the Commissioner and creates public rights and duties, which the application of the doctrine of estoppel would thwart.”⁴³ Similar reasoning was applied by Kitto J in *Federal Commissioner of Taxation v. Wade*, who observed, “No conduct on the part of the Commissioner could operate as an estoppel against the operation of the Act.”⁴⁴

39 1926 HCA 28, at paragraph 4 (emphasis added).

40 2001 NSWSC 550, at paragraph 12.

41 79 ATC 4081, at 4085.

42 91 ATC 4180.

43 Ibid., at 4195.

44 (1951), 84 CLR 105, 117.

Consequently, the commissioner has been estopped in Australia only in extraordinary cases in which the commissioner has sought to resile from an explicit and clear commitment made to an individual taxpayer that is tantamount to a contractual commitment, raising no questions of limits on the exercise of statutory powers or public duties.⁴⁵

In New Zealand, the courts have been equally unequivocal in rejecting the possibility of common-law duties coexisting with tax officials' public duties. The prime example is *Ch'elle*.⁴⁶ In this case, the NZ Court of Appeal affirmed the "undesirability of imposing a duty of care on the Commissioner, given the elaborate statutory construct within which the Commissioner and taxpayers interrelate,"⁴⁷ and struck out the taxpayer's negligence action.⁴⁸

The only hint of a potential softening of this judicial approach in Australasia arose very recently in *Farab*,⁴⁹ in which the Australian Federal Court rejected the Australian commissioner's interlocutory application to strike out the taxpayer's negligence claim. In *Farab*, the commissioner, consistent with the general reasoning in *Harris* and *Lucas*, contended that the commissioner's only duty is to the Crown and "there is no reason to impose on him a common law duty of care."⁵⁰ Despite

45 Cases in which the taxpayer has been successful in having estoppel-like responsibilities imposed on the commissioner of taxation are *Cox v. Deputy Federal Commissioner of Land Tax, Tasmania*, [1914] HCA 3; and *Queensland Trustees Ltd. v. Fowles*, [1910] HCA 51. For a detailed exposition of these cases, see Cameron Rider, "Estoppel of the Revenue: A Review of Recent Developments" (1994) 23:3 *Australian Tax Review* 135-52.

46 *Ch'elle*, supra note 32.

47 *Ibid.*, at paragraph 56.

48 Interestingly, in so doing, the court made direct reference to Canadian authority, expressly applying the reasoning of McKay J in *City Centre Properties*, supra note 15.

49 *Farab*, supra note 32. The facts of this case are relatively straightforward. Essentially, the plaintiff, Farab, was the victim of the fraudulent actions of its former tax agent ("Strathfield Tax") and the principal of Strathfield Tax, Mr. Kennedy. Mr. Kennedy prepared and lodged business activity statements, purportedly on behalf of the plaintiff, which generated substantial tax refunds due to the plaintiff. However, unknown to the plaintiff, Mr. Kennedy nominated a bank account held by a company that he controlled ("Vias") into which the refunds due to the plaintiff were paid, effectively perpetrating a fraudulent misappropriation of the tax refunds. The genesis of the specific allegations of misconduct and negligence against the commissioner stemmed from the fact that the tax officers had been auditing both Strathfield Tax and the plaintiff during much of the period in which the refunds were continuing to be erroneously paid into the Vias bank account (2012-2014). The plaintiff asserted that these payments continued notwithstanding knowledge acquired by the tax officers in the process of carrying out the audit of Strathfield Tax, putting them on notice of the misuse or possible misuse of that account.

50 *Farab*, supra note 32, at paragraph 37. See also *Harris*, supra note 40, at paragraph 12, reproduced in full in the text above at note 40. In *Farab*, supra note 32, at paragraph 74, the commissioner, citing *Deputy Federal Commissioner of Taxation v. Brown*, 1958 HCA 2, at paragraph 4, also submitted that imposing a duty of care would be inconsistent with the assertion that the relevant legislative scheme constituted a "complete and exhaustive code

expressing some sympathy with this viewpoint,⁵¹ Wigney J ultimately reasoned that there were insufficient grounds to conclude that in the specific circumstances pleaded in *Farab*, “the existence of a duty of care . . . is necessarily inconsistent or incompatible with the statutory scheme, or would impose impossible or prohibitive burdens on the Commissioner in the context of the statutory scheme.”⁵² It remains to be seen whether this more nuanced approach will carry through to any future substantive hearing of *Farab*.

TAX AUDIT AND INVESTIGATION DUTIES

Some of the most intractable debates evident in recent Canadian and Australasian judicial consideration of taxpayer negligence claims against tax officials pertain to whether and to what extent any duty of care can be imposed on tax officials conducting tax audits or other investigatory functions.

The Canadian Position

In Canada, judicial discussion has centred on whether duties are owed only in tax audits involving criminal investigation or potential criminal sanction. This criminal/civil investigation distinction is significant since the Supreme Court of Canada determined in *Hamilton-Wentworth*⁵³ that a duty of care can be imposed on police in cases of negligent criminal investigation of criminal suspects—effectively affirming the existence of a tort of negligent investigation. In *Leroux*, the court relied on *Hamilton-Wentworth* and concluded that a CRA audit involving no criminal investigation can trigger a duty of care.

This is not the first time that *Hamilton-Wentworth* has been applied in a context other than a criminal investigation.⁵⁴ Prior to *Leroux*, it had also been applied in a tax case against the CRA involving an audit of the taxpayer where there was no criminal allegation or criminal investigation against the plaintiff, but merely against an

of the rights and obligations of the commissioner and other officers of his department to members of the general public who are subject to its provisions and of those members of the general public to his department.” It is worth noting that *Brown* concerned the High Court’s dismissal of a claim by the commissioner that he could pursue an equitable action against the beneficiary of an estate for a tax debt of the deceased that had not been assessed as owing until after the estate had been distributed. Hence, the comments from *Brown* sought to be relied on by the commissioner in *Farab* related to restricting the powers of the commissioner, rather than limiting the rights of taxpayers.

51 See *Farab*, supra note 32, at paragraph 75.

52 Ibid., at paragraph 89.

53 *Hamilton-Wentworth*, supra note 38.

54 See, for example, *Correia v. Canac Kitchens*, 2008 ONCA 506. In this case, the Ontario Court of Appeal applied the tort of negligent investigation established in *Hamilton-Wentworth* to the case of negligent investigation by a firm of private investigators retained to investigate employees. The court observed, *ibid.*, at paragraph 48, that “on a policy level, the case for recognizing a duty of care in respect of private investigation firms may be stronger than for the police.”

unrelated associate of the plaintiff.⁵⁵ The reasoning in *Leroux* went further, however, applying *Hamilton-Wentworth* in a tax audit context involving no criminal allegation against anybody. Humphries J reasoned that the duty established in *Hamilton-Wentworth* applied in *Leroux* because of the “extended and personal relationship between the auditors and the taxpayer” and “the foreseeably huge and devastating effects” of the audit on the taxpayer.⁵⁶

The underlying logic is that in such situations there is no reason to distinguish between the duty and standard of care owed by a police investigator to a suspect and that owed by a CRA auditor to an audit subject.⁵⁷ Similar reasoning was applied in *Gordon*, in which the Federal Court drew an analogy between subjects of tax audits and situations involving police and a suspect, positing that in both instances the subjects of the investigation have “critical personal interests . . . engaged” in the conduct of the investigation and have “an expectation that the investigation would be conducted in a competent manner.”⁵⁸

The clear implication of the *Leroux* and *Gordon* approaches is that CRA auditors can, through their interactions with taxpayers during the audit process, place themselves in a situation in which they will owe duties of care similar to those owed by criminal investigators, as recognized in *Hamilton-Wentworth*. According to the reasoning in *Leroux*, this risk is heightened in cases in which the outcome of the audit includes imposing huge and potentially devastating penalties on the taxpayer.

The approach taken in *Leroux* and *Gordon* remains contentious in Canada. It was expressly rejected by the Queen’s Bench of Alberta in *Grenon v. Canada Revenue Agency*.⁵⁹ In the subsequent appeal hearing, the Alberta Court of Appeal distinguished

55 *Neumann*, supra note 4, where the BC Court of Appeal appeared to accept that the tort of negligent investigation applied in the case of the execution of a warrant under the ITA. *Neumann* involved an allegation that the CRA had negligently obtained and executed a search warrant to search the plaintiff’s home as part of a tax-evasion investigation of a business associate of the plaintiff. The court was prepared to proceed on the basis that the CRA owed a duty of care to the plaintiff third party, only finding against the plaintiff for failure to establish a breach of that duty.

56 *Leroux*, supra note 2, at paragraph 301.

57 This was a significant justification for Humphries J’s deviation from previous cases in which taxpayers subjected to negligent audits failed to establish the existence of a duty of care owed to them by the CRA. Specifically, in *Leroux*, supra note 2, at paragraph 300, Humphries J distinguished *Canus* (supra note 11), 783783 *Alberta* (supra note 1), and *Leighton* (supra note 10) on this basis.

58 *Gordon*, supra note 2, at paragraph 158. It should be noted, however, that *Gordon* was a case involving serious criminal allegations against the taxpayers being audited. Specifically, the chartered accountant plaintiffs and their accounting firm were accused of fraud by the CRA for the methodology that they employed in claiming research and development tax credits for their clients. As a result, the Crown pursued criminal charges against the plaintiffs, which were ultimately dropped after almost seven years.

59 2016 ABQB 260. The plaintiff taxpayer appealed this Queen’s Bench determination, and the appeal was heard in 2017 by the Alberta Court of Appeal (*Grenon*, supra note 25). The appeal

Hamilton-Wentworth,⁶⁰ ruling that a duty of care by the CRA could arise only in the context of tax audits and investigations involving possible criminal sanction.⁶¹

It is unclear which approach will ultimately prevail (although the most recent superior court case is *Gordon*). It is also possible that an altogether different approach will emerge to resolve the issue. For example, tax audits might be excluded from the proper scope of the duty established in *Hamilton-Wentworth* simply because an audit is not an “investigation” at all. There is authority from the Supreme Court of Canada for this characterization of tax audits. Specifically, in *Jarvis*,⁶² the Supreme Court distinguished an audit (a process leading to the determination of the income tax owed by the taxpayer) from the exercise of investigative power (a process leading to the determination of the potential penal liability of the taxpayer).⁶³ It could therefore be argued that if the predominant purpose of an audit of a taxpayer’s affairs is not to determine whether a penal liability should be imposed,⁶⁴ such an audit cannot be considered to be an investigation—and, by extension, a *Hamilton-Wentworth*

was unsuccessful, and the negligence action was struck out. Notwithstanding the comprehensive rejection of the plaintiff’s arguments, the court left the door open to the prospect that a negligence claim could be sustainable against the CRA in future cases. Specifically, the court cited the wide range of cases to date involving strike-out applications against such claims at the pleading stage, concluding that “[n]one of the striking cases is determinative”: *Grenon*, supra note 25, at paragraph 15.

- 60 Specifically, the court observed, “*Hill v Hamilton-Wentworth* involved an exceptional set of circumstances. Moreover, there were particular considerations relevant to proximity and policy applicable to the relationship in that case which are not present here. Those included the likelihood of imprisonment, the legal duties owed by the police under the *Charter*, and the importance of balancing the need for police to be able to investigate effectively with the protection of the fundamental rights of a suspect or accused person.” *Grenon*, supra note 25, at paragraph 22.
- 61 In an unsuccessful attempt to echo the *Leroux* characterization of the relationship between taxpayers and the CRA, the plaintiff had asserted that “as a result of the Audit, the CRA and the CRA Personnel were ‘in a close and direct relationship’ to Grenon and knew that ‘carelessness by them would likely have a close, direct and monumental effect’ on Grenon”: *Grenon*, supra note 59 (QB), at paragraph 16.
- 62 *Jarvis*, supra note 37.
- 63 *Ibid.*, at paragraph 2. *Jarvis* is not mentioned in any of the cases subsequent to *Leroux* with the exception of *Agence du revenu du Québec c. Groupe Enico inc.*, 2016 QCCA 76, at paragraph 85, where *Jarvis* was raised in the context of delineating the scope of the powers of Revenu Québec.
- 64 The Supreme Court in *Jarvis*, supra note 37, at paragraph 94, proposed a series of factors to assist in determining the predominant purpose of an audit, such as asking the following questions:
 - “Was the general conduct of the authorities such that it was consistent with the pursuit of a criminal investigation?”
 - “Is the evidence sought relevant to taxpayer liability generally? Or, as is the case with evidence as to the taxpayer’s *mens rea*, is the evidence relevant only to the taxpayer’s penal liability?”
 - “Are there any other circumstances or factors that can lead the trial judge to the conclusion that the compliance audit had in reality become a criminal investigation?”

duty does not arise. There is no evidence of application of the *Jarvis* approach in the negligence cases to date. However, it is clear that, as Hughes J held in *Gordon*, with respect to the defendants' appeal against the prothonotary's refusal to strike out the plaintiff's claim, "[t]he case law is clearly evolving in this area, and the last word has yet to be written by an appellate court."⁶⁵

A further unresolved matter recurring in Canada is the question of whether and in what circumstances a tax official has any duty to warn taxpayers of potential harm identified in carrying out audits, investigations, or other checks of taxpayer information. In *Scheuer*,⁶⁶ the taxpayers claimed that the CRA was negligent in failing to warn them of risks involved in their investment in a tax shelter donation program that was ultimately found to be a sham.⁶⁷ The Federal Court of Appeal rejected the taxpayers' claim on the basis that to impose a duty of care in this case would "effectively create an insurance scheme for investors at great cost to the taxpaying public."⁶⁸ The decision in *Scheuer* is unsurprising. Actions that seek to impose duties on public officials to warn citizens of potential economic risks are notoriously difficult to prove in Canada. The Supreme Court of Canada's decisions in *Cooper*⁶⁹ and *Imperial Tobacco*⁷⁰ present obstacles for taxpayers attempting to establish a duty to warn.

Nevertheless, attempts to create the duty continue. For example, in *Easton v. Canada (Revenue Agency)*,⁷¹ the Federal Court held that CRA officials are under no

65 *Gordon*, supra note 38 (FC), at paragraph 39. The defendants were unsuccessful, and their appeal was dismissed by Hughes J.

66 *Scheuer*, supra note 1. The Federal Court of Appeal overturned the Federal Court decision of Diner J, striking out the plaintiffs' negligence claim (*Scheuer v. Canada*, 2015 FC 74). At the Federal Court, the defendants (the CRA and the attorney general of Canada) had failed in their first attempt to have the taxpayers' negligence claim struck out.

67 For a brief summary of the facts by Diner J at first instance, see *Scheuer*, supra note 66 (FC), at paragraph 4.

68 *Scheuer*, supra note 1, at paragraph 43, citing *Cooper*, supra note 9, at paragraph 55. The court also concluded that "this policy consideration applies to a duty of care to warn against investment in an improvident or suspect tax shelter . . . consistent with Parliament's intent that taxpayers should participate in a tax shelter at their own peril, not at the peril of Canadian taxpayers generally": *Scheuer*, supra note 1, at paragraph 44.

69 *Cooper*, supra note 9.

70 *Imperial Tobacco*, supra note 22, concerned a motion to strike out tobacco company allegations against the Canadian government of negligent misrepresentations and negligent design and failure to warn, based on alleged duties of care to warn the public of the risks posed by smoking "mild" cigarettes. The Supreme Court allowed the strike-out application on the basis that no such duty of care was owed by the Canadian government, and the plaintiff's claim therefore had no reasonable prospect of success.

71 2017 FC 113. The case was factually straightforward: the taxpayer had made a mistake in his tax return in claiming a deduction for non-deductible interest payments. The taxpayer argued that the mistake "was so obvious and important that, although he did not see it, the CRA should have seen it, and immediately correct [sic] it, rather than process his tax returns as submitted": *ibid.*, at paragraph 5.

duty to detect obvious mistakes that taxpayers have made in their tax returns. Similarly, in *Herrington v. Canada (National Revenue)*,⁷² the taxpayer argued that the duty of care that the CRA owes to Canadian taxpayers, as established in *Leroux*, extends to an obligation to inform taxpayers of income statement documentation missing from income tax returns and a duty to warn taxpayers before levying penalties. Again, the taxpayer's argument was rejected by the Federal Court.

Australasian Approaches

There is no recognized tort of negligent investigation in Australia or New Zealand equivalent to that recognized by the Supreme Court of Canada in *Hamilton-Wentworth*. In fact, the Australian High Court expressly rejected the existence of such a duty in *Tame v. New South Wales*.⁷³ Similarly, in *Gregory v. Gollan*, the High Court of New Zealand determined “that no such duty exists.”⁷⁴ The Australian and NZ approaches echo the UK courts' position. In *Hill v. Chief Constable of West Yorkshire*,⁷⁵ the House of Lords held that investigative bodies do not owe a duty of care to the subject of an investigation.⁷⁶ Following this reasoning, the Australian High Court has held:

[W]hen public authorities, or their officers, are charged with the responsibility of conducting investigations, or exercising powers, in the public interest, or in the interests of a specified class of persons, the law would not ordinarily subject them to a duty to have regard to the interests of another class of persons where that would impose upon them conflicting claims or obligations.⁷⁷

Although there is no evidence of any shift away from this general approach to the private-law duties of police and other investigatory bodies, the interlocutory

72 2016 FC 953.

73 2002 HCA 35. The court reasoned, *ibid.*, at paragraph 231, “It is unlikely that an investigating police officer owes a duty of care to a person whose conduct is under investigation.” Other Australian authorities for the proposition that police investigators owe no duty to suspects include *Courtney v. State of Tasmania*, 2000 TASSC 83; *Wilson and Ors v. State of New South Wales*, 2001 NSWSC 869, at paragraph 63; *Gruber bbnf Gruber v. Backhouse, the Commonwealth of Australia and Cotterill*, 2003 ACTSC 18, at paragraph 41 (AusLII); and *Duke v. State of New South Wales and Ors*, 2005 NSWSC 632, at paragraph 23.

74 2006 NZHC 426, at paragraph 16.

75 1987 UKHL 12.

76 The reasoning in *West Yorkshire* stems from concerns that imposing such a duty “would give rise to conflicting obligations, or would be contrary to public policy because it would cause the body to adopt an overly defensive approach or would otherwise impede the carrying out of the body's primary functions.” See *Farab*, *supra* note 32, at paragraph 90.

77 *Sullivan v. Moody*, 2001 HCA 59, at paragraph 60. Other Australian cases in which *West Yorkshire* has been applied include *State of NSW v. Tyszyk*, 2008 NSWCA 107; *Cran v. State of New South Wales*, 2004 NSWCA 92; *Rush v. Commissioner of Police*, 2006 FCA 12; and the cases cited in note 73, *supra*.

decision of the Australian Federal Court in *Farab* indicates that the matter may prove relevant in determining future negligence claims against Australian tax officials. Specifically, Wigney J indicated a willingness to distinguish the facts and circumstances of the plaintiff's proposed negligence case from the Australian cases concerning duties of care owed by police and other investigatory bodies.⁷⁸

Serendipitously, the law in Canada and that in Australasia may ultimately converge on the question of when a duty of care arises for tax officials carrying out audits involving no criminal allegations against the taxpayer. In Canada, the taxpayer's path is to extend the application of the Supreme Court of Canada's reasoning in *Hamilton-Wentworth* by drawing an analogy between criminal investigations and tax audits. In Australia and New Zealand, the taxpayer's path is to disclaim any such analogy.

Another unresolved issue in Australasia is the question of whether and in what circumstances tax auditors owe a duty to warn taxpayers or third parties of potential harm identified as part of an audit or investigation into the affairs of a taxpayer. In Australia, this question is also likely to be considered in any future substantive hearing of *Farab*. Wigney J has already pre-empted the likely starting point for resolving the issue, conceding that

as a general proposition, . . . it is unlikely to be the case that, when tax officers are undertaking investigations into the tax liabilities of a particular taxpayer, they owe a general duty to all other taxpayers, or other third parties in respect of the conduct of the investigation.⁷⁹

However, Wigney J was prepared to concede that particular facts might support the recognition of a common-law duty of care to persons potentially affected by harm identified during a tax audit. In Australia, the matter is likely to be resolved by assessing the degree of "control" of the tax officials over the relevant harm. The significance of control as a "salient feature"⁸⁰ for determining the taxpayer's claim was explained by Wigney J in *Farab*, citing the Australian High Court:

[O]n occasions, the powers vested by statute in a public authority may give it such a significant and special measure of control over the safety of the person or property of citizens as to impose upon the authority a duty of care. This may oblige the particular authority to exercise those powers to avert a danger to safety or to bring the danger to

78 *Farab*, supra note 32, at paragraph 93.

79 *Ibid.*, at paragraph 92.

80 The "salient features" approach to determining whether to impose a duty of care in novel cases involving statutory authorities has a long history in Australia. In 1976, in *Caltex Oil (Australia) Pty Ltd v. Dredge "Willemstad"*, 1976 HCA 65, at paragraph 46, Stephen J isolated a number of features that combined to constitute a sufficiently close relationship to give rise to a duty of care. However, the significance of this salient features approach was more recently affirmed by the High Court in cases such as *Crimmins v. Stevedoring Industry Finance Committee*, 1999 HCA 59; *Graham Barclay Oysters Pty Ltd v. Ryan*, 2002 HCA 54; and *Sullivan*, supra note 77.

the knowledge of citizens otherwise at hazard from the danger. In this regard, the factor of control is of fundamental importance.⁸¹

In determining the extent of control by the commissioner of taxation over the risk of harm to the plaintiff and, hence, the duty or otherwise to warn the taxpayer of that risk, Australian courts are likely to be especially careful to ensure that any finding is confined to the particular facts of the case. Thus, even if a taxpayer were to succeed, there is likely to be little scope to infer from that success the existence of any broader duty to warn.

RESIDUAL POLICY CONCERNS

Residual policy concerns are significant factors for judicial consideration in taxpayer negligence claims against tax officials. Courts have raised concerns that imposing a duty of care might expose tax authorities to large and indeterminate liability by opening the floodgates to litigation⁸² or unwittingly generate a range of overly defensive tax officer responses, or “chilling effects.”⁸³ The approaches to dealing with these concerns in Canada and Australasia have been far from uniform both within and across the various jurisdictions.

81 *Farah*, supra note 32, at paragraph 45, citing *Brodie v. Singleton Shire Council*, 2001 HCA 29, at paragraph 102.

82 The indeterminate liability concern encapsulates the desire to avoid “liability in an indeterminate amount for an indeterminate time to an indeterminate class.” This is the oft-quoted summary of the indeterminacy issue by a US jurist, Cardozo J, in *Ultramares Corporation v. Touche*, 255 NY 170 (NYCA 1931), at 179. One commentator has described the indeterminacy concern and its specific relevance to the duty-of-care question in the following terms: “One of the driving forces behind rejecting the existence of a duty of care has been the fear that it may expose a defendant to an indeterminate liability. Indeterminacy refers to not finding a duty of care when the liability flowing from that duty cannot be realistically calculated. Whether the liability is indeterminate will be determined by looking at whether the defendant knew or ought to have known of the number of claims and the nature of those claims.” Michael Legg, “Negligent Acts and Pure Economic Loss in the High Court” (2000) 12:1 *Insurance Law Journal* 101-10, at 107.

83 The chill factor effect is based on the premise that imposing liability on tax officials might provoke a range of overly defensive responses in the performance of their duties. For example, in the United States, chill factor concerns have been used to defend the powers of tax authorities to revoke or modify revenue rulings on a retroactive basis. For discussion, see Edward A. Morse, “Reflections on the Rule of Law and ‘Clear Reflection of Income’: What Constrains Discretion?” (1999) 8:3 *Cornell Journal of Law and Public Policy* 445-539, at 490. Similarly, it has been argued that higher-risk tax collection activities may be avoided for fear of being sued if a mistake is made. For example, reductions in tax collection actions by the US Internal Revenue Service (IRS) in the 1990s have been attributed to the threat of personal actions for damages against tax officials. For discussion, see Christopher M. Pietruszkiewicz, “A Constitutional Cause of Action and the Internal Revenue Code: Can You Shoot (Sue) the Messenger?” (2004) 54:1 *Syracuse Law Review* 1-68, at 5; and Seth Kaufman, “IRS Restructuring and Reform Act of 1998: Monopoly of Force, Administrative Accountability, and Due Process” (1998) 50:4 *Administrative Law Review* 819-36, at 827. It has also been argued that overdefensiveness might manifest in a reluctance by tax authorities to bring forward

The Canadian Position

In Canada, the relevance of residual policy concerns is assured as long as such claims are considered novel and courts are therefore required to continue to apply the two-stage *Anns-Cooper* test.⁸⁴ It will be recalled that the second stage of the *Anns-Cooper* test specifically requires judges to consider whether there are any residual policy considerations that might militate against imposing a duty of care.⁸⁵

In *Leroux*, Humphries J dismissed concerns about chilling effects, pointing out that holding tax auditors to a standard of care that makes them more careful is “not necessarily a bad thing.”⁸⁶ She similarly dismissed concerns about opening the floodgates to litigation and to large and indeterminate liability, describing the path to taxpayer recovery as “a steep uphill one” and concluding that “[i]t is difficult to envision a glut of lawsuits overcoming these onerous burdens.”⁸⁷

The significance ascribed to residual policy concerns in the context of taxpayer claims against the CRA continues to be debated.⁸⁸ While *Hamilton-Wentworth* is not a tax case, the reasoning of the Supreme Court of Canada in that case is instructive. The court cited a number of empirical and academic studies, and concluded that the “chilling effect” scenario remains speculative and “is not (on the basis of present knowledge) a convincing policy rationale for negating a duty of care.”⁸⁹

difficult cases for litigation, and a reduction in the pool of applicants for employment as public servants. See, for example, the comments of the United States Supreme Court in *Harlow v. Fitzgerald*, 457 US 800 (1982), at 816.

84 In *Grenon*, supra note 25, it was argued that in the wake of *Leroux*, taxpayer negligence claims should no longer be considered as raising a novel duty of care. The Alberta Court of Appeal rejected that argument, describing this characterization of the current state of Canadian law on the question of common-law duties owed by CRA officials to taxpayers as an “overreach” of the existing jurisprudence: *ibid.*, at paragraph 10.

85 See the text accompanying note 12, supra.

86 *Leroux*, supra note 2, at paragraph 287, referring to the following comments made in *Hamilton-Wentworth*, supra note 38, at paragraph 56: “In theory, it is conceivable that police might become more careful in conducting investigations if a duty of care in tort is recognized. However, this is not necessarily a bad thing. The police officer must strike a reasonable balance between cautiousness and prudence on the one hand, and efficiency on the other.”

87 *Leroux*, supra note 2, at paragraph 307. The full substantive observations of the court on the matter were as follows: “As for the spectre of widespread litigation, the battle for any plaintiff in this situation is a steep uphill one, as Mr. Leroux has found. While taxpayers subjected to an audit constitute a larger class as compared to those subjected wrongfully to criminal investigation as in *Hill*, in order to rely on a duty of care a potential plaintiff must establish the requisite degree of foreseeability and proximity in their particular situation, followed by proven breaches, causation, and damages. Any suit will be rigorously defended with unlimited resources. . . . It is difficult to envision a glut of lawsuits overcoming these onerous burdens.” *Ibid.*

88 Indeterminate liability or “floodgates” arguments often go hand-in-glove with chill factor concerns, and judges frequently discuss these issues together. See, for example, *783783 Alberta*, supra note 1; and *Nelles v. Ontario*, [1989] 2 SCR 170.

89 *Hamilton-Wentworth*, supra note 38, at paragraph 57. The majority judgment in *Hamilton-Wentworth* continues, *ibid.*, at paragraph 58: “The lack of evidence of a chilling effect despite

Although the jurisprudence is not uniform, several Canadian judges have taken a similar approach in tax cases. For example, in *Sherman v. Canada (Minister of National Revenue)*, Layden-Stevenson J agreed with the taxpayer's contention that "the chilling effect on future investigations is not a valid reason to refuse disclosure."⁹⁰ In contrast, in *Canadian Taxpayers Federation v. Ontario (Minister of Finance)*, Rouleau J dismissed the plaintiff's negligent misrepresentation claim pertaining to a broken written election promise not to introduce any new taxes, and observed:

Imposing a duty of care in circumstances such as exist in the present case would have a chilling effect. . . . Once elected, members [of the legislature] would be concerned about the representations they made during their election campaigns and would not consider themselves at liberty to act and vote in the public interest on each bill as it came before the legislature.⁹¹

Of course, it is important to note that, although this was a tax case involving assertions of negligence, it involved no allegations of CRA negligence. At most, the case may be indicative of the type of reasoning that could arise in factual situations in which the CRA might seek to resile from written representations made to taxpayers.

In *Scheuer*,⁹² the Federal Court adopted a similar approach to the court in *Leroux*, concluding that large and indeterminate liability should not negate a duty of care imposed on CRA officials. The court characterized the issue as "not necessarily determinative," particularly in cases involving a prospective liability to a clear and very narrow class of prospective claimants.⁹³ It will be recalled that *Scheuer* involved a claim by investors in a specific tax shelter donation program that was ultimately found to be a sham.⁹⁴

On the other hand, concerns of large and indeterminate liability were given more credence in *Grenon*. The Federal Court of Appeal resisted imposing a duty of

numerous studies is sufficient to dispose of the suggestion that recognition of a tort duty would motivate prudent officers not to proceed with investigations 'except in cases where the evidence is overwhelming.' This lack of evidence should not surprise us, given the nature of the tort. All the tort of negligent investigation requires is that the police act reasonably in the circumstances."

90 2004 FC 1423, at paragraph 16. This is similar to the approach in *Rubin v. Canada (Minister of Transport)*, 1997 CanLII 6385 (FCA), in which the chill factor argument was repeatedly described as "nebulous."

91 2004 CanLII 48177 (ONSC), at paragraph 71. For further examples, see 783783 *Alberta*, supra note 1; and *Leighton*, supra note 10.

92 *Scheuer*, supra note 66 (FC), at paragraphs 36-37. By way of comparison, in the subsequent appeal hearing, although the issue was not expressly addressed, the Federal Court of Appeal hinted at indeterminate liability concerns, noting the fear of creating an expensive "insurance scheme" (see *Cooper*, supra note 9, at paragraph 55) through imposing a duty of care in the circumstances pleaded by the plaintiff: *Scheuer*, supra note 1 (FCA), at paragraph 43.

93 *Scheuer*, supra note 66 (FC), at paragraph 36.

94 For a brief summary of the facts by Diner J, see *ibid.*, at paragraph 4.

care (in part) because of fear of raising the “spectre of indeterminate liability” through establishing “a duty . . . to all.”⁹⁵ It should be noted, however, that *Grenon* involved purported tax liabilities in the range of \$500 million. It is unclear whether this fact influenced the reasoning in the case. It remains to be seen which point of view will prevail in future.

Australasian Approaches

Concerns similar to those found in the Canadian case law are often raised in Australasian courts by tax authorities seeking to have taxpayers’ tortious claims against them struck out.⁹⁶ In Australia, there is evidence of judicial skepticism toward the chilling effect argument mirroring that exhibited by many Canadian judges, but the similarity with Canada ends there. Australian judges do not display the same willingness to address policy arguments so directly. As a result, residual policy concerns have received less explicit consideration by the courts.

In *Pape v. Commissioner of Taxation*, the commissioner argued that the taxpayer’s attempts to place constitutional limits on the appropriation power contained in section 81 of the Australian constitution would cause Parliament to be constantly “‘looking over its shoulder and being fearful of the long-term consequences’ if it made an appropriation outside power.”⁹⁷ The Australian High Court rejected the argument, observing that “[t]he occasional declaration that federal legislation is invalid does not cause the progress of government to be unduly chilled or stultified.”⁹⁸ While this case involved no allegation of negligence, it provides one of the few examples of the High Court’s expressly addressing chill factor concerns in a tax context and the cursory judicial disposition of the issue.

Similar trends are evident in New Zealand. For example, in *Ch’elle*, a similarly cursory approach (albeit validating chill factor concerns) was adopted. In *Ch’elle*, Keane J accepted, without elaboration, that “[t]here is a legitimate public interest in regulatory bodies being free to perform their role without the chilling effect of undue vulnerability to actions for negligence.”⁹⁹ The case involved allegations of negligence in the commissioner’s resiling from an earlier private tax ruling and disallowing goods and services tax (GST) credits claimed by the taxpayer.

As far as indeterminate liability arguments are concerned, there have been very few specific comments in Australasian cases, although the observations of Mason CJ

95 *Grenon*, supra note 25, at paragraph 13.

96 See, for example, *Farah*, supra note 32, at paragraph 90.

97 2009 HCA 23, at paragraph 589. The commissioner was relying on paragraph 24 of *Victoria v. Commonwealth and Hayden*, 1975 HCA 52, per Murphy J, who asserted that a narrow construction of the provision would have a “chilling effect . . . on governmental and parliamentary initiatives.” See *Pape*, supra, at paragraph 685.

98 *Pape*, supra note 97, at paragraph 596.

99 *Ch’elle*, supra note 32, at paragraph 87, affirming views expressed in *Rolls-Royce New Zealand Ltd v. Carter Holt Harvey Ltd*, 2004 NZCA 97.

in *Commissioner of State Revenue (Vic) v. Royal Insurance Australia Ltd*¹⁰⁰ are pertinent. In that case, Mason CJ indicated support for the proposition that loss from government error is more fairly borne by the taxpaying public as a whole than by victims of error by a revenue authority.¹⁰¹ While those comments were made in the context of an equitable claim for restitution against a state revenue authority, they indicate a judicial willingness to discount any concerns about potential disruption of public finances that might result from permitting private-law taxpayer claims.

STANDARD OF CARE

Despite the relatively large volume of taxpayer tort claims against Canadian tax officials, as already noted, taxpayer success in establishing the existence of a duty of care has been rare. Hence, there has been limited opportunity for judges to consider the standard of care required of tax officials to satisfy that duty of care. In both Australia and New Zealand, given the complete absence of any superior court recognition of a duty of care to taxpayers, unsurprisingly, there has been virtually no consideration of this issue. However, the limited judicial guidance to date indicates significant uncertainty and the emergence of this challenge as another common unresolved controversy.

The Canadian Position

Given the landmark recognition of a duty of care in *Leroux*, Humphries J had the opportunity to pronounce on the standard of care expected of tax auditors to fulfill the duty of care owed to taxpayers. However, the only general guidance provided by Humphries J was the acceptance, without elaboration, that CRA officials should be expected to adhere to the standards set out in the Canadian Taxpayer Bill of Rights (TBOR).¹⁰²

100 1994 HCA 61.

101 Ibid., at paragraph 26. For further discussion, see Keith Mason, "Money Claims By and Against the State," in P.D. Finn, ed., *Essays on Law and Government: The Citizen and the State in the Court*, vol. 2 (Sydney: Law Book, 1996), 101-35, at 104.

102 *Leroux*, supra note 2, at paragraph 315. TBOR assures the right of taxpayers

1. to receive entitlements and to pay no more and no less than what is required by law;
2. to service in both official languages;
3. to privacy and confidentiality;
4. to a formal review and a subsequent appeal;
5. to be treated professionally, courteously, and fairly;
6. to complete, accurate, clear, and timely information;
7. unless otherwise provided by law, not to pay income tax amounts in dispute before an impartial review;
8. to have the law applied consistently;
9. to lodge a service complaint and to be provided with an explanation of CRA findings;
10. to have the costs of compliance taken into account in the CRA's administration of tax legislation;

The majority of Humphries J's comments were directed to a number of specific complaints arising from the facts of the case.¹⁰³ Humphries J found that the CRA auditors had met the requisite standard of care expected of a reasonably competent auditor in all respects, save for the "manner in which penalties for income tax were considered and assessed."¹⁰⁴ The impugned actions included threatening the plaintiff with "gross negligence" penalties if he did not sign a statute-barred waiver for the 1993 tax year, an act that Humphries J described as a "punitive quid pro quo,"¹⁰⁵ concluding that the CRA auditors "simply proceeded with no apparent care or comprehension as to what they were doing to the taxpayer."¹⁰⁶

Beyond *Leroux*, it is difficult to find any settled Canadian judicial guidance on the standard of care expected of tax officials. In fact, it has been expressly noted that "[t]here are no directions in the [ITA] about how the Minister and his employees should carry out the duties under the [ITA],"¹⁰⁷ and that there is no standard set out anywhere, either implicitly or explicitly, to fix the essential requirements of an assessment or the intensity of any examination of a taxpayer.¹⁰⁸

Consistent with *Leroux*, in *Ludmer*, the Quebec Superior Court concluded that "the CRA must act reasonably in the conduct of an audit. The Taxpayer Bill of Rights helps define what a reasonable auditor would do."¹⁰⁹ However, it bears

-
11. to expect the CRA to be accountable;
 12. to relief from penalties and interest under tax legislation because of extraordinary circumstances;
 13. to expect the CRA to publish service standards and report annually;
 14. to expect the CRA to warn about questionable tax schemes in a timely manner;
 15. to be represented by a person of the taxpayer's choice; and
 16. to lodge a service complaint or request a formal review without fear of reprisal.

For more information, see Canada Revenue Agency, "Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer" (www.canada.ca/content/dam/cra-arc/formspubs/pub/rc17/rc17-18e.pdf).

- 103 These included the characterization of the plaintiff's income and expenses, the imposition of penalties, the process used on the plaintiff's internal CRA appeal, and the GST audit and assessment process.
- 104 *Leroux*, supra note 2, at paragraph 355.
- 105 *Ibid.*, at paragraph 351. This reasoning resembles a misfeasance characterization. Misfeasance in public office was raised in *Leroux* but struck out at the pleading stage of the proceedings.
- 106 *Ibid.*, at paragraph 353.
- 107 *Canus*, supra note 11, at paragraph 74.
- 108 *Ibid.*, at paragraph 75, citing comments of the Supreme Court of Canada in *Western Minerals Ltd. v. Minister of National Revenue*, [1962] SCR 592.
- 109 *Ludmer*, supra note 21, at paragraph 151, where the court also noted:
 - Negligence is sufficient to establish fault;
 - It is not necessary to prove that the CRA acted maliciously with a view to hurting the Plaintiffs. Intentional conduct will be necessary for punitive damages;

reiterating that *Ludmer* was a case decided according to the laws applicable in Quebec rather than Canadian common-law negligence principles.¹¹⁰ In contrast, most recently the Federal Court in *Gordon* considered the potential for TBOR to sustain allegations of a breach of duty of care, characterizing that duty as “nothing more than a set of aspirational principles” with no binding legal effect, and noting that the breach of a duty of care is not, per se, evidence of negligence.¹¹¹

Australasian Approaches

The absence of judicial authority in Australia makes it difficult to predict whether an approach comparable to that taken in *Leroux*, applying a standard of care informed by TBOR, will emerge. To date, however, judicial observations made in passing hint at a likely negative response to any suggestion that the Australian Taxpayers’ Charter¹¹² should be used as a tool for determining the standard of care expected of tax officials. In *Harris*, Grove J cursorily dismissed the taxpayer’s negligence claim and rejected the concept of the charter’s supporting a negligence claim. Grove J observed that “a departure from [a] standard” set out in documents such as the taxpayers’ charter did not give persons affected by the departure a “right to recover tort damages.”¹¹³ Further, he observed that “a duty [of care could not be] . . . established by

-
- The CRA can be wrong without being at fault—the CRA does not commit a fault if it reasonably takes a position that turns out to be wrong;
 - To the extent that the CRA has certain powers under the ITA, it must exercise those powers reasonably and not in an abusive fashion.

110 See *supra* note 21.

111 *Gordon*, *supra* note 2, at paragraph 168. The court characterized in similar terms the “TOM II Manual”—a manual containing a set of procedural guidelines for the conduct of CRA Special Investigations officials—which the plaintiffs unsuccessfully asserted had been breached by the CRA.

112 The Australian Taxpayers’ Charter commitments currently consist of the following:

- Treating you fairly and reasonably
- Treating you as being honest unless you act otherwise
- Offering you professional service and assistance
- Accepting you can be represented by a person of your choice and get advice
- Respecting your privacy
- Keeping the information we hold about you confidential
- Giving you access to information we hold about you
- Helping you to get things right
- Explaining the decisions we make about you
- Respecting your right to a review
- Respecting your right to make a complaint
- Making it easier for you to comply
- Being accountable.

For further information, see Australian Taxation Office, “Taxpayers’ Charter” (www.ato.gov.au/About-ATO/Commitments-and-reporting/Taxpayers--charter), “Your rights,” at 4-9.

113 *Harris*, *supra* note 40, at paragraph 12.

reference to proclamations such as the Taxpayers Charter which [merely] express aims of treating [taxpayers] . . . fairly and reasonably.”¹¹⁴ This approach echoes the reasoning of the Canadian Federal Court in *Gordon*, which characterized TBOR as “aspirational”¹¹⁵ and also observed that there is “no tort of ‘unfairness.’”¹¹⁶

While there has been no judicial comment in New Zealand, the NZ Inland Revenue Department (IRD) charter,¹¹⁷ like the Australian charter, has no legal force. It is very much a statement of IRD service commitments. Nevertheless, in the event of a future recognition of a duty of care owed by tax officials to NZ taxpayers, there would be nothing preventing NZ judges from referring to the charter to inform the relevant standard of care expected of tax officials.

A PRIMER FOR POLICY MAKERS’ CONSIDERATION

In this part of the article, attention turns to suggestions for reform to help address the unresolved controversies exposed in the preceding analysis of the Canadian, Australian, and NZ case law. As noted in the introduction to the article, these suggestions are not presented as a fully formed blueprint for reform. They are simply proposed as potentially viable options for consideration and debate.

Coexisting Common-Law and Public Duties

Courts uniformly continue to grapple with whether tax officials owe coexisting common-law duties to taxpayers alongside their statutory duties. Resolution of the issue has been hindered by the absence of any overarching express statutory statement addressing the possibility or desirability of imposing common-law duties on tax officials. In fact, the lack of tax-specific legislative guidance has generated various judicial responses, most of which have resulted in the rejection of taxpayer negligence claims.

In Australia, there has been no express legislative statement directly addressing the question of to whom the Australian commissioner owes his tax administration duties. This reticence has been interpreted as evincing a statutory intent to preclude the possibility of private-law duties coexisting with the commissioner’s public duties. Some Canadian courts have used similar reasoning to justify the rejection of any common-law duty of care imposed on tax officials. For example, as Dario J observed in *Grenon*,

114 Ibid.

115 *Gordon*, supra note 2, at paragraph 168.

116 Ibid., at paragraph 167.

117 New Zealand, Inland Revenue Department, “Inland Revenue’s Charter” (www.classic.ird.govt.nz/aboutir/commitment/aboutir-charter.html).

[s]hould Parliament wish to temper the CRA's authority by imposing a duty of care, it may do so. It is not appropriate for this Court to attempt to achieve that result through an unprincipled application of the law of negligence.¹¹⁸

There are few signs of any consistent shifts in judicial approach toward a more accommodating view of coexisting public and private duties, despite Canadian decisions such as *Leroux* (from which there appear to be early signs of retreat). This situation has developed notwithstanding the existence of general legislation in each jurisdiction establishing a starting premise that statutory authorities are subject to potential common-law suit. For example, in New Zealand, section 27(3) of the New Zealand Bill of Rights Act 1990 specifically provides:

Every person has the right to bring civil proceedings against, and to defend civil proceedings brought by, the Crown, and to have those proceedings heard, according to law, in the same way as civil proceedings between individuals.

In Australia, Crown immunity from suit was similarly abolished by section 64 of the Australian Judiciary Act 1903. Section 64 provides:

In any suit to which the Commonwealth or a State is a party, the rights of parties shall as nearly as possible be the same, and judgment may be given and costs awarded on either side, as in a suit between subject and subject.

Australian states and territories have similarly abrogated Crown immunity from suit in their respective jurisdictions. In Canada, section 3 of the Crown Liability and Proceedings Act¹¹⁹ serves a similar purpose. It provides that the Crown is liable for the damages for which it would be liable if it were a person, in respect of torts committed by servants of the Crown.

One author writing about the Canadian legislation has suggested that the courts in cases such as *Canus* have applied an unnecessarily narrow interpretation of the Crown Liability and Proceedings Act, and has proposed that the statute be amended to provide clearer judicial guidance.¹²⁰ However, even setting aside such concerns, the limitation of this legislation is that, while it deals with the ability to bring an

118 *Grenon*, supra note 59 (QB), at paragraph 84. This statement echoes the reasoning in earlier cases such as *Canus*, supra note 11, and *Leighton*, supra note 10. In contrast, the New Zealand Law Commission recently expressed the view that determining any principles limiting the liability of the Crown or its instrumentalities is “best left to the courts to continue to develop as they have in the past”: New Zealand Law Commission, *A New Crown Civil Proceedings Act for New Zealand*, NZLC IP no. 35 (Wellington, NZ: Law Commission, April 2014), at paragraph 3.1 (www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20IP35.pdf).

119 RSC 1985, c. C-50.

120 See Fazel, supra note 5, especially at 609-10.

action arising out of the negligence of tax officials, it provides little by way of clarity on the judicial approaches to resolving those claims once they are brought. It is in this particular respect that the analysis of the common unresolved controversies exposed in this article indicates that more specific legislative guidance is needed.

With this fact in mind, a useful starting point for both Australian and Canadian lawmakers might be to consider enacting legislation modelled on the “care and management” provisions contained in sections 6 and 6A of the New Zealand Tax Administration Act 1994 [TAA].¹²¹ Section 6A(2) is especially pertinent. It provides that in fulfilling the commissioner’s obligations for the care and management of the NZ tax system, “it is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law.”¹²²

In New Zealand, this express obligation to maximize revenue collection has been relied on by judges to conclude that imposing private-law duties on tax officials would contradict the express revenue collection maximization obligations of the IRD. This narrow interpretation appears to be reflected in the approach in *Ch’elle* and a number of other cases.¹²³ Hence, such legislation might not result in more frequent successful taxpayer negligence claims against tax officials. But it would provide a more robust legislative backing to current restrictive judicial approaches, and more certainty for taxpayers and tax officials.

Of course, such provisions could be drafted to more readily accommodate taxpayer claims if so desired. Viewed holistically, the NZ care and management provisions already support a more accommodating approach. For example, section 6 of the TAA requires all tax officials to ensure the integrity of the tax system—including protection of the “rights of taxpayers to have their liability determined fairly,

121 The expression “care and management” used in section 6A(2) of the TAA comes from the corresponding UK legislative scheme contained in the Inland Revenue Regulation Act 1809, (UK) and the Taxes Management Act 1970 (UK), 1970, c. 9. For a discussion of the operation of the UK provisions, see *Inland Revenue Commissioners v. National Federation of Self-Employed and Small Businesses Ltd.*, [1981] 55 TC 133 (www.bailii.org/uk/cases/UKHL/1981/TC_55_133.pdf).

122 Section 6A(2) of the TAA in its substantive entirety states:

It is the duty of the Commissioner to collect over time the highest net revenue that is practicable within the law having regard to:

- (a) the resources available to the Commissioner; and
- (b) the importance of promoting compliance, especially voluntary compliance, by all persons with the Inland Revenue Acts; and
- (c) the compliance costs incurred by persons.

123 For example, as the NZ High Court, per Harrison J, noted in *Westpac Banking Corporation v. Commissioner of Inland Revenue*, 2007 NZHC 1151, at paragraph 46, the provisions reduce the scope to challenge tax authority decisions “to rare or exceptional cases.” For an example of academic commentary supporting a similarly narrow interpretation of the care and management provisions, see Andrew Alston, “Taxpayers’ Rights in New Zealand” (1997) 7:1 *Revenue Law Journal* 211–25, at 212.

impartially, and according to law.”¹²⁴ Hence, the revenue collection maximization obligations of the IRD are qualified rather than absolute.

Irrespective of its final form, legislative clarity might also help judges to move away from problematic sweeping characterizations of tax official functions that are currently relied upon—particularly in Canada—to reach and support conclusions concerning the possibility of coexisting common-law and public tax official duties. Prime among these are the policy/operational dichotomy and related regulatory/non-regulatory function delineations.

In Canada, there is some evidence that these distinctions are starting to lose favour. For example, in *Carboun & Sons Enterprises Ltd. v. Canada (Attorney General)*,¹²⁵ the BC Court of Appeal chose not to rely on any distinction between regulators and non-regulatory bodies. Instead, the court called for a less categorical and dichotomous approach to determining whether the relevant statutory scheme permits the imposition of common-law duties on statutory authorities such as the CRA.¹²⁶

Such distinctions, particularly the policy/operational dichotomy, have also lost favour in common-law courts outside Canada.¹²⁷ For example, Australian courts today favour a more overt “incremental approach”¹²⁸ founded on an examination of

124 Section 6(2)(b) of the TAA.

125 2015 BCCA 163. This case involved allegations that the plaintiff had suffered losses as a result of negligence and misfeasance of the government of Canada arising from delays of government officials in carrying out an environmental assessment of the plaintiff’s planned property development. At the BC Court of Appeal, the Canadian government unsuccessfully sought to have the plaintiff’s statement of claim struck out on the basis that the public duties contained in the relevant statute (the Fisheries Act, RSC 1985, c. F-14) were irreconcilable with a private duty of care in negligence and therefore the plaintiff’s claim had no reasonable prospect of success.

126 For example, the court conceded that the distinction requires affording “due deference” to the decision of a public official to prioritize particular public interests over those of private individuals, even if those priorities result in private individual losses through otherwise apparently operational failures (for example, delays in making or communicating a decision): *Carboun*, supra note 125, at paragraph 125.

127 In large part, this is due to the difficulty of delineating between policy and operational acts. The dilemma was enunciated by Lord Slynn in the English case of *Barrett v. Enfield London Borough Council*, [2001] 2 AC 550, at 571: “[It] does not . . . mean that if an element of discretion is involved in an act being done . . . common law negligence is necessarily ruled out. . . . [A]s has often been said even knocking a nail into a piece of wood involves the exercise of some choice or discretion and yet there may be a duty of care in the way it is done.” Lord Slynn’s reference to “knocking a nail” is derived from the US case of *Ham v. Los Angeles County*, 45 Cal. App. 148 (1920), at 162, where it was noted that “[i]t would be difficult to conceive of any official act, no matter how directly ministerial that did not admit of some discretion in the manner of its performance, even if it involved only the driving of a nail.”

128 In Australia, this rationale was first broached by Brennan J in *Council of the Shire of Sutherland v. Heyman*, 1985 HCA 41, at paragraph 14, in the following terms: “It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care

the “salient features”¹²⁹ of the particular case. This approach was most recently applied by the Australian Federal Court in *Farah*.

While the Australian approaches are no substitute for legislative clarification, an overt shift away from the application of dichotomies to classify tax officials’ duties in Canada may be worth considering in the interim.¹³⁰ It would certainly help to produce more realistic outcomes, reflecting the reality that not all tax official functions fit neatly within any single silo.

Duties of Tax Officials in Carrying Out Audits

A similar prescription of legislative clarification would aid in addressing the vexing question of the common-law duties (if any) to be imposed on tax officials in carrying out audits. In fact, legislative guidance on this issue is likely to prove the most practically useful intervention because the majority of taxpayer negligence claims to date have involved allegedly defective tax audits and investigations.¹³¹

At present, the legislative silence is likely resulting in judicial rejection of more taxpayer claims against tax auditors than might otherwise be the case. For example,

restrained only by indefinable ‘considerations which ought to negative, or to reduce or limit the scope of duty or the class of persons to whom it is owed.’” For similar views applied in the United Kingdom, see *Caparo Plc v. Dickman*, [1990] 2 AC 605 (HL); *X (Minors) v. Bedfordshire County Council*, 1995 UKHL 9; and *Barrett*, supra note 127. The incremental approach was adopted in recent leading Australian cases involving allegations of negligence against public authorities including *Crimmins*, supra note 80; and *Pyrenees Shire Council v. Day*, 1998 HCA 3. See also *infra* note 135.

129 See the discussion in note 80, *supra*.

130 As noted in note 126, *supra*, and the accompanying text, there is some evidence of such a shift in judicial thinking in Canada (for example, in *Carboun*, supra note 125); however, this is far from a uniform trend.

131 Statutory protections afforded to tax officials carrying out other core tax functions, such as tax assessments, limit the avenues for taxpayer challenge and recovery. For example, section 109 of the New Zealand TAA provides:

Except in objection proceedings under Part 8 or a challenge under Part 8A,

(a) no disputable decision may be disputed in a court or in any proceedings on any ground whatsoever; and

(b) every disputable decision and, where relevant, all of its particulars are deemed to be, and are to be taken as being, correct in all respects.

In Australia, similar restrictions are contained in section 175 of the Income Tax Assessment Act 1936, No. 27, 1936, and division 350 of schedule 1 of the Taxation Administration Act 1953, No. 1, 1953. These provisions effectively provide that production of a notice of assessment is conclusive evidence of the due making of the assessment and, except in proceeding under part IVC of the Taxation Administration Act 1953 on a review or appeal relating to the assessment, that the amount and all the particulars of the assessment are correct. In Canada, similar restrictions are contained in subsection 152(8) of the ITA, which provides, “An assessment shall, subject to being varied or vacated on an objection or appeal under this Part and subject to a reassessment, be deemed to be valid and binding notwithstanding any error, defect or omission in the assessment or in any proceeding under this Act relating thereto.”

in Canada, according to Hood J in *Canus*, the absence of legislative directions concerning the “intensity of taxpayer examinations” evinces a statutory intent to preclude the existence of any duty of care owed by tax auditors to taxpayers in carrying out audits.¹³²

Despite the arguably dubious reasoning behind the assertion that statutory silence indicates an intention to preclude the imposition of common-law duties on tax auditors, it is understandable that judges have adopted this position.¹³³ Ever conscious of the separation of legislative and judicial functions, judges are naturally reluctant to risk overstepping their judicial mandate by inferring a non-existent legislative intent.¹³⁴

In addition, without legislative guidance, it is unlikely that judges will be able to move beyond the current judicial preoccupations with attempting to draw analogies between tax audits and other investigatory contexts, such as criminal investigations, in order to determine taxpayer negligence claims. This is because the development of new tort-law duties and standards in novel cases in each of the jurisdictions examined occurs gradually through reference to analogous cases and circumstances.¹³⁵ Ultimately, therefore, it is unrealistic to expect superior court development of a stand-alone thread of authority dealing with tax auditors that is derived independently of any comparison with broadly analogous contexts such as criminal investigations. A stand-alone body of case law can only be built on a foundation of legislative clarity concerning the nature of tax audit and investigation duties.

132 See supra notes 107 and 108, and the accompanying text.

133 As noted by Lord Wilberforce in *Anns*, supra note 9, at 5, statutory silence does not absolve public officials from all private-law responsibility; rather, in such circumstances, the common-law duty is simply modified to “a duty to avoid causing extra or additional damage beyond what must be expected to arise from the exercise of the [statutory] power or duty.” It is difficult, therefore, to sustain an argument that the absence of specific legislative directives as to how CRA officials are to carry out their duties necessarily negates any common-law duty of care to taxpayers. To sustain this argument, there must be something more specific in the legislative scheme.

134 Concerns such as these underpin core principles used to assist in resolving novel negligence claims against public officials, such as the policy/operational dichotomy. This has been confirmed in a number of jurisdictions, including Australia and the United Kingdom. For example, see *Rowling v. Takaro Properties Ltd.*, [1988] AC 473 (PC), at 501, where Lord Keith of Kinkel noted that the policy/operational distinction was developed to address “the need to exclude altogether those cases in which the decision under attack is of such a kind that a question whether it has been made negligently is unsuitable for judicial resolution.” Similar comments were made by the Australian High Court in *Heyman*, supra note 128, at paragraph 39. For academic discussion, see R.A. Buckley, “Negligence in the Public Sphere: Is Clarity Possible?” (2000) 51:1 *Northern Ireland Legal Quarterly* 25-47, at 41.

135 As discussed in note 128, supra, in Australia a formal “incremental approach” has long been used for resolving novel tort claims. For example, see *Heyman*, supra note 128, and *Sullivan*, supra note 77. Pertinently, both of these cases were recently cited by the Australian Federal Court in *Furab*, supra note 32, at paragraph 41. For an interesting academic discussion of incrementalism in Australia, see Prue Vines, “The Needle in the Haystack: Principle in the Duty of Care in Negligence” (2000) 23:2 *University of New South Wales Law Journal* 35-57.

To the extent that policy makers continue to be absent from this space and judges are left to continue to resolve the question of auditor duties unaided by legislative clarification, perhaps the best course is for judges to move beyond the criminal/civil investigation debate that has occupied so much attention to date—particularly in Canada. A useful alternative starting point might be the voluminous case law concerning the duties of private-sector auditors. Discussion of this body of law is conspicuously absent from the tax auditor negligence cases in all three of the jurisdictions examined.

There are likely good reasons for this, including the absence of comparable public duties owed by private-sector auditors and the interweaving of contractual and private-law duties in most cases involving private-sector audits. However, even if unsuitable for establishing a general thread of legal authority concerning tax auditor duties and standards of care, this body of case law may still prove useful. For example, it could assist in determining unresolved questions such as the judicial treatment of the duty of tax officials in carrying out audits to warn third parties who are not the subject of the audit that the audit findings could have potentially detrimental effects on those third parties. There are many cases considering the duty of private-sector auditors to warn persons with whom there is no contractual auditor-client relationship of risks identified as part of an audit.¹³⁶

In Australia, there is evidence of some judicial willingness to extrapolate from cases concerning other private-sector professionals, such as bankers, to address duty-to-warn issues.¹³⁷ Such comparisons with private-sector employees—auditors, bankers, and others—will likely become more relevant over time as tax authorities increasingly seek to apply private-sector service standards and practices to their

136 The issue has been the subject of significant judicial attention across the common-law world. Leading examples include, in the United States, *Ultramares Corporation v. Touche*, supra note 82; in the United Kingdom, *Caparo Plc*, supra note 128; in Canada, *Haig v. Bamford et al.*, [1977] 1 SCR 466; in New Zealand, *Scott Group Ltd v. Macfarlane*, 1977 NZCA 8; and in Australia, *Esanda Finance Corporation Ltd v. Peat Marwick Hungerfords*, 1997 HCA 8. The issue has also long been a fertile subject for academic discussion. For an excellent summary of the law across common-law jurisdictions, see Martin Davies, “The Liability of Auditors to Third Parties in Negligence” (1991) 14:1 *University of New South Wales Law Review* 171-97. In the United States, the academic discussion commenced almost a century ago. For an early example, see David Himmelblau, “Auditors’ Responsibilities to Third Parties” (1933) 8:2 *Accounting Review* 99-104.

137 In *Farah*, supra note 32, at paragraphs 79-88, the Australian Federal Court referred to banking-law cases concerning the duties of bankers to check customer bank account details and potential misuses of taxpayer bank accounts. Pertinently, the court drew direct parallels between the duties of bankers and those of tax officials, observing, “Like a bank acting on an otherwise valid instruction to pay out funds, the Commissioner [of Taxation] could not be expected to be under any duty to withhold a refund, or make further inquiries, unless he was in some way on notice that there was some irregularity in relation to the nominated account, or some other facts which might suggest fraud or dishonesty. It is, however, at least arguable that the Commissioner might owe a duty of care to a taxpayer in respect of the payment of refunds if he is on notice of such matters.” *Ibid.*, at paragraph 88.

day-to-day operations and taxpayer interactions.¹³⁸ In this context, submissions in taxpayer negligence cases calling for tax officials to be held to private-sector accountability standards will inevitably become increasingly common.

Residual Policy Concerns

The preceding discussion has revealed an array of judicial approaches to dealing with residual policy concerns, such as the fear of indeterminate liability and the fear of generating overly defensive responses by imposing common-law liability on public officials. To address this unresolved controversy, there is a range of possible solutions. These solutions involve contributions by the judiciary, the legislature, and researchers alike.

In terms of judicial action, judges in tax cases should attempt to follow the lead of the Supreme Court of Canada in *Hamilton-Wentworth* and subject residual policy concerns to genuine evidentiary scrutiny. It will be recalled that in *Hamilton-Wentworth* the court dealt with the policy concerns raised only after close consideration of empirical research testing the validity of those concerns.

Ideally, judges could go a step further and overtly weigh competing policy concerns. For example, increased trust and confidence in the fairness of the tax administration system resulting from imposing a common-law duty of care in cases of clear tax official negligence might generate positive taxpayer compliance behaviours.¹³⁹ These positive behavioural responses might counter any potential negative behavioural responses of tax officials to successful taxpayer claims. This type of weighing of policy concerns is implicit in the court's comments in *Leroux* that making tax officials liable in tort is "not necessarily a bad thing."¹⁴⁰

138 An obvious indicator is the adoption of private-sector nomenclature, such as referring to taxpayers as "customers" or "clients," and more broadly the corporate business plans of the respective tax authorities in each jurisdiction examined.

139 The positive relationship between greater taxpayer trust and confidence, and increased voluntary compliance is well known and generally accepted. For good examples of the research into the link, see Kristina Murphy, "The Role of Trust in Nurturing Compliance: A Study of Accused Tax Avoiders" (2004) 28:2 *Law and Human Behaviour* 187-209; John T. Scholz and Mark Lubell, "Trust and Taxpaying: Testing the Heuristic Approach to Collective Action" (1998) 42:2 *American Journal of Political Science* 398-417; and K. Murphy, "Procedural Justice and Tax Compliance" (2003) 38:3 *Australian Journal of Social Issues* 379-407. Some recent empirical work by the US National Taxpayer Advocate Service also hints at the existence of this link; see National Taxpayer Advocate Service, *Annual Report to Congress 2018*, vol. 2 (Washington, DC: Internal Revenue Service, 2019) (https://taxpayeradvocate.irs.gov/Media/Default/Documents/2018-ARC/ARC18_Volume2.pdf). A recent "service transformation" statement by the CRA appears to acknowledge the link: "[O]ur commitment to the client experience will be at the centre of everything we do, with a view to increasing trust in the CRA and fostering sustainable voluntary compliance." Canada Revenue Agency, "Summary of the Corporate Business Plan 2019-20: With Perspectives to 2021-22, Trusted, Helpful and Fair by Putting People First," at 16 (www.canada.ca/content/dam/cra-arc/corp-info/aboutcra/corp-bsns-plan/2019-2022/smmry22-en.pdf).

140 See *supra* note 86.

Unfortunately, judges across all three jurisdictions are severely hampered in their ability to apply such rigorous and balanced scrutiny to residual policy concerns in tax cases, owing to the absence of tax-specific empirical study of these concerns. In particular, there is at present no empirical clarity on important questions such as how tax officials will respond to the threat of suit or how taxpayers will respond to any increased prospect of success in any taxpayer claim against tax officials. Hence, there is a clear and pressing need for researchers to engage with these issues.¹⁴¹

Even with the best efforts of researchers, it may prove impossible to fully understand and predict the behavioural responses of taxpayers and tax officials should the courts become more willing to accept the ability of taxpayers to sue tax officials for negligence. If this is the case, the answer may be for the legislature to intervene and form a view on whether or not the potential risks would be offset by the benefits of allowing such claims to proceed. A considered legislative approach along these lines would necessarily involve some assessment of the acceptable limits of any exposure to potential negative consequences if taxpayers were to bring such a suit. Examples of this type of approach are encapsulated in legislation in the United States.

The US Internal Revenue Code¹⁴² (IRC) includes limited statutory rights to sue tax officials for damages, which extend to certain unauthorized negligent tax collection actions.¹⁴³ This right to sue contains a number of restrictions aimed at limiting potential exposure to indeterminate liability and undue generation of negative behavioural responses through exposing tax officials to negligence claims. Restrictions on the right to sue include a requirement to exhaust all other administrative avenues of relief prior to seeking statutory damages relief.¹⁴⁴ Any loss recoverable is also

141 As far as the chill factor effect is concerned, a useful starting point for such research engagement is the Australian work by Creyke and McMillan into the effects of adverse judicial review determinations on government bodies: see Robin Creyke and John McMillan, "The Operation of Judicial Review in Australia," in Marc Hertogh and Simon Halliday, eds., *Judicial Review and Bureaucratic Impact: International and Interdisciplinary Perspectives* (Cambridge: Cambridge University Press, 2004), 161-89. The findings from that study indicated that, aside from a few noted exceptions, there was no evidence of significant overdefensiveness or chill factor consequences. The study concluded, *ibid.*, at 187, that changes brought about by an adverse judicial review outcome were generally received by affected agencies as "valuable and instructive."

142 Internal Revenue Code of 1986, as amended.

143 Specifically, section 7433 of the IRC. Section 7433(a) contains the primary cause of action. It relevantly provides, "If, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title, such taxpayer may bring a civil action for damages against the United States in a district court of the United States."

144 Section 7433(d)(1) of the IRC provides, "A judgment for damages shall not be awarded . . . unless the court determines that the plaintiff has exhausted the administrative remedies available to such plaintiff within the Internal Revenue Service."

reduced to the extent that the loss could have reasonably been mitigated by the aggrieved taxpayer.¹⁴⁵

The US statutory damages remedy for negligence also imposes a tight statute of limitations: claims must be made within two years of the date on which the right to action accrues.¹⁴⁶ The incorporation of adverse costs consequences for unsuccessful claimants and clear monetary limits on the quantum that can be claimed—a modest \$100,000 (inclusive of costs) in the case of a negligence claim¹⁴⁷—are also intended to address fears of potential erosion of the revenue.

The US approach is not raised here as an exemplar or template for Canada, Australia, or New Zealand to follow. It arose out of a particular political climate¹⁴⁸ and legal context,¹⁴⁹ and it has its critics.¹⁵⁰ However, its existence shows that it is possible for both the legislature and the judiciary to share the burden of delineating the proper limits of taxpayers' ability to sue tax officials for negligence, bearing in mind potentially valid—but largely untested—residual policy concerns.

145 Section 7433(d)(2) of the IRC provides, "The amount of damages awarded . . . shall be reduced by the amount of such damages which could have reasonably been mitigated by the plaintiff." This may be an especially pertinent addition in any Canadian legislative proposal, since there is already evidence in the Canadian cases of the significance of mitigation to taxpayer success. Specifically, in *Leroux*, supra note 2, the plaintiff was ultimately unsuccessful because he was considered to have failed to demonstrate a sufficient causal link between the negligence and his alleged losses, and to have taken insufficient steps to mitigate his losses. Humphries J considered the plaintiff's 18-month delay in appealing the CRA tax assessments as an unacceptable failure to mitigate his losses: *Leroux*, supra note 2, at paragraph 386.

146 This limitation is contained in section 7433(d)(3) of the IRC.

147 Section 7433(b) of the IRC. The maximum is \$1 million for cases involving reckless or intentional actions.

148 This climate has been described as one in which Congress was prompted to act in response to "thousands of *horror stories* received from constituents concerning dealings with the IRS": Linda A. Shaya, "The New Taxpayer's Bill of Rights: Panacea or Placebo?" (1988) 65:3 *University of Detroit Law Review* 445-526, at 445 (emphasis in original). For further discussion, see Creighton R. Meland, "Omnibus Taxpayers' Bill of Rights Act: Taxpayers' Remedy or Political Placebo?" (1988) 86:7 *Michigan Law Review* 1787-1818.

149 Although claims against tax officials have been permitted for decades under the Federal Tort Claims Act 1964 (FTCA), the statute contains a specific carve-out preserving immunity from suit in cases involving tax collection or assessment. Specifically, 28 US Code section 2680(c) provides that, with four specified exceptions, the FTCA does not authorize claims "arising in respect of the assessment or collection of any tax or customs duty, or the detention of any goods, merchandise, or other property by any officer of customs or excise or any other law enforcement officer." Hence, from a legal perspective, section 7433 of the IRC was enacted to modify this restriction on the ability to sue in respect of certain tax collection actions.

150 For examples of some of the critiques of the legislation, see Abe Greenbaum, "United States Taxpayer Bill of Rights 1, 2, and 3: A Path to the Future or Old Whine in New Bottles?" in Duncan Bentley, ed., *Taxpayers' Rights: An International Perspective* (Gold Coast, Qld.: Revenue Law Journal, School of Law, Bond University, 1998), 347-79; and Leandra Lederman, "Of Taxpayer Rights, Wrongs and a Proposed Remedy" (2000) 87:8 *Tax Notes* 1133-42.

Standard of Care

As noted above, there is little guidance on the standard of care to be expected of tax officials in Canada, Australia, or New Zealand. The only real guidance is the emerging Canadian proposition that standards set out in charters of taxpayer rights such as TBOR should be considered the minimum standard. However, even if this approach emerges as the accepted minimum across all jurisdictions, practical problems remain. These stem from the general and aspirational nature of many of the commitments set out in TBOR and its international equivalents, such as Australia's taxpayers' charter and New Zealand's IRD charter. Specifically, many of these commitments are incapable of providing much practical guidance for either taxpayers or tax auditors on the expected standard of care.

For example, how does the TBOR right to be treated "courteously," or the equivalent NZ IRD charter commitment to "courteous and professional" treatment, translate to a measurable standard of care?¹⁵¹ While this example may appear trite, concepts such as "fairness" (also included in TBOR and Australia's Taxpayers' Charter)¹⁵² are much more significant in the legal context, and they are open to a similarly broad range of contextual interpretations, which are difficult to translate into specific standards of care capable of providing practical guidance for taxpayers or tax officials.¹⁵³

Again, legislative clarification may ultimately prove to be the most practically useful path. While it may be undesirable or impossible to reduce concepts such as fairness to an all-encompassing closed list of functional standards, it is possible to implement legislative or regulatory measures that could be of some guidance.

151 TBOR contains a right "to be treated professionally, courteously, and fairly," which is elaborated as follows: "You can expect we will treat you courteously and with consideration at all times, including when we ask for information or arrange interviews and audits. Integrity, professionalism, respect, and collaboration are our core values and reflect our commitment to giving you the best possible service. You can also expect us to listen to you and to take your circumstances into account, which is part of the process of making impartial decisions according to the law. We will then explain our decision and inform you of your rights and obligations regarding that decision." "Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer," *supra* note 102, at 6. See also the IRD charter, *supra* note 117.

152 Australia's charter currently refers to a number of general and aspirational commitments, such as treating the taxpayer "fairly" and offering the taxpayer "professional service and assistance"; see *supra* note 112. As noted in note 151, *supra*, Canada's TBOR contains an express commitment to treat taxpayers fairly. New Zealand's IRD charter does not make express reference to fairness but does include a commitment to "consistency and equity": New Zealand, Inland Revenue Department, "[Inland Revenue's Charter (IR 614)] How We Will Work with You," March 2009 (www.classic.ird.govt.nz/resources/b/c/bccdf4004ba3d313a262bf9ef8e4b077/ir614.pdf).

153 For example, as noted by the Supreme Court of Canada in *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 SCR 817, at 819, procedural fairness, which is central to the concept of natural justice in judicial review proceedings, is "flexible and variable and depends on an appreciation of the context of particular statute and the rights affected."

Again, it may be useful to look to the United States for an example and a trigger for discussion among policy makers. In the United States, requirements that tax official supervisors annually assess their staff for compliance with obligations to treat taxpayers “fairly” have been legislatively enshrined. Specifically, section 1204(b) of the IRC requires Internal Revenue Service (IRS) managers to “use the fair and equitable treatment of taxpayers by employees as one of the standards for evaluating employee performance.” Further, section 7803(d)(1)(2000) of the IRC requires the Treasury inspector general for tax administration to annually evaluate whether the IRS has complied with section 1204(b).

This type of legislative development provides an opportunity to translate aspirations such as the fair treatment of taxpayers into measurable performance standards. In turn, such performance standards could provide clearer guidance for taxpayers and tax officials on the question of how such aspirations might translate into minimum common-law standards of care—provided that they are made public.¹⁵⁴ Ideally, if expected standards were entrenched in such a practical and overt way, one would expect those standards over time to translate into better performance by tax officials, fostering taxpayer trust and confidence and, perhaps, minimizing taxpayer negligence claims. Tax officials could also use compliance with such measures as solid evidentiary proof of having met the minimum standard of care expected of them.

CONCLUSION

As has been apparent from the outset, the law pertaining to duties owed by tax officials to taxpayers is significantly more developed in Canada than it is in Australasia,

154 In this respect, in 2019 the Australian Parliament’s Standing Committee on Tax and Revenue recommended that the Australian Taxation Office formulate appropriate benchmarking performance indicators to assess its performance against the Taxpayers’ Charter commitments, providing both quantitative and qualitative assessments. Parliament of Australia, House of Representatives Standing Committee on Tax and Revenue, *2017 Annual Report of the Australian Taxation Office Fairness, Functions and Frameworks—Performance Review* (Canberra: Commonwealth of Australia, February 2019), at paragraph 5.72 (https://parlinfo.aph.gov.au/parlInfo/download/committees/reportrep/024240/toc_pdf/2017AnnualReportoftheAustralianTaxationOffice.pdf). In Canada, a recent audit by the Office of the Auditor General made a number of recommendations for better reporting by the CRA, finding that “[t]he Agency also did not accurately report the results of its compliance activities, and its reporting was incomplete.” However, the recommendations did not extend to recommending that the CRA set benchmarks for reporting to evaluate compliance with TBOR commitments. See Office of the Auditor General of Canada, *2018 Fall Reports of the Auditor General of Canada to the Parliament of Canada: Report 7—Compliance Activities—Canada Revenue Agency* (Ottawa: Office of the Auditor General, 2018), at paragraph 7.92 (www.oag-bvg.gc.ca/internet/English/parl_oag_201811_07_e_43205.html). In New Zealand, the IRD collects data, but no longer reports publicly, on its charter performance and has ceased to include such information in its annual reports. The IRD does, however, publicize staff awards for those who display the values and expectations of the charter. For example, see New Zealand, Inland Revenue, “Annual Report 2018,” at 69 (www.classic.ird.govt.nz/resources/0/7/0774560a-7b44-4c03-8a76-cebe59f042c3/annual-report-2018.pdf).

simply by virtue of the volume and frequency of cases. However, it is questionable whether this has resulted in much more clarity for Canadian taxpayers or for Canadian tax officials seeking to determine the precise nature and scope of any common-law duties. Standing in the way of legal clarity are a number of unresolved controversies and emerging judicial challenges. The analysis in this article has demonstrated that such unresolved controversies and judicial challenges plague all three of the jurisdictions examined. Further, there is little evidence of any emerging uniform judicial resolution to any of these controversies and challenges.

This is unsurprising. Negligence claims against tax officials raise an array of public policy concerns that common-law courts are not well equipped to resolve.¹⁵⁵ These underpin a number of the core challenges examined in this article, especially the question of the possibility of coexisting common-law and public-law duties, and residual public policy concerns about imposing a common-law duty of care on tax officials. Resolution of these matters is hindered by a legislative vacuum in all three of the jurisdictions examined.

Accordingly, a number of possible legislative interventions have been proposed. These include a call for a motherhood statement clarifying legislative intent on the question of whether taxpayers are owed common-law duties by tax officials. At a fundamental level, this would confirm whether the prospect of taxpayers successfully suing negligent tax officials is real or merely hypothetical. If the existence of common-law duties to taxpayers were expressly confirmed, litigants and judges could focus on interpreting specific statutory provisions to determine whether a duty exists in the particular factual context. This would be a vast improvement on the generic debates prominent in a number of the judgments examined in this article and conducted in the present legislative void.

Neither this suggestion nor the other reform options canvassed are proposed as a panacea for the unresolved controversies identified in this article. Collectively, however, they do serve as a useful primer to spark sorely needed consideration and debate among policy makers. It is in this spirit that these suggestions for reform have been posited in this article. They have also been made with an awareness of the continuing, undiminished, and essential role of the judiciary in resolving taxpayer negligence claims against tax officials.

Irrespective of whether any of the specific recommendations made in this article are adopted, development and implementation of any solution to the unresolved highlighted controversies will take time. In the interim, we are likely to see continuing incremental, piecemeal, and potentially inconsistent judicial development across

155 Arguments concerning the suitability of courts to determine claims involving statutory authorities and the complex public policy concerns that these claims raise are sometimes expressed in terms of lack of “judicial competency” or “institutional competence.” For discussion of judicial competency to assess cases involving the exercise of powers by statutory authorities, see Paul Craig and Duncan Fairgrieve, “‘Barrett,’ Negligence and Discretionary Powers” (1999) 4 *Public Law* 626-50, especially at 632; and Chris Finn, “The Justiciability of Administrative Decisions: A Redundant Concept?” (2002) 30:2 *Federal Law Review* 239-63.

all three of the jurisdictions examined. It is also noteworthy that judicial consideration to date has not yet extended to extensive consideration of other key elements of the tort of negligence, such as causation, mitigation of loss, or proof and quantification of compensable damage.¹⁵⁶ It is likely that such consideration will give rise to further uncertainties and unresolved controversies.

Consequently, there will be continuing uncertainty, both for taxpayers seeking a remedy for negligent tax official behaviour and for tax officials seeking to carry out their duties free of the hovering spectre of a potential common-law suit.

156 As noted in note 145, *supra*, in *Leroux*, *supra* note 2, the plaintiff lost his case owing to a failure to establish causation or to adequately mitigate his losses. Causation principles and their application in *Leroux* were subsequently considered in *Groupe Enico inc.*, *supra* note 63, although in the context of deliberate action rather than negligence, and common themes have not yet emerged. Other recent Canadian cases make only passing reference to causation. For example, the Federal Court in *Gordon*, *supra* note 2, at paragraph 167, simply noted that “the requirement for a causal link between an investigative error and the outcome of the investigation is a significant liability limitation.” Such issues have not, to date, received any attention in Australia or New Zealand in the context of claims arising out of negligence by tax officials.

Policy Forum: Editors' Introduction— Election Platform Costing by the Parliamentary Budget Officer

The government of Stephen Harper created the position of the parliamentary budget officer (PBO)¹ in 2006, as promised by the Conservative Party in the 2005-6 election campaign. The mandate of the PBO was broad from the start, and included any analysis of matters relating to the nation's finances or economy. However, it did not provide for a role for the PBO during election periods. In 2017, the government of Justin Trudeau fulfilled its 2015 election campaign promise to amend the Parliament of Canada Act, to include in the mandate a role for the PBO during elections.² The new legislation included detailed provisions for costing of election campaign proposals from political parties.

Costing of election platforms involves estimating the federal fiscal impact of a proposed tax or expenditure measure. Some of these measures, such as changing a tax rate, are simple. Others involve complex calculations of takeup rates, administrative costs, and interactions with other programs and policies. Platform costing is a service that other countries' budget offices have been offering for some time, but for Canada this is new. Ontario's Financial Accountability Office, for example, has not moved into the platform-costing area.

The 2019 federal election was the first election with the PBO offering a platform-costing service. This Policy Forum aims to analyze the performance of the existing platform-costing framework and to provide guidance for the direction forward for future election campaigns.

The PBO released its own assessment of election proposal costing in early 2020.³ The evaluation proposed administrative changes relating to management of time budgets, reporting on "fixed envelope" amounts, and expansion of the use of memorandums of understanding. There were also proposals to update the range

1 In this introduction and the three articles that follow, "PBO" may refer to either the parliamentary budget officer or the Office of the Parliamentary Budget Officer, depending on the context.

2 Section 79.2 of the Parliament of Canada Act, RSC 1985, c. P-1, as amended, lays out the general mandate. Section 79.21 contains the mandate for general election periods, enacted by an Act To Implement Certain Provisions of the Budget Tabled in Parliament on March 22, 2017 and Other Measures, SC 2017, c. 20, section 128; royal assent June 22, 2017.

3 See Canada, Office of the Parliamentary Budget Officer, *Evaluation of Election Proposal Costing 2019* (Ottawa: PBO, January 2020) (www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/ADM001/ADM001_en.pdf).

and scope of the analysis by, for example, shifting to a five-year baseline window, providing more online tools, and expanding to distributional and behavioural response analysis. The report concluded that “there is a consensus that the [election platform-costing] service provided to political parties enhanced the credibility of the democratic process.”⁴

In our view, the self-assessment from the PBO was on target for its proposed changes and fair in concluding that the service had enhanced the democratic process. However, a deeper analysis from outside experts can further enhance the discussion of possible changes to the election platform-costing service for the next election. The three articles gathered here attempt to make this contribution.

The first article by two former PBO officials, Mostafa Askari and Kevin Page, shows the boundary of what a PBO can and should do, using the example of the analysis that the institution offered during the 2019 election.⁵ The University of Ottawa’s Institute of Fiscal Studies and Democracy provided assessments and grades of each party’s overall platform, using the criteria of realistic assumptions, fiscal responsibility, and transparency. These judgments are more subjective in nature than the “just numbers” approach of the PBO and might have been tough for a non-partisan parliamentary office to attempt. Askari and Page argue that the PBO should stick to technical and specific costings, leaving outside institutions to provide the more subjective complementary judgments.

The second article is by Scott Cameron, who writes from his worldwide experience with budget offices.⁶ Cameron begins with a comparison of election costings in the Netherlands and Australia to open up the range of possible outcomes. He then describes and assesses how well the PBO performed during the 2019 election and provides several useful suggestions for reform. He advocates expanding the scope of the service to include not just distributional analysis but also environmental and social analysis of platforms. He also proposes publishing pre-election reports of the complete platform, rather than piecemeal policy items, in order to best capture interactions across policies. Finally, he suggests a reconsideration of whether the PBO’s platform-costing reports should be published or confidential. Confidential reports can be useful to parties (and eventually to voters) by allowing parties to pre-test policies without having them published.

The third article is by two political scientists, Jennifer Robson and Mark Jarvis. They argue that Canada should learn from international experience, drawing on the examples of the Netherlands, Australia, and Ireland. In order to obtain more detailed analyses and to advance public debate, they propose earlier submission and costing of platform items. This would allow time for a more comprehensive analysis

4 Ibid., at 1.

5 Mostafa Askari and Kevin Page left the PBO well before the 2019 election cycle, so are able to comment on the process with sufficient perspective.

6 Scott Cameron had a hand in designing some of the administrative procedures for election platform costing but left the PBO before the 2019 election campaign started.

of the overall impact of each platform, incorporating dynamic costing and interactions between policies. Finally, Robson and Jarvis propose some administrative reforms, allowing better PBO access to departmental data or more central organization of the PBO's data access through the Privy Council Office or the Treasury Board.

With a minority government, a new election could arrive earlier than the October 16, 2023 fixed election date. It is therefore wise for Canadians to begin to consider what we want the PBO to do during the next election. All Canadians benefit from an informed and fact-based election campaign, and an optimized PBO can help to push our political debates in that direction.

Alan Macnaughton
Kevin Milligan
Editors

Policy Forum: Assessing Party Platforms for Fiscal Credibility in the 2019 Federal Election

Mostafa Askari and Kevin Page*

PRÉCIS

Les programmes électoraux des partis sont importants. Ils donnent une indication des priorités des partis politiques et à qui les partis s'adressent. Les programmes électoraux peuvent servir à prévoir le comportement du gouvernement et constituent un outil utile pour obliger un gouvernement à rendre des comptes. Lors de l'élection fédérale de 2019, tous les grands partis ont publié des documents décrivant une série de positions politiques visant à relever les défis politiques à court et à moyen terme. Pour la première fois, tous les partis ont travaillé avec le directeur parlementaire du budget et ont publié des évaluations indépendantes du coût des principales mesures qu'ils proposaient. L'Institut des finances publiques et de la démocratie (IFPD) de l'Université d'Ottawa a évalué si le plan financier — recettes, dépenses et soldes — et les hypothèses économiques et financières sous-jacentes à chaque programme électoral étaient réalistes, responsables et transparents. Cet article décrit l'approche adoptée par l'IFPD pour évaluer la crédibilité financière des programmes électoraux des partis, les résultats obtenus et les implications potentielles pour gouverner dans un Parlement où le gouvernement est minoritaire et les prochaines élections.

ABSTRACT

Party platforms are important. They signal what matters for political parties and with whom parties are engaging. Platforms can be used to predict government behaviour and are an important tool to hold a government to account. In the 2019 federal election, all the major parties released platform documents outlining an array of policy positions to address short- and medium-term policy challenges. For the first time, all political parties worked with the parliamentary budget officer and released independent costings of their major proposals. The Institute of Fiscal Studies and Democracy (IFSD) at the University of Ottawa provided an assessment of whether the fiscal plan—revenues, spending, and balances—and the economic and fiscal assumptions underlying each platform were realistic, responsible, and transparent. This article describes the approach taken by the IFSD to assess the fiscal credibility of party platforms, what was found, and the potential implications for governing in a minority Parliament and future elections.

* Of the Institute of Fiscal Studies and Democracy, University of Ottawa (e-mail: mostafa.askari@ifsd.ca; kevin.page@ifsd.ca).

KEYWORDS: ELECTIONS ■ POLITICAL PARTIES ■ FISCAL PLANNING ■ TRANSPARENCY ■ COSTING ■ EVALUATION

CONTENTS

Context	482
Assessment Framework for Fiscal Credibility	484
Political Party Results	487
Looking Back and Forward	487

CONTEXT

It is generally accepted that elections play a critical role in democracies. Citizens must be given the opportunity to elect representatives in elections that are free and fair. The role that elections can play in holding governments accountable is less axiomatic. There are a number of factors that make elections challenging mechanisms for accountability, including low levels of voter turnout and the complexity of policy issues (that is, limited cognition). In Canada's 2019 federal election, voter turnout was 66 percent—below the average turnout since 1867 (70.5 percent) but higher than in most elections since 2000. The extent to which voters were able to grasp the nuances in policy priorities and directions across parties (for example, affordability, climate change, and health care, among others) is an open question for debate and research.

Party platforms play an important role in political campaigns. It is now an expected practice that parties will provide a document with their vision for the country, priorities to address the major challenges, policy positions and proposals, and a fiscal plan.

There are three reasons why platforms matter: first, they signal what matters for political parties and with whom the party is engaging; second, they predict government behaviour; and third, they are an important tool for citizens and parliamentarians to hold a new government to account.

According to a 2017 international comparison study that examined party platforms in 12 countries (including Canada),¹ parties that form governments generally fulfill high percentages of their election pledges. It is safe to say that, overall, parties are likely to govern, or at least try to govern, according to the pledges set out in their platforms. Platforms are a road map of what the particular parties want to implement and achieve in the future.

1 Robert Thomson, Terry Royed, Elin Naurin, Joaquín Artés, Rory Costello, Laurenz Ennsner-Jedenastik, Mark Ferguson, Petia Kostadinova, Catherine Moury, François Pétry, and Katrin Praprotnik, "The Fulfillment of Parties' Election Pledges: A Comparative Study on the Impact of Power Sharing" (2017) 61:3 *American Journal of Political Science* 527-42 (<https://doi.org/10.1111/ajps.12313>).

Platforms are also an important communicative tool to voters. They are a statement by which parties assert their strengths and demonstrate their principles to their base supporters as well as to other voters. Voters tune in to platform statements as a way to infer the policy positions of candidates and parties.

Despite the relevance of political platforms, there are few international or recognized standards that exist for their formulation and content. While content on campaign organization and strategy abounds, less consideration is given to these guiding documents. Given this remarkable gap, it can be difficult to assess whether a platform has been well drafted and whether its commitments are feasible from an accountability perspective.

In the 1990s, Prime Minister Jean Chrétien successfully took on the fiscal challenge of high debt. While the government benefited from an environment of continuous growth, the setting of deficit-reduction targets was a key element of the Liberal platform (the so-called Red Book)² in 1993.

In 2008, Prime Minister Stephen Harper was forced to refocus his government's agenda when the world financial crisis hit. The Conservative Party's platform in 2008³ made little to no mention of the dark economic clouds that were on the horizon. Notwithstanding good intentions, governments can still be hit by unforeseen events, such as a financial crisis, that will upset platform plans.

To help support all parties with their platform-planning challenges, the Liberal government under Prime Minister Justin Trudeau implemented a 2015 electoral commitment in the 2017 budget to strengthen the role of the parliamentary budget officer (PBO). The budget officer was made an officer of Parliament. The mandate was expanded and additional resources were provided to include the costing of party electoral platforms.⁴

Giving all parties access to PBO technical expertise on costing issues was a positive step. Estimating the potential fiscal costs of complex tax measures such as the taxation of digital companies, or major spending reforms such as pharmacare, is challenging. The provision of this service by an independent and reputable office enhanced confidence in the numbers used by political parties. To provide a baseline to underpin platform costing, the PBO released a pre-election economic and fiscal outlook in the summer of 2019.⁵

The five major political parties in the 2019 federal election used the PBO baseline and made significant use of PBO costing. It can be argued that the work of the PBO

2 Liberal Party of Canada, *Creating Opportunity: The Liberal Plan for Canada* (Ottawa: LPC, 1993).

3 Conservative Party of Canada, *The True North Strong and Free: Stephen Harper's Plan for Canadians* (Ottawa: CPC, 2008).

4 These changes were enacted by an Act To Implement Certain Provisions of the Budget Tabled in Parliament on March 22, 2017 and Other Measures, SC 2017, c. 20, section 128; royal assent June 22, 2017.

5 Office of the Parliamentary Budget Officer, *Election Proposal Costing Baseline* (Ottawa: PBO, June 2019).

created space for political parties to spend more time debating policy priorities and directions, and less time defending the veracity of their numbers. What the PBO did not do, because it was not part of its mandate, was assess the overall fiscal plans of political parties.

To address this gap, at least in part, the Institute of Fiscal Studies and Democracy (IFSD) assessed the fiscal credibility⁶ of the platforms as a whole. This work was led by the authors of this article and Sahir Khan, all former senior members of the parliamentary budget office. While fiscal management is just one dimension of a party platform, it is an important one. We have learned from recent history that the ability of parties to implement their platform can depend critically on the economic and fiscal outlook and a government's capacity for fiscal management. The path forward can start with the party platform.

In this article, we outline the framework used by the IFSD to score the fiscal credibility of the political party platforms. We present our findings and compare results for the five major political parties. We make the case that, thanks to the work of all major parties and the PBO costings of specific initiatives, Canada achieved a relatively high mark for fiscal transparency and responsibility in the 2019 federal election campaign.

ASSESSMENT FRAMEWORK FOR FISCAL CREDIBILITY

For the 2019 federal election, the IFSD examined platforms based on a framework for fiscal credibility underpinned by three principles:

1. realistic and credible economic and fiscal projections,
2. responsible fiscal management, and
3. transparency.

The IFSD acknowledges that scoring the platforms on the basis of these principles involves a degree of judgment. To highlight the nature of the judgment, evaluation criteria and a simple scoring system were designed.⁷ For each criterion linked to a particular principle, a political party could achieve a score of 0, 1, or 2,

6 The term “fiscal credibility” has been used by economists over the years. We think the clearest interpretation was provided by Scott Clark, a former federal deputy minister of finance. See C. Scott Clark, “What Is ‘Credible’ Fiscal Policy? The Canadian Experience, 1983-2010: The View of a Former Practitioner,” in Fred Gorbet and Andrew Sharpe, eds., *New Directions for Intelligent Government in Canada: Papers in Honour of Ian Stewart* (Ottawa: Centre for the Study of Living Standards, 2011), 101-26.

7 The criteria and scoring system were outlined in a paper posted on the IFSD website. Kevin Page, Mostafa Askari, and Emily Woolner, “IFSD Platform Assessment Framework: Fiscal Credibility of 2019 Federal Party Election Platforms,” *Last Page Blog*, September 16, 2019 (<https://ifsd.ca/en/blog/last-page-blog/assessment-party-platforms>).

depending on the degree to which the platform responded to or aligned with the principle. A platform could achieve a total score of 18 based on this fiscal credibility assessment. First-class standing would require a score of 14 out of 18, or 78 percent. This would be a good score and would suggest that the platform performs well from a fiscal credibility perspective and should provide some confidence to voters. The assessment framework is illustrated in table 1.

Realistic assumptions are a critical component of planning. Political platforms that are based on a realistic view of the planning environment are more likely to generate confidence and trust, and are better able to support successful implementation of new policies and programs in a timely manner. Political platforms should be designed in a way that sheds light on the need for and the nature of adjustments to priorities and policies as unanticipated developments or risks materialize.

In 2008, political platforms in the fall federal election in Canada did not acknowledge the prospects for a global financial crisis and a recession. Unforeseen events can have serious consequences. The crisis created significant hardship for Canadians and required the government and Parliament to undertake extraordinary measures within months of an election. A number of analysts have suggested that the failure of leaders across the globe to see and address risks building in the leadup to the financial crisis fundamentally damaged trust in democratic institutions.

Responsibility in fiscal management means managing the full range of policy challenges with taxpayer dollars in a fiscally sustainable manner. Budgetary constraints are required to ensure that fiscal policy supports economic growth and stabilization (that is, through budgetary deficits when the economy is weak and surpluses when the economy is strong), and that public debt does not grow out of balance with Canada's gross domestic product (GDP) and thus impair future economic outcomes for citizens and the policy choices of future governments. Given the uncertainty associated with planning environments, responsible fiscal management also implies embedding in the fiscal-planning framework a level of prudence to address risks.

In 2019, Canada's federal government was in a relatively good fiscal position, as illustrated by a relatively modest budgetary deficit and public debt. The budgetary deficit was structural in nature—meaning that a deficit is run while the economy is believed to be operating near its trend level. In this context, the fiscal policy stance was modestly accommodative with respect to growth. Reflecting low interest rates, the carrying cost of debt (public debt interest relative to budgetary revenues) was at historic low levels. According to the PBO's pre-election economic and fiscal baseline projections, budgetary deficits and debt relative to GDP were expected to decline over the medium term. The PBO estimated that the federal fiscal structure was currently sustainable in the face of aging demographics.⁸

Transparency is the sine qua non of political discourse, accountability, and trust. Political leaders may be inclined to be vague on the details of new policy proposals

8 Office of the Parliamentary Budget Officer, *Sustainability Report, 2018* (Ottawa: PBO, September 2018).

TABLE 1 IFSD Assessment Framework

Principle	Assessment
Realistic and credible economic and fiscal assumptions	<p>The platform uses the updated latest PBO baseline economic and fiscal forecast.</p> <p>Economic challenges are articulated.</p> <p>Fiscal challenges are articulated.</p>
Responsible fiscal management	<p>The platform commitments are consistent with a defensible medium-term fiscal strategy and framework.</p> <p>The platform's commitments maintain long-term fiscal sustainability.</p> <p>The fiscal-planning framework contains adequate provisions for fiscal risks, economic risks, and unforeseen events.</p>
Transparency	<p>The platform provides economic and fiscal forecasts for five years (2019-2023) with details on key indicators, which incorporate the proposed policy measures.</p> <p>The platform provides sufficient detail on the proposed measures.</p> <p>The platform provides a clear implementation plan for key policy measures.</p>

PBO = Office of the Parliamentary Budget Officer.

(for example, policy parameters, costs, impacts, and risks), for any number of reasons: they do not have that information; details expose tradeoffs that create winners and losers; and there are factors beyond the party's control that are critical to success, among other reasons. The pressure is on citizens, civil society, and political opponents to push for greater transparency in political discussions and policy platforms in the leadup to an election.

Policy platforms are not budgets or legislation to be tabled in Parliament. The level of detail required for financial due diligence in a legislative setting is much higher. Nonetheless, political parties will lay out plans in party platforms that involve tens of billions of dollars of taxpayers' money over the next five years, and should the party be successful in forming a government, it will likely declare that it has been given a political and policy mandate to move forward. It is important, in this regard, that policy platforms be as transparent as possible. This means that platforms should provide sufficient detail on the proposed measures, and a clear and feasible implementation plan.

Major political parties were well positioned to have strong political platforms for the 2019 federal election from a fiscal credibility perspective (that is, first-class standing). The Liberal government's change to the legislation underpinning the PBO was a major factor.

POLITICAL PARTY RESULTS

The IFSD prepared fiscal credibility assessments for all party platforms, including the first and second releases of the Green Party fiscal plan. The results of the assessments were published on the IFSD website within 24 hours of a platform's release. An arrangement was made with the *Toronto Star* to ensure print media coverage, and some TV networks highlighted the assessment results.

Four of the major political parties passed the assessment (see table 2). In this regard, the IFSD concluded that the electorate was sufficiently well prepared to understand the fiscal consequences of party platform proposals. The Liberal Party received a good grade (first-class standing), with the Conservative Party close behind. Both the Green Party and the New Democratic Party (NDP) received a pass—but a relatively weak grade.

The five major political parties made good use of PBO analysis, including the pre-election economic and fiscal outlook and PBO costings for the more complex tax and spending proposals. Most of the political parties clearly linked their platform to PBO projections and costings. All major parties presented fiscal plans with a declining projected budgetary deficit as a percentage of GDP (figure 1) and a declining debt-to-GDP ratio over the medium term (a five-year horizon, 2019–20 through 2023–24). The Conservative Party committed to a balanced budget in 2024–25. With these fiscal plans, it was concluded that all major parties had presented platforms that would be fiscally sustainable over the long term (that is, debt would not rise relative to GDP in the face of aging demographics). This fiscal sustainability assertion is consistent with analysis by the PBO and the federal Department of Finance.

The distinguishing feature between the Liberal and Conservative platforms from a fiscal credibility scoring perspective was the disparity on the issue of transparency. The relatively low score for the Conservative Party reflects the party's reliance on a large (unspecified) spending restraint measure to achieve its fiscal objective of a balanced budget in 2024–25. Moreover, the party's fiscal plan was released relatively late in the campaign, after all the political debates.

While the Green Party and NDP fiscal plans received a passing grade, their scores were significantly lower than those of the Liberal and Conservative parties. The Green Party and NDP scores are largely attributable to credibility concerns (relating to economic impact, and public management and implementation challenges) tied to historically large tax increases in the short term to pay for ambitious and aspirational plans to address a number of issues—climate change, pharmacare, accessibility to post-secondary education, First Nations, and infrastructure expansion (see figure 2).

LOOKING BACK AND FORWARD

History will judge whether the 2019 federal election was a high-water mark for policy platforms backed by fiscal plans underpinned by common assumptions about the economic and fiscal outlook, and for independent costing of major proposals. At a

TABLE 2 IFSD Political Platform Scoring on Fiscal Credibility, 2019 Election

Assessment	IFSD source				
	LPC	CPC	GPC	NDP	Bloc
	<i>percent</i>				
Principle					
Realistic assumptions	70	75	70	58	33
Responsible fiscal management	83	83	42	50	25
Transparency	83	58	50	42	33
Overall (average score)	80	72	53	50	31

LPC = Liberal Party of Canada; CPC = Conservative Party of Canada; GPC = Green Party of Canada; NDP = New Democratic Party of Canada; Bloc = Bloc Québécois.

minimum, the IFSD believes, it is a big step in the right direction for transparency and responsibility, strengthening confidence and trust around political debates. At a time when political commentators in other countries talk about a post-truth environment, Canada has been making positive strides.

This movement in a positive direction can be credited to several sources: a current commitment by political parties to transparency; the initiative of the Liberal government following the 2015 election in strengthening the PBO and providing resources to cost political platforms; the work of the PBO in preparing costings and staying above the political fray; and positive pressure by the media and citizens.

As noted, we are former members of the PBO. We supported the Liberal government's proposal to expand the PBO's legislative mandate to include costing of political party platform proposals and to make the budget officer an officer of Parliament. While this work is relatively novel for legislative budget offices, there are precedents in the Netherlands and Australia. We think the success of PBO's costing efforts in the 2019 federal election will be noticed internationally and could create positive pressure for other independent fiscal institutions around the world to provide a similar service.

The IFSD views the work that it conducted around assessing the fiscal credibility of party platforms as complementary and supportive. It is similar to the work that many academics undertook in assessing various aspects of party platforms, including the economic and distributional impacts of specific tax changes or platform commitments on climate change. To strengthen our democracy, it is important that civil society be engaged. There is always room for improvement.

To the extent that the IFSD was successful in participating in platform assessment, that success can be attributed in part to the design of a simple framework for making timely judgments while minimizing political bias, and to the fact that the media and political parties saw value in highlighting the results. It is also hoped that political parties will feel pressure to raise their game with respect to fiscal transparency and responsibility if they know that they will be assessed by credible, independent actors.

FIGURE 1 Projected Budget Deficit as a Percentage of GDP, Political Parties' Fiscal Plans, 2019 Election

GDP = gross domestic product; LPC = Liberal Party of Canada; CPC = Conservative Party of Canada; NDP = New Democratic Party; GPC = Green Party of Canada.

FIGURE 2 Projected Change in Average Revenues and Expenditures, 2020-21 to 2023-24, as a Percentage of GDP, Political Parties' Fiscal Plans, 2019 Election

GDP = gross domestic product; LPC = Liberal Party of Canada; CPC = Conservative Party of Canada; NDP = New Democratic Party; GPC = Green Party of Canada.

We think the more general fiscal credibility assessments provided by the IFSD will remain outside the purview of legislative budget offices like the PBO for the foreseeable future. It is easier to maintain and protect the independence and non-partisan reputation of the PBO if its mandate is restricted to specific and technical costings of platform proposals, as opposed to broader judgments that address issues like the defensibility of medium-term fiscal strategies.

Looking ahead, we feel it would be a mistake to underestimate the relative fiscal credibility success of the 2019 election from a citizen perspective. In the current minority Parliament, we could be facing an election sooner rather than later. Maintaining standards in the next election could be a challenge.

One opportunity for improvement would be to utilize the time before the next election to help political parties to develop and strengthen plans to implement bolder policy initiatives. For example, while both the Green Party and the NDP signalled a political commitment toward a single-payer pharmacare system and benefited from a PBO costing, they were not in a position to lay out a plan over the medium term that could garner support with provincial governments and industries. Similarly, the significant increase in revenues required to support a federal option necessitates consideration of complicated and controversial tax measures, including wealth taxes, which likely warrant further analysis to facilitate decision making and possible implementation. The road to better policy platforms starts now.

The IFSD plans to continue to provide fiscal credibility assessments in the next federal election. We plan to refine our scoring system to better clarify judgments, and to release (once again) a pre-election framework and scoring system. One area in which the IFSD has not done work, and which could be considered by colleagues in other think tanks and universities, is the provision of economic impact assessments of fiscal plans. In the 2019 election, the parties prepared their fiscal plans without measuring the potential economic and fiscal feedback effects of the proposals. It would be useful if parties had access to this type of analysis while putting together their platforms.

Policy Forum: Independent Platform Costing—Balancing the Interests of the Public and Parties

Scott Cameron*

PRÉCIS

Cet article présente une évaluation de la conception de la méthode d'évaluation indépendante du coût des programmes électoraux au Canada, telle qu'elle a été établie par la Loi sur le Parlement du Canada et les décisions de fonctionnement du directeur parlementaire du budget. L'auteur compare l'équilibre atteint entre servir les intérêts du public et ceux des partis politiques au Canada avec l'équilibre atteint aux Pays-Bas et en Australie. Bien que la législation canadienne tende à être au service des partis politiques, dans la pratique, la culture d'évaluation du coût qui s'est développée lors de l'élection générale de 2019 a élevé le niveau du débat et produit une quantité d'informations comparable à ce que l'on attendrait d'un service conçu pour favoriser le public. L'article se termine par une discussion des options pour étendre le service d'évaluation du coût des politiques pour les prochaines élections.

ABSTRACT

This article provides an evaluation of the design of independent election platform costing in Canada, as established by the Parliament of Canada Act and the operating decisions of the parliamentary budget officer. The author compares the balance struck between serving the interests of the public and the interests of political parties in Canada with the balance struck in the Netherlands and Australia. Although Canada's legislation is tilted in favour of serving political parties, in practice the costing culture that evolved during the 2019 general election raised the level of debate and produced an amount of information comparable to what would be expected of a service designed to favour the public. The article concludes with a discussion of options for expanding the policy-costing service for future elections.

KEYWORDS: ELECTIONS ■ POLITICAL PARTIES ■ PARLIAMENTARY BUDGET OFFICER ■ COSTING ■ POLICY ■ EVALUATION

* Budgeting and Public Expenditures Division of the Directorate for Public Governance, Organisation for Economic Co-operation and Development (OECD), Paris (e-mail: cameron.scott.d@gmail.com). The opinions expressed and arguments employed herein do not necessarily reflect the official views of the OECD or of the governments of its member countries.

CONTENTS

Introduction	492
The Balance Struck by Those Who Came Before	494
The Dutch Model	494
The Australian Model	495
Striking the Canadian Balance	496
Walking the High Wire: Did the PBO Traverse It or Tumble?	499
The Future of Platform Costing in Canada	502

INTRODUCTION

Changes to the Parliament of Canada Act in 2017 granted the parliamentary budget officer (PBO) a separate and distinct mandate to estimate the cost of election platform proposals at a party's request.¹ The 43rd general election in 2019 was the first test of the costing service.

Empowering an independent body to scrutinize campaign promises can serve the interests of both the public and political parties. For the public, an impartial arbiter can increase the amount of policy analysis available and focus the debate on accurate facts so that voters can achieve an election outcome that better reflects their will.² Cementing accurate policy details also sets concrete benchmarks to better hold politicians to their promises in the years following the election so that governments continue to reflect the voters' will.

Individuals, firms, and markets can also use the information in preparing for policy changes and price-in election outcomes, thereby increasing stability and economic efficiency.³ Additionally, the discipline imposed on parties that are subjected to independent policy scrutiny can combat deficit bias—the tendency of governments to borrow rather than save (although whether that is in the public interest is a subject of debate).⁴

For parties, the main benefit is a levelling of the analytical playing field between non-governing parties and the incumbent government. In the run-up to the campaign period, the incumbent has access to the full resources of the public service,

1 Parliament of Canada Act, RSC 1985, c. P-1, as amended, section 79.21, incorporating changes enacted by An Act To Implement Certain Provisions of the Budget Tabled in Parliament on March 22, 2017 and Other Measures, SC 2017, c. 20, section 128; royal assent June 22, 2017.

2 Alan Renwick and Michela Palese, *Doing Democracy Better: How Can Information and Discourse in Election and Referendum Campaigns in the UK Be Improved?* (London, UK: University College London, School of Public Policy, The Constitution Unit, March 2019).

3 Brian Knight, "Are Policy Platforms Capitalized into Equity Prices? Evidence from the Bush/Gore 2000 Presidential Election" (2006) 90:4-5 *Journal of Public Economics* 751-73 (<https://doi.org/10.1016/j.jpubeco.2005.06.003>).

4 Lars Calmfors and Simon Wren-Lewis, "What Should Fiscal Councils Do?" (2011) 26:68 *Economic Policy* 649-95.

such as career experts working with confidential administration databases and non-public microsimulation models. A policy-costing service gives non-governing parties similar tools, eliminating this incumbency advantage.

For the governing party, creating and using the service can signal the government's fiscal credibility to voters. It may also allow the incumbent to communicate policy messages with a stamp of neutrality and authority that the public service would be unwilling or unable to provide during the campaign.⁵

All parties may benefit from the discipline imposed by impartial costing in developing their platforms, since they are forced to make firm and detailed policy decisions sooner rather than later. This can weed out wild politics from the extreme wings of parties and ease consensus building both within the party and across parties when forming coalitions or garnering minority support.⁶ Parties also benefit financially, requiring fewer consultants, academics, and think tanks to prepare their platforms, and receiving free press coverage each time the budget office posts costings online.

In designing the costing framework, legislators must consider the tension between public interest and party interest. The public is best served when cost estimates are mandatory and transparent, providing the largest information set on which voters can base their decisions and making it available as early as possible. Parties benefit most when estimates are voluntary and confidential, so that they can choose what information they will reveal to the public and when.

The independent public office empowered with preparing platform estimates must walk a political high wire. Serve parties too eagerly and the office's reputation for being non-political will be threatened. Go too far in defending the public interest and parties may withdraw from the process entirely, or spurn the services of the office in the regular session of Parliament following the election.

With the ballots from the 2019 election now counted, it is possible to evaluate the balance struck by Canadian legislators and the PBO during its first election test. I begin by laying out two precedents, the Dutch and Australian models. I then assess how the Canadian framework compares with its precedents and describe the performance of the PBO in the 2019 election. I close with several options for expanding the costing framework for future elections.⁷

5 The public service typically stays out of the public eye from the time Parliament is dissolved until such time as the government is reconstituted following an election.

6 Edwin van de Haar, "CPB Netherlands Bureau for Economic Policy Analysis: Dutch (Economic) Policy-Making" (2015) 10:2 *Contemporary Social Science* 182-90 (<https://doi.org/10.1080/21582041.2015.1052540>).

7 I acknowledge here my role as one of the architects of the Canadian framework. I worked at the PBO from 2012 to March 2019 and had no role in the implementation of the framework during the campaign period that began June 23, 2019.

THE BALANCE STRUCK BY THOSE WHO CAME BEFORE

The Dutch Model

The Netherlands' Centraal Planbureau (CPB) (Netherlands Bureau for Economic Policy Analysis) is an offshoot of the Ministry of Economic Affairs, Agriculture and Innovation, with operational independence. In 2018, the CPB had a budget of €17.1 million and employed 117 full-time staff.⁸ It began to perform the role of independent election platform evaluator in 1986 at the request of the legislature's three biggest parties.⁹

All political parties holding at least one seat in the Dutch House of Representatives may submit their platforms to the CPB voluntarily. The office publishes an assessment of the platforms before each election in a document called *Charted Choices*. Nearly all parties participate. In the most recent 2017 election, 11 parties submitted their platforms and *Charted Choices* assessed 1,165 potential policy measures, or an average of 106 for each party.¹⁰

The scope of the CPB's analysis has expanded far beyond financial costs to include a full range of welfare analysis (for example, distributional and gender analysis, environmental impacts, and educational outcomes) and a full range of macroeconomic feedback (dynamic scoring), including a policy's impact on short- and long-run employment, innovation, household disposable income, and purchasing power. The scope has been expanded at the request of political parties, which use the bureau's analysis of social and economic outcomes to attract their targeted voters.

Kraan argues that the high rate of participation and the broad scope of the service is the result of "typically Dutch" politics and culture.¹¹ Dutch government relies on fragmented multi-party coalitions, in which weak finance ministers are normal. Policy is made through lengthy bottom-up negotiation and consensus building. The parties rely on *Charted Choices* to construct coalition agreements to govern, aided by a negotiator picked by the Crown. Nearly all (as high as 95 percent) of the finalized measures are pulled from *Charted Choices*, and the agreement is returned to the CPB for a final costing that will constitute the new government's fixed four-year expenditure framework.¹² Kraan reports that parties participate because they fear

8 See the Netherlands' country profile in the independent fiscal institutions database available on the website of the Organisation for Economic Co-operation and Development (OECD): www.oecd.org/governance/budgeting/oecdnetworkofparliamentarybudgetofficialspbo.htm.

9 Van de Haar, supra note 6, at 186.

10 Centraal Planbureau (CPB Netherlands Bureau for Economic Policy Analysis), *Keuzes in Kaart 2018-2021, Charted Choices 2018-2021, Chapter 1 and 2, the Headlines* (The Hague: CPB, 2017) (www.cpb.nl/sites/default/files/omnidownload/Charted-Choices-2018-2021.pdf).

11 Dirk-Jan Kraan, "Typically Dutch" (2005) 4:4 *OECD Journal on Budgeting* 103-25.

12 Wim Suyker, *Hoe Sterk Is de Samenhang Tussen Regeerakkoord en de Doorgerekende Verkiezingsprogramma's?* [How Strong Is the Correlation Between Coalition Agreement and the Costed Election Manifestos?] (The Hague: Centraal Planbureau [CPB Netherlands Bureau for Economic Policy Analysis], January 2013), at 7.

being labelled as economically irresponsible and being left out of negotiations more than they fear a negative assessment.

Charted Choices results in nuanced and evidence-based debates among a sophisticated electorate that embraces the analytical framework of the CPB and engages in good faith, acknowledging the tenuous underpinnings of the broader calculation effort, but nonetheless viewing the results as the most credible numbers around which to make decisions.¹³

On paper, the CPB's model is somewhat balanced between public and party interests. Submitting platforms for *Charted Choices* is voluntary but not confidential. If a party chooses not to engage, its proposals will only be estimated and will be published post-election only if the party forms part of the government and its policies directly enter the coalition agreement. However, in practice, Dutch political culture shifts the balance of the CPB's service conclusively toward the public interest, with virtually all parties participating and an astonishingly comprehensive array of analysis supplied to voters.

The Australian Model

The Australian federal PBO was created in 2012 as a parliamentary department, headed by a statutory officer reporting to the president of the Senate and the speaker of the House of Representatives. In 2018-19, the office had a budget of AU\$8.6 million and employed 40 full-time staff.¹⁴ The office and its role in electoral platform costings were born from a hung Parliament under the terms of a confidence-and-supply deal demanded by the Australian Green Party and three independent members of Parliament (MPs).¹⁵

The PBO inherited responsibility for costing proposals from the Department of Finance, which was required to cost opposition party proposals upon request during the four to six weeks before an election. The Department of Finance was charged with the duty by the Charter of Budget Honesty in 1998, following a large deficit revision and perceived financial deception during the preceding election campaign. Smaller opposition parties considered this first framework to have had several failures: it was initially offered only to the two major parties; the window was too short for any back-and-forth discussions; requests had to go through the Prime Minister's Office and could be accessed through freedom-of-information applications; the final estimates were not confidential; and there were suspicions of bias in favour of the governing party. All parties continue to have the option of going to

13 Van de Haar, *supra* note 6, at 187.

14 See Australia's country profile in the OECD's independent fiscal institutions database, *supra* note 8.

15 Robyn Munro and Akash Paun, *Pre-Election Policy Costing Mechanisms in Australia, Whitehall in Year Five of the Coalition: Lessons from Elsewhere* (London, UK: Institute for Government, March 2014), at 2.

the Department of Finance during the campaign period, and this option has been exercised by the incumbent.¹⁶

Use of the PBO's costing service is extended to all MPs. The PBO estimates only the financial impact of policies. Fulfilled requests are confidential during the regular parliamentary session but must be published if requests are made during the campaign period. Parties have shown an overwhelming preference to have platform commitments costed during the confidential parliamentary session.

The Australian PBO is required to draft a post-election report that includes a compulsory assessment of the fiscal impact of each party's full platform. On the day before the election, parties are required to submit a written list of their public announcements. The PBO may also use its discretion to add policies if it feels that the list is incomplete. The report is released after the election, so as not to influence the outcome, but with the intention of holding parties accountable for their promises and encouraging them to be transparent during the campaign. The post-election report tips the balance of the Australian costing process squarely toward the public interest, with the PBO acting as what van de Haar calls "election police."¹⁷

The legislatures of two Australian states—New South Wales and Victoria—have also created PBOs with platform-costing mandates, adopting models similar to the federal PBO. Notably, the PBO in the state of Victoria will prepare an optional pre-election report at a party's request.¹⁸ This report examines the entire suite of policies chosen by the party for its platform and estimates interaction effects and overall budgetary balance implications. In both states, parties have the option of going to the Department of Treasury and Finance, as is the case at the federal level.

STRIKING THE CANADIAN BALANCE

The Canadian PBO, created in 2006 and beginning operations in 2008, has 40 staff with a budget in 2018-19 of \$7.6 million.¹⁹ The mandate to cost elections was added neither as a response to a multi-party consensus demand to assist coalition forming, as in the Netherlands, nor following an episode of fiscal mismanagement or a failure of a departmental costing service to satisfy party needs, as in Australia. Rather, the service was conceived unilaterally by advisers to the governing Liberal Party of Canada after observing two particularly heated disputes during the early days of the 2015 general election.²⁰

16 Ibid., at 13.

17 Van de Haar, *supra* note 6, at 186.

18 The State of Victoria, Parliamentary Budget Office, *Report of PBO Operations for the 2018 Victorian General Election* (Melbourne: PBO, March 2019).

19 Canada, Office of the Parliamentary Budget Officer, *2018-19 Report on the Activities of the Office of the Parliamentary Budget Officer* (Ottawa: PBO, June 2019) (www.pbo-dpb.gc.ca/web/default/files/Documents/2018-19_PBO_Annual_Report_EN.pdf).

20 Based on my personal communications with persons familiar with the matter.

1. Canada's two best-resourced parties (including the Liberal Party) attacked a third party for the cost of its commitments, floating their own assessments of its platform before they had even released platforms of their own.
2. The Liberal Party's claims surrounding the number of beneficiaries of its proposed children's benefits program were challenged by the Opposition, dragging the non-partisan Library of Parliament (which had provided the numbers) into the fray in contravention of its policy of reticence when Parliament is dissolved.

These disputes highlighted the need for an independent arbiter of platform promises who could speak when Parliament was dissolved. Creating such a role complemented the Liberal platform commitment to "fair and open government," adopted to contrast the party with an incumbent that had been accused of being secretive.²¹ The resulting legislation, part of the Parliament of Canada Act,²² is characterized by the following:

- All parties or independent MPs with representation in the House of Commons at the start of the campaign period (defined as the period that begins 120 days prior to the election) may voluntarily submit requests to have the PBO cost their proposals.
- Measures are to be assessed individually, not as platforms. That is, the legislation does not prescribe that the PBO will estimate the aggregate fiscal impact of a party's combined measures, including overall borrowing and debt profiles.
- The scope of the PBO's analysis is limited to a policy's financial cost.
- Analysis can be provided confidentially; however, the PBO is required to publish a completed costing if (1) a party publicly announces a measure that it asked the PBO to cost and the party has not withdrawn the request, and (2) the party submits written notification of the announcement to the PBO. Parties are required by the legislation to provide written notification if a policy that was requested has been publicly announced, but there is no defined time period in which to do so and no enforcement mechanism should a party fail to comply with this requirement.

One element of Canada's legislation is a significant departure from both the Netherlands and the Australian models: The PBO's estimates are not based on the government's official economic- and fiscal-planning assumptions, nor will they be used to plan the budget following the election. Owing to past institutional decisions, the PBO's economic and fiscal models are independent from those of the Department of Finance. In the Netherlands, the CPB's costings, forecasts, and

21 Liberal Party of Canada, *Real Change: A New Plan for a Strong Middle Class* (Ottawa: LPC, 2015) (www.liberal.ca/files/2015/10/New-plan-for-a-strong-middle-class.pdf).

22 Supra note 1.

assumptions directly underpin the government's official medium-term framework. In Australia, the PBO does not do its own economic and fiscal forecasting; its costings use the government's official economic and fiscal assumptions. Although the Australian PBO's costings may differ from official estimates during the election period, they are eventually reconciled in the post-election report. In Canada, voters can only roughly compare campaign platforms with the most recent budget of the incumbent government and the first budget of the new government.

Canada's legislation leaves some areas of discretion to the parliamentary budget officer, particularly the practical details of how the PBO will engage with parties, the breadth of considerations that the PBO's analysts may use to determine financial costs, and the information that the PBO provides to Canadians in revealing how costs were determined. In laying out the policy-costing framework, the parliamentary budget officer set himself the objective of "enhancing public confidence in the election process."²³ However, he was constrained in his decisions by the wording of the law surrounding financial costs and the uncertainty of how the inaugural costing facility would play out. He therefore opted for a risk-management approach characterized by the following:²⁴

- The PBO would not publish distributional, gender, or sectoral analysis in arriving at financial costs.
- The PBO would adjust its estimates for the behavioural response of taxpayers and beneficiaries if the evidence base was robust, but would not provide dynamic scoring (that is, it would not adjust the underlying economic assumptions of a costing to include the impact of a policy on factor markets and economic growth). A common example of dynamic scoring is a corporate tax cut that partially pays for itself by reducing the cost of capital, spurring investment, and raising output.
- Although the legislation intended that measures would be assessed individually, the PBO would allow parties to request that cross-platform interactions be considered on a case-by-case basis. For example, if a party proposed both to expand a taxable benefit and to decrease the personal income tax rate, it could elect to have these policies assessed together to capture the interaction between the two. The PBO would assist parties by flagging any potential interactions as requests were received.
- The PBO would distribute its analytical resources equally among all parties and independent MPs in the House of Commons, regardless of the number of contested seats, using pre-announced resource limits for analyst hours and pecuniary expenses (which would be applied only if the analysis required costly external data).

23 Canada, Office of the Parliamentary Budget Officer, *Evaluation of Election Proposal Costing 2019* (Ottawa: PBO, January 2020), at 3 (www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/ADM001/ADM001_en.pdf).

24 Ibid.

- While the legislation allowed the PBO to seek the assistance of federal departments in carrying out its campaign mandate,²⁵ the PBO would give parties the option to forbid its collaboration with the public service if they were concerned that measures would be leaked to the incumbent or that the public service was biased. The PBO also opted not to disclose to the public whether assistance was provided or whether costings were handled by departments.
- The PBO would have structured meetings with each party as each costing was submitted and as it was finalized, in order to give parties the opportunity to prioritize, revise, or withdraw the request before publicly announcing the policy.
- Although the PBO would not cost overall platforms or endorse the platform costings of others, it would help parties to prepare their own platforms by publishing its economic and fiscal baseline before the campaign period, along with tools to calculate the overall impact of new measures on interest expenses, the budgetary balance, and public debt.

The balance of Canada's costing framework is tipped in favour of the interests of parties. Parties are in control of what the public does or does not see during the campaign. They have full discretion to use a PBO costing, to use their own estimates, or to announce measures uncoded. Further, there is no post-election mechanism for the PBO to serve as the election police, as in Australia. Finally, by focusing only on financial costs, forgoing broader welfare analysis, the costing framework leaves a gap in important policy information relevant to voters.

However, judging from the experience in the Netherlands and Australia, the practical culture that arises during the costing process can be a far greater factor in determining whose interests are ultimately served.

WALKING THE HIGH WIRE: DID THE PBO TRAVERSE IT OR TUMBLE?

By all accounts, Canada's first experience with independent costing was a success. The process fell quickly into the rhythm envisioned by the framers: A party would announce a platform commitment, and journalists and election watchers would rush to the PBO's website to view the details and costs, generating a flurry of commentary. Academics and think tanks compared the estimates with their own calculations, and the level of methodological detail that the PBO provided allowed differences to be resolved.

Before the campaign, most stakeholders were reluctant to embrace the idea of independent platform scrutiny; the former parliamentary budget officer and at least one politician were particularly outspoken.²⁶ But in the end, the five most

25 It signed memorandums to this effect with five departments.

26 Marie-Danielle Smith, "Parliamentary Budget Officer Raises Concerns Over 'Restrictions' in Liberal Bill, Says Wasn't Consulted," *National Post*, April 12, 2017 (<https://nationalpost.com/>)

prominent parties (the Liberal Party of Canada, the Conservative Party of Canada, the New Democratic Party of Canada, the Green Party of Canada, and the Bloc Québécois) submitted a combined 216 requests, of which 115 were published—that is, roughly half of the requests submitted to the PBO were ultimately announced in platforms.²⁷

While participation was high, coverage fell short of that reported in the CPB's *Charted Choices* and the Australian PBO's post-election report. The Canadian PBO estimates that it assessed only half of the measures that parties announced (with the remainder either assessed by parties' advisers themselves or left uncoded). Further, no independent MPs and neither of the leaders of two parties with lone representatives participated.²⁸

Parties were also inclined to relegate transparency to the PBO's website, publishing fewer policy details in their own campaign material than they provided to the PBO.²⁹ Comparing platforms from the 2019 election with platforms from the 2015 election, it is somewhat inconclusive whether the exercise pushed parties to be more transparent themselves, but three of the five main party platforms showed some increase in detailed financial information. That said, there was a demonstrable expansion of information available to the electorate directly from the PBO.

Because the PBO did not provide full platform evaluations, the process left a role for traditional consultants and think tanks to pull the PBO's estimates together and calculate fiscal aggregates. All of the parties that showed the bottom-line fiscal impact of their platforms did so using the PBO's pre-election economic and fiscal baselines, and most parties used the PBO's tool to calculate public debt charges.

The structured meetings between the PBO and parties during a proposal's costing played an important role in encouraging participation. The option to prioritize requests so that they could be timed with announcements and to revoke requests and go back to the drawing board after seeing the costs was exercised by parties and was a crucial consideration in their decision to participate.³⁰

At the beginning of the legislated 120-day campaign period, the PBO allotted 2,600 hours of analyst time for each party. The system for deducting analyst time

news/politics/parliamentary-budget-officer-raises-concerns-over-restrictions-in-liberal-bill-says-wasnt-consulted); and Bill Curry, "Conservatives Challenge Finance Department's Role in Plan To Assess Cost of Campaign Promises," *Globe and Mail*, November 23, 2018 (www.theglobeandmail.com/politics/article-conservatives-challenge-finance-departments-role-in-plan-to-assess).

27 Supra note 23, at 5.

28 Eligible parties with lone representatives that did not participate included the People's Party of Canada and the Co-operative Commonwealth Federation.

29 This tendency was noted by stakeholders in the tax consulting industry; see, for example, KPMG LLP, "Post-2019 Election—Possible Tax Changes," *Tax News Flash Canada* no. 2019-43, October 22, 2019 (<https://assets.kpmg/content/dam/kpmg/ca/pdf/tnf/2019/ca-post-2019-election-possible-tax-changes.pdf>).

30 Supra note 23, at 5, and my personal communications with persons familiar with the matter.

for requests as they came in had growing pains, with some parties questioning their deductions. The resource restrictions were a risk-mitigation tool and were ultimately abandoned once the PBO had a sense of the workload and felt confident that it could meet the demands of all parties over the remaining campaign period. This did not stop some parties from using the resource constraints as an excuse for submitting only a subset of their measures to be costed—an argument that does not seem to be supported by evidence.³¹

All parties ultimately submitted written notification of a policy's announcement; however, some did so simultaneously with announcements, in the spirit of the legislation, while one (the incumbent party) exploited a legislative grey area to withhold written notification so that it could publish costs all at once closer to the election. It is difficult to say whether the governing party found a strategic advantage in exploiting the ambiguity in the legislation, but other parties were concerned with what they perceived as gaming the system.³²

It is difficult to determine conclusively whether the new process and information available helped the party that won a plurality to garner sufficient minority support to form a government. However, the new government appears to have borrowed elements of tax and national pharmaceutical coverage proposals from other parties, and it may have been aided in doing so by having the costs at hand from the PBO.

An unexpected windfall from the framework was that it improved relations between the PBO and the public service, which had suffered from a decade-long dispute over information access. The process created new formal and informal data-sharing arrangements, particularly between the PBO and the Department of Finance, Employment and Social Development Canada, and Statistics Canada. The process also strengthened the PBO's relationships with parties and their policy communities. A legacy of the platform-costing process could be better analysis from better data access and more interest from parties during the regular parliamentary session.

The campaign period was not without stumbles. As expected, the stickhandling of cross-platform interaction effects proved challenging, requiring some cost estimates to be revised and republished without a clear system of version control. For example, the cost of the Conservative Party of Canada's maternity and parental leave tax credit was revised following the subsequent announcement of a personal income tax rate reduction, leading to some confusion as commentators juggled multiple versions of cost estimates.

Many proposals that parties included in platforms were changes to discretionary spending envelopes requiring no cost estimate—for example, investing \$15 million annually in reducing gang violence or reducing international assistance by \$1.5 billion annually. Others were aspirational measures without firm details to cost, such

31 Supra note 23, at 8-9, and my personal communications with persons familiar with the matter.

32 Lucas Powers, "Trudeau Not Acting in 'Good Faith' on PBO Platform Costing, Economist Says," *CBC*, September 19, 2019 (www.cbc.ca/news/politics/trudeau-pbo-costing-platform-1.5289127).

as finding \$750 million in new revenues by investing in tax enforcement. The PBO anticipated requests to cost such measures and communicated to parties that it would not accept them. However, the decision was reversed during the campaign, and the PBO published some discretionary-spending and tax-enforcement targets on its website, with the caveat that it had made no attempt to verify their validity. The change in policy was communicated unevenly across parties, and some questionable proposals were given an unintentional stamp of authority. This led to public confusion and resentment among parties at the inconsistent treatment.³³ In Australia, the PBO will not accept such requests during the campaign period but will publish them in its post-election assessment of entire platforms, provided that the policies are sufficiently detailed.

Although the parliamentary budget officer was not meant to cost or endorse overall platforms, he came dangerously close to doing so by complimenting one party's extensive use of the costing facilities and the firm footing of its platform in a round of media interviews given in the week before the election.³⁴ This caused concern and frustration among some other parties, which felt that he had erred in wading into politics.³⁵

Overall, the tightrope was deftly walked, tilted as it was to serving parties. But importantly, the culture that developed around the costing process proved a counter-balance to shift the process toward the public interest. Fully costed platforms by most major parties were published well ahead of voting day, generating considerable discussion in the press and commentariat. The level of public debate was indisputably raised.

THE FUTURE OF PLATFORM COSTING IN CANADA

The 2019 general election costing process demonstrated both the PBO's analytical prowess and the will of participants to act in good faith. With considerable concerns quelled and uncertainty resolved, the PBO and legislators may now opt to broaden the framework or adjust the balance between party and public interests. Here are a few options to do so.

- *Expand the scope of analysis.* Restricting policy analysis to financial cost leaves a vacancy in information available to the public and gives the incumbent an ongoing advantage, with its access to the public service supply of social, economic, and environmental analysis to sell its platform to voters. Legislators and the PBO could offer this breadth of support to all parties, borrowing a

33 Based on my personal communications with persons familiar with the matter.

34 BNN Bloomberg, "Conservatives Have the Least Uncertainty Attached to Their Platform: PBO" (www.bnnbloomberg.ca/economics/video/conservatives-have-the-least-uncertainty-attached-to-their-platform-pbo-1802890).

35 Based on my personal communications with persons familiar with the matter.

page from the Netherlands, and at the same time expand the information set available to the electorate. The PBO has already indicated that it will provide distributional analysis in the next election and that it does not feel that legislative changes are necessary to do so.³⁶ If the PBO moves to expand the scope of its analysis, it may benefit from an innovation that both Australia and the Netherlands have implemented to assist the calculation effort: the creation of an advisory council of academics, practitioners, and other outside experts that helps to improve analytical models and build public trust in them.

- *Offer optional pre-election reports.* To resolve the difficulties of capturing cross-platform interactions when costing individual measures, the PBO could offer parties the chance to request pre-election platform reports, like those prepared by the Victoria state PBO in Australia. These reports would offer parties the chance to volunteer to have their complete platforms evaluated, including interactions between measures and the bottom-line impact on the budgetary balance and public debt. The process should include a single cutoff date for all parties and MPs submitting platforms, and reports for all participants should be published at the same time. The PBO could also include a scenario that constrains the costings and aggregate platform assessments to the official Department of Finance economic and fiscal-planning assumptions, so that voters can compare platforms with official past and future budget plans.
- *Offer confidential services during the regular parliamentary session.* The first parliamentary budget officer decided that the office would not offer confidential analysis to parliamentarians during the PBO's normal mandate, insisting instead on leading by example on openness and transparency. The latest changes to the Parliament of Canada Act codify this philosophy in law. But this leaves a gap in the resources available to parliamentarians that conventional PBOs are meant to fill. Non-governing parliamentarians currently have no confidential mechanism for exploring financial proposals outside the campaign period, except through the Library of Parliament, which does not have comparable resources or powers of information access devoted to budget research. Nor should budget expertise be replicated in two parliamentary offices; the PBO is required by the Parliament of Canada Act to cooperate with the Library of Parliament "to avoid any unnecessary duplication of resources and services."³⁷ With the expanded resources that the PBO has been given to carry out its campaign mandate, it could offer confidential fulfilment of costing requests outside the campaign period. This could be accomplished either by amendment of the Parliament of Canada Act or through an operational agreement with the Library of Parliament to share the PBO's analytical resources in fulfilling confidential requests through the library. Allowing parties

36 Supra note 23, at 7. Others (including myself) disagree, feeling that the language of the Parliament of Canada Act is clear: The PBO is to estimate only the direct financial costs of policies.

37 Parliament of Canada Act, section 79.12.

to access confidential costing advice throughout the parliamentary schedule would reduce the workload during the campaign period, potentially allowing the PBO to remove resource limits.

While these options appear to primarily support the interests of parties rather than the public, the experience in the Netherlands shows that the two are not mutually exclusive. With the right costing culture and incentives, an equilibrium can emerge where parties participate in the platform-costing service to the fullest extent possible and thereby ratchet up the transparency of campaign promises to the public.

Broad platform analysis by designated public authorities such as PBOs, fiscal councils, and planning bureaus is an idea whose time has come. Belgium and Latvia both tested the waters in 2019, largely following the Netherlands model, albeit with a reduced scope. There have also been calls to implement the service in the United Kingdom and Ireland, and the Netherlands hosted a conference in November 2019 on the topic, generating considerable interest from abroad. No matter the high wire that Canada's PBO is asked to traverse during the next election campaign, it will be leading the way for others, as the Netherlands and Australia did for Canada.

Policy Forum: Public Costing of Party Platforms—Learning from International Experience

Jennifer Robson and Mark Jarvis*

PRÉCIS

Le Canada a maintenant connu une élection fédérale avec un nouveau régime d'évaluation du coût des programmes électoraux par le directeur parlementaire du budget (DPB). D'autres pays, qui ont une expérience beaucoup plus grande à cet égard, ont adopté des approches assez différentes d'évaluation du coût public des propositions électorales des partis. Toute discussion des modifications qui pourraient être apportées à l'approche du Canada devrait s'inspirer de cette expérience internationale. Plus précisément, certains autres pays ont défini plus clairement les obligations des ministères dans l'établissement du coût des programmes électoraux et ont géré les pressions qui découlent de la réalisation d'une analyse technique détaillée dans les contraintes de temps imposées par la période électorale.

ABSTRACT

Canada has now experienced one federal election under a new regime of platform costing by the parliamentary budget officer (PBO). Other countries, with considerably more experience in this regard, have adopted rather different approaches to public costing of party election promises. Discussion of any amendments to Canada's approach should be informed by that international experience. Specifically, some other countries have more clearly articulated the obligations of government departments in platform costing and managed the pressures that come with doing detailed, technical analysis under the time constraints of the writ period.

KEYWORDS: ELECTIONS ■ POLITICAL PARTIES ■ PARLIAMENTARY BUDGET OFFICER ■ COSTING ■ POLICY

* Jennifer Robson is an associate professor in the Political Management program at Carleton University, Ottawa (e-mail: jennifer.robson@carleton.ca). Mark Jarvis is an author, editor, and contributor to numerous publications, including Peter Aucoin, Mark D. Jarvis, and Lori Turnbull, *Democratizing the Constitution: Reforming Responsible Government* (Toronto: Emond Montgomery, 2011). The views expressed here are those of the authors alone.

CONTENTS

Introduction	506
How Does Election Platform Costing Work in the Netherlands?	507
How Does Election Platform Costing Work in Australia?	508
How Does Election Platform Costing Work in Ireland?	511
Lessons from International Practice for the Future of the PBO Costing Service in Canada	513

INTRODUCTION

Many countries, Canada now among them, provide some form of public support to parties in costing their election promises. The 2019 federal election was the first in Canada since Parliament granted new statutory roles to the parliamentary budget officer (PBO), including the role of costing the election commitments of parties with official status in the House of Commons.¹ Readers will want to consult the article by Scott Cameron in this Policy Forum for a discussion of how the Canadian PBO worked to introduce its new costing service.

Notwithstanding key differences in the design and operation of different election-costing regimes, certain broad principles are evident in each of the countries that have adopted public support for platform costing. The first principle is that voters in an election are entitled to key information. When voters have better information on the competing policy ideas on offer in an election, they are better equipped to make a decision at the ballot box. This in turn bolsters the credibility of the election process itself and the significance of electoral outcomes in shaping the future policy direction of a government. But to be useful, the information offered to voters must be rigorous, clear, and transparent. That is, voters must be able to be confident in the quality of the information, comprehend the content, and understand how it was developed. And the information has to be adequate and timely. That is, voters must have enough information and enough time to make use of it in exercising their vote.

The second principle is a fundamental commitment to a permanent, professional, and non-partisan public service, including officers of Parliament. This means that the public service cannot be used during the writ period to improve or hinder the electoral aspirations of any political party or candidate. This requires special separation of the partisan elected officials in Cabinet posts from some of the activities of the government departments that they continue to lead in accordance with the caretaker convention, including the costing of party platforms. The principle of

1 The expanded mandate was granted with the enactment of An Act To Implement Certain Provisions of the Budget Tabled in Parliament on March 22, 2017 and Other Measures, SC 2017, c. 20; royal assent June 22, 2017. Official party status, for the purposes of parliamentary procedure, has been associated with having at least 12 members in the House of Commons. Marc Bosc and André Gagnon, eds., *House of Commons Procedure and Practice*, 3d ed. (Ottawa: House of Commons, 2017).

restraint central to the caretaker convention is not new, but the new electoral role for the PBO demands that this work receives careful and ongoing respect.

At the start of 2020, the PBO released a report and self-evaluation of the functioning of the new platform-costing regime, including nine recommendations for improvement in advance of the next election.² The report concluded that, while the costing service had “enhanced the credibility of the democratic process . . . some adjustments are desirable.”³ As stakeholders launch a discussion on what, if any, changes to the PBO costing role and process should be made, our aim here is to reflect on what Canada might learn from experience in other advanced democracies. We briefly describe certain key features of the existing systems of platform costing in each of the Netherlands, Australia, and Ireland. Again, readers looking for more detailed discussions of the Dutch and Australian systems will want to read the article by Scott Cameron in this Policy Forum. We discuss these examples in terms of the two key principles of providing transparent and adequate information to voters and protecting the non-partisan public service. Finally, we offer some concluding ideas on what Canada might take away from international practice.

HOW DOES ELECTION PLATFORM COSTING WORK IN THE NETHERLANDS?

The longest-running system of public support for party platform costing is in the Netherlands. There, the Centraal Planbureau (CPB) has been providing analysis of the costs of platform promises since 1986.⁴ Unlike Canada’s PBO, the CPB is actually part of the government executive under the Ministry of Economic Affairs, Agriculture and Innovation.⁵ As a public but quasi-independent body, the CPB has access to much of the government’s internal and unpublished financial information. It also maintains working-level relationships with government ministries to gain additional information. The CPB reports that this system works well and that it receives information that it requests from ministries in a timely manner.⁶ The CPB’s economic and fiscal projections are used as the official foundation for national public budgeting in the Netherlands, and the bureau maintains a clear and written agreement on the respective roles and responsibilities of each of the relevant actors with the Dutch Council of State.

2 Canada, Office of the Parliamentary Budget Officer, *Evaluation of Election Proposal Costing 2019* (Ottawa: PBO, January 2020) (herein referred to as “PBO Evaluation”) (www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/ADM001/ADM001_en.pdf).

3 Ibid., at 1.

4 CPB Netherlands Bureau for Economic Policy Analysis, “What Does CPB Do?” (www.cpb.nl/en/what-does-cpb-do).

5 “Netherlands” (2015) 15:2 *OECD Journal on Budgeting* 175–88.

6 Ibid., at 177.

In the leadup to an election, the CPB will publish a four-year economic and fiscal projection to inform the platform development work of the political parties. The analysis of the platforms is published as a single report, detailing a comparative analysis of all party platforms against baseline assumptions on government revenues and spending, as well as projections of macroeconomic and microeconomic impacts, including changes to economic growth, income distribution, and even key health-system indicators.⁷ Parties are not required to participate in this comparative analysis, but the CPB reports that almost all do and, what's more, they provide copies of their platforms well in advance of the election. For example, the most recent report, published in February 2017, covers the platforms of 11 political parties, all of which provided their platforms to the CPB in November 2016 for an election that took place five months later, in March 2017.

In the Canadian context, this degree of advance election planning by political parties is virtually unheard of. While work on policy platforms generally begins in advance of campaigns, in recent elections platforms have regularly not been finalized and released until shortly before election day. As the PBO has noted, the volume of requests for costing of platform proposals during the 2019 election was initially quite limited and increased significantly as the federal campaigns continued,⁸ signalling that parties are still making decisions on what promises to make even as the day of the election approaches. In addition to having significantly more time to do the work, the ability of the CPB to provide detailed comparative analysis also relies on having complete lists of platform promises from parties before the work of costing begins. This allows the CPB to consider the net economic effects of packages of proposals for policy change. By contrast, the PBO service is built for informing parties of the fiscal cost of individual policy ideas, where these ideas may not even make their way into the final list of public promises a party makes. The PBO will only publish costing of proposals that have already been announced by a political party. In fact, the PBO reports that it costed almost twice as many policy ideas from parties as were ever made public.⁹ But in the Netherlands, where coalition governments are the norm, the CPB's comparative analysis informs both voters and the parties themselves of relative differences (or similarities) in overall policy direction, a key consideration when negotiating interparty agreements to form a government.

HOW DOES ELECTION PLATFORM COSTING WORK IN AUSTRALIA?

Australia, like Canada, has a parliamentary budget officer whose mandate includes costing policy proposals for parliamentarians and publishing fiscal analysis of the

7 Centraal Planbureau [CPB Netherlands Bureau for Economic Policy Analysis], *Keuzes in Kaart 2018-2021, Charted Choices 2018-2021, Chapter 1 and 2, the Headlines* (The Hague: CPB, 2017) (www.cpb.nl/sites/default/files/omnidownload/Charted-Choices-2018-2021.pdf).

8 PBO *Evaluation*, supra note 2, at 5.

9 Ibid.

election platform commitments of major parties. The Australian PBO was created in 2012, in part to supplement an older system (in place since 1998) that allows parties to ask government departments for assistance in costing policy proposals.¹⁰ A 2014 study by the Institute on Government found that this older system has not been well used by Australian political parties, even when it initially was available only to parliamentarians in the governing or official opposition parties. This was, at least in part, because both the requests and responses from departments must be made public, and with limited advance notice to the requesting party. When access was later expanded to include third parties in Parliament, new problems emerged. Government documents revealed that costing requests were not always kept confidential by officials and were shared with ministerial staffers and the Prime Minister's Office. The Prime Minister's Office also exercised an informal veto over requests received by departments and did refuse to let some costing work proceed. This not only violated any expectation of confidentiality that the parties thought they might enjoy in seeking advice, but also posed a clear risk to the non-partisan nature of the professional public service that is foundational in Westminster systems of government such as those of Australia and Canada.

Under Australia's new regime, the Australian PBO offers a service similar in many respects to the Canadian PBO. One exception is that, in Australia, parliamentarians can submit policy proposals for confidential costing to the PBO outside the election period. The Australian PBO will prioritize these requests, taking into account whether the request is on a matter under active debate in Parliament, the importance of the item relative to others submitted by the same party, the number of seats held by the party, and the level of demand for PBO services from the same party.¹¹ The contents of both the request and the response will be kept confidential by the PBO if requested by the parliamentarian. Importantly, that confidentiality enables political parties and their representatives to reconsider and refine policy ideas on the basis of the new information and analysis received from the PBO. In principle, this should lead to more robust policy proposals from political officials who can have an opportunity to carefully consider an idea before making and defending a public commitment. Furthermore, it is an approach that mirrors a government's access to confidential advice from non-partisan public servants. The Canadian PBO offers no such confidential service outside the election period.

During the caretaker period, the Australian PBO will accept requests to cost policies that have already been announced by a political party or an independent parliamentarian seeking re-election.¹² Before polling day, the PBO will release the

10 Robyn Munro and Akash Paun, *Pre-Election Policy Costing Mechanisms in Australia, Whitehall in Year Five of the Coalition: Lessons from Elsewhere* (London, UK: Institute for Government, March 2014).

11 Australia, Parliamentary Budget Office, *PBO Costing Processes, Timeframes and Prioritisation Framework*, Information Paper no. 1/2018 (Canberra: PBO, February 15, 2018).

12 Australia, Parliamentary Budget Office, *Costing Policy Proposals During the Caretaker Period*, PBO Guidance no. 03/2018 (Canberra: PBO, 2018).

requests received, the cost estimates that it was able to complete, and a list of proposals that it was not able to cost in advance of voting day. The PBO will notify the requesting party immediately before publication of a costing of a policy idea. There are two potential avenues for parties to keep platform costings confidential. First, the PBO will continue, depending on other demands, to complete any requests for confidential analysis that were submitted before the start of the writ. Second, instead of making requests to the PBO, parties with official status in Parliament can choose to submit platform proposals for costing to the Australian Treasury and Finance departments rather than the PBO. Qualitative research by Munro and Paun suggests that the governing party is inclined to make use of this public service route, while opposition parties may prefer to use the PBO.¹³ It seems that there may be some lingering mistrust that the public service will keep a request confidential from political offices, even in a caretaker period.

In addition to costing of individual proposals, the Australian PBO is mandated to provide analysis of the net fiscal impact of the full set of election commitments made by political parties.¹⁴ On the day before the election vote, all parties are required to provide the PBO with the list of policy measures that form their final election platform. By legislation, no more than 30 days later, the PBO must publish a report on the medium-term impacts for government finances of each set of policy proposals.¹⁵ The report also offers more detailed discussion of any policy proposals that are expected to cost more than AU\$1 billion annually and of the 10 most expensive policy proposals in each party platform. The net effects of platforms in terms of public debt charges, government receipts, and total spending are also reported. Like the Dutch CPB, the Australian PBO imposes a common economic and fiscal outlook across all parties as the baseline for the costing exercise. With regard to the principle of informing voters, a post-election report cannot provide voters with the same opportunity to compare and contrast the various policy packages offered by competing political parties before casting their ballots. It does, however, provide voters, media, and opposition parties with another resource with which to hold a winning party (or coalition) accountable for its spending and revenue choices while in office. It may also impose some greater analytical discipline on political parties. When parties know that their entire policy package will be subjected to external and public scrutiny, they may be less willing to risk using jiggery-pokery to alter the perceived costs of individual commitments or their full platform. In this regard, Canada's system of voluntary costing of individual policy measures may not be providing voters with the same level of comprehensive and comparative evaluation that is available before voting in the Netherlands and soon after in Australia.

13 Munro and Paun, *supra* note 10, at 13.

14 *Ibid.*, at 14.

15 Australia, Parliamentary Budget Office, *Post-Election Report of Election Commitments: Medium-Term Reporting*, PBO Guidance no. 02/2018 (Canberra: PBO, 2018).

HOW DOES ELECTION PLATFORM COSTING WORK IN IRELAND?

Independent platform costing has been available to political parties in the Republic of Ireland since the 1980s.¹⁶ In Ireland, parties request costing assessments directly from a key central agency of the executive, the Department of Finance. This differs, at least qualitatively, from both the Netherlands and Australia. While the Dutch CPB is an executive body and carries clout as the authoritative source of information for public budgeting in the country, it operates independently of the government of the day. Although Australian parties can approach the Department of Finance directly, opposition parties appear reluctant to exercise this option, preferring the distance created by having the PBO act as a go-between. This contrast between the Irish approach and international practice raises the question of how the Irish make it possible for all parties to enjoy fair access to public service advice and information without politicizing their public service. The answer is not clear.

It appears to us, as outside observers, that the Irish have maintained this delicate balance by choosing a much less flexible system than that used in Canada. The Irish system maintains narrow parameters over the timing and scope of requests and how requests are managed. There are three points in the political calendar when parties are permitted to submit proposals for costing:¹⁷

1. in the months preceding a general election,
2. during the annual government budget process, and
3. during the negotiation of a coalition agreement (or Programme for Government) after a national election.¹⁸

Department of Finance assessments of proposals are restricted to financial costings and do not include assessments of other considerations such as feasibility or benefits relative to alternatives.¹⁹ Evaluations of the costs of proposals are also limited to individual policy items, or packages of related policies, in contrast to the Dutch practice of evaluating full platforms, and exclude comments on other policy proposals, existing policy, or economic forecasts.²⁰ According to Munro and Paun,

16 John FitzGerald, "Counting the Cost of Election Promises," *Irish Times*, January 20, 2015 (www.irishtimes.com/business/economy/counting-the-cost-of-election-promises-1.2071430).

17 Robyn Munro and Akash Paun, *The Irish Facility for Policy Costings, Whitehall in Year Five of the Coalition: Lessons from Elsewhere* (London, UK: Institute for Government, March 2014).

18 Ibid., at 2. In Ireland, coalition has become the norm increasing the importance of negotiating coalition agreements. While negotiating parties have made limited use of costing assessments, there is a view that that greater civil service input could improve the quality of future Programmes for Government.

19 Munro and Paun, *supra* note 17.

20 Ibid.

the Irish system also struggles to assess more complex and transformational policy proposals, and while parties can submit packages of related policies, few ever do.²¹

The Irish Department of Finance does take care to keep requests for costing confidential from the sitting minister or president. While the Australian experience suggests that confidentiality of opposition requests for costing is not always respected, the Irish seem to have found a way to make their system work. All parties submit their requests directly to the secretary general (the deputy minister equivalent) of the Department of Finance, who then passes on the requests to relevant officials to carry out the necessary analysis, via a coordinator. The minister and political aides are never informed. Officials are not told who initiated the request for costing.²² The requests and all documentation related to the requests are also exempt from freedom-of-information legislation.

However, this appearance of de jure formality and tight control belies the de facto reality of the Irish system, which seems to be quite informal, with public servants exercising considerable discretion. For example, research suggests that “depending on the relationship between the individuals involved, officials may provide additional information on the pros and cons of a policy, or on potential implementation challenges,”²³ with departmental officials taking “a very broad interpretation of their mandate.”²⁴ This may reflect a greater fluidity in information sharing and interaction between public servants and political parties than exists in the Netherlands, Australia, or Canada. Further, although the Irish system recognizes three distinct periods during which costing of policy may be requested by opposition parties, in practice the timelines may be far more fluid. Because there is no fixed election date in Ireland, pre-election costing opens at the discretion of the deputy head of the Department of Finance, usually when the first costing request is received from an opposition party.²⁵

Notwithstanding that the actual practice appears to be messier than is intended by the design of the system, the Irish approach still seems to work. Parties make use of the system, and voters gain information on the costs of different policies on offer, both during and between elections. A clear norm has emerged that parties will make costings of all major policy proposals public, a norm enforced by media criticism of parties that do not make use of the public support for costing their policy ideas.²⁶

21 Ibid.

22 Ibid.

23 Ibid., at 2.

24 Ibid., at 9.

25 Ibid.

26 For an example of criticism, see John McHale, “Irish Voters Should Demand Better Party Manifestos,” *Irish Times*, February 7, 2020 (www.irishtimes.com/opinion/irish-voters-should-demand-better-party-manifestos-1.4164045). See also “Irish Party Leaders Clash Over Election Promises,” *itv*, January 31, 2020 (www.itv.com/news/2020-01-31/irish-party-leaders-clash-over-election-promises).

Leaks, which are recognized as having the potential to completely undermine the system, have not occurred. The Department of Finance's analyses and assumptions are cited and respected by parties. However, given the variation between the design and practice of costings, risks to the non-partisan nature of the professional public service may remain.

LESSONS FROM INTERNATIONAL PRACTICE FOR THE FUTURE OF THE PBO COSTING SERVICE IN CANADA

The 2019 federal election was Canada's first federal election under a new regime that allowed officially recognized political parties to seek costing of policies by the PBO as part of the development of their platforms.

There was much to commend both in the design of this regime and in its first application in an election. Although the regime relies on voluntary participation, all parties officially recognized in the House of Commons, as well as representatives of some smaller parties, used the PBO costing service, suggesting that there was a strong incentive for parties to take part. When parties made public policy commitments during the writ period, voters were able to access the PBO's independent analysis of those items that it had costed. It does not appear that any officially recognized party used the PBO for every one of the policy commitments contained in its final complete election platform, but the PBO analysis no doubt improved the transparency of the parties' platforms. And, finally, the regime operated in a manner that respected the non-partisan nature of the service, preserved the confidentiality of requests, and adhered to the principles of the caretaker convention. The PBO was able to make requests to the federal Department of Finance and other government departments to complete costings for parties without breaching the confidentiality promised to political parties. While one of us had previously worried that party requests may be leaked and undermine trust in the system,²⁷ we are pleased to note that these fears did not come to pass. The separation of the analysis of requests from the political elements of the executive and respect for the confidentiality of requests allowed parties to adjust or drop policy ideas that turned out not to be prudent when subjected to rigorous costing analysis. The absence of leaked requests for policies that were not later released and of indications of politicization of the work may build trust in the system and lead to further use of PBO analysis. Preserving this nascent legitimacy is necessary to maintain, and perhaps also expand on, the current regime moving forward.

Indeed, we see opportunities to adapt Canadian practice informed by what has worked (and not worked) in other countries with longer histories of supporting parties in costing their policies. In table 1, we summarize the key similarities and differences of the four jurisdictions discussed in this article.

27 Jennifer Robson, "The Problem with Involving the PBO in Elections," *Maclean's*, April 12, 2017.

TABLE 1 Core Features of Costing Regimes in Canada, the Netherlands, Australia, and Ireland

Feature	Canada	Netherlands	Australia	Ireland
Is participation mandatory?	No	No	No	No
Is the service internal or external to government?	Mixed	Internal	External	Internal
Is public disclosure of costing automated?	No	Yes	Yes ^a	No
Is public disclosure limited to proposals that parties have announced?	No	No	Yes ^a	No
Does the costing body publish a comprehensive (roll-up) report of platforms?	No	Yes	Yes	No

a For requests made during the caretaker period.

While the PBO has made its own recommendations,²⁸ informed by our review of other platform-costing regimes, we propose three possibilities for consideration for evolving the current Canadian approach. First, we note that other countries appear to permit or even require parties to submit policy ideas for costing well before election day. In Canada, parties could also be encouraged to submit requests earlier. This would, at a minimum, help to better align PBO and departmental resources with the timing and the level of demand during the pre-election costing period. The simplest and least costly manner for doing this may be to alter the way that time on requests is apportioned to the parties. In the 2019 election, parties received a lump-sum budget of time that they could draw down over the duration of the pre-election costing service. Instead, the amount of time allocated to each party could be allocated for different phases of the pre-election period, declining in a stepwise fashion. When the staff time available to parties declines (and cannot be replaced), they may have more incentive to submit policy ideas for analysis earlier, in contrast to the experience of the PBO in this first round. This change would also encourage parties to start their platform work earlier and could lead to better-quality election manifestos to inform voters before election day.

Second, inspired by the Dutch model, consideration could be given to expanding the PBO's role to include a comprehensive report on the full impacts of party platforms for federal budgeting. Even if the reports were not published until after the election, the approach may still encourage parties to be more rigorous in their own analysis and policy choices. Even if information on the net fiscal impacts of all party platforms would not be available to voters before casting a ballot, the information might still help voters to hold a governing party to account and would give

28 PBO *Evaluation*, supra note 2.

voters a clearer sense of the opposition parties' relative fiscal responsibility. Over time, this comprehensive analysis of competing platforms might even be possible in the pre-election period. This may require some innovation on modelling approaches at the PBO to increase its ability to undertake "dynamic costing" with platforms that combine more complex policies or multiple fiscal measures.

Third, we see an opportunity to further clarify the relationships and obligations of government departments to provide information and assistance to the PBO. While we want to be clear that there was no sign for concern during the 2019 election, the level of discretion that rests with officials in the Irish model leaves us uneasy. Canada's system wisely keeps the federal public service at arm's length from the work of costing the election promises of political parties. But that system may be enhanced by either expanding the use of memorandums of understanding between the PBO and government departments, or, conversely, establishing a government-wide standard for supporting the PBO in platform costing.

Finally, the international examples also remind us that the norms evident in practice are at least as important as, or perhaps more important than, the formal rules for institutions. Canada's system for providing public support to evaluate the costs of election promises by political parties has already established some healthy norms that should be bolstered through repeated and successful experiences in using the PBO costing system. We are fortunate to have a good foundation to build on.

A Tax Policy Legacy: Tim Edgar's Contributions to Tax Scholarship and Tax Legislation

Richard Krever*

PRÉCIS

Le décès de Tim Edgar en décembre 2016 a porté un coup dur au domaine de la recherche en fiscalité au Canada et dans le monde, en plus d'être une triste perte pour la *Revue fiscale canadienne*, à laquelle il a contribué pendant plus de trois décennies. Les livres, les articles de revue et les chapitres de livre de Tim couvrent un large éventail de questions de politique fiscale, et ils ont grandement contribué à aider les décideurs politiques, les universitaires et les étudiants à comprendre certains des domaines les plus difficiles du droit fiscal sur le plan conceptuel et technique. Le livre de Tim Edgar sur l'imposition des accords financiers, publié par la Fondation canadienne de fiscalité, est considéré par les décideurs politiques du monde entier comme l'autorité absolue en la matière. Il présente une voie raisonnée pour extraire la composante dette des instruments financiers et l'assujettir à une imposition neutre des gains accumulés. Dans un domaine étroitement connexe, son analyse détaillée des difficultés auxquelles font face les décideurs politiques qui cherchent à appliquer de manière neutre la taxe sur les produits et services (TPS) aux fournitures financières est considérée comme un travail fondamental dans ce domaine, et sa proposition de supprimer la taxe sur les fournitures interentreprises a été adoptée directement en Nouvelle-Zélande et par un mécanisme indirect à Singapour. Le travail de Tim Edgar sur la règle générale anti-évitement est très souvent cité, tandis que sa proposition d'étendre les règles sur la capitalisation restreinte aux investissements à l'étranger a été adoptée en Australie. L'analyse exhaustive de Tim Edgar du système canadien de pseudo-imputation ouvre la voie à une remise en question indispensable du système. Plus le sujet était difficile, plus Tim Edgar l'a étudié en profondeur et l'a disséqué méthodiquement pour arriver à des recommandations éclairées de réforme. Les travaux de Tim Edgar continueront d'être lus, cités et mis en application pendant de nombreuses années.

ABSTRACT

Tim Edgar's passing in December 2016 dealt a severe blow to tax scholarship in Canada and globally, not to mention being a sad loss for this journal, to which he was a

* Professor, Law School, University of Western Australia; International Fellow, Centre for Business Taxation at the University of Oxford.

contributor for over three decades. Tim's books, journal articles, and book chapters spanned a wide spectrum of tax policy issues and have played a central role in helping policy makers, academics, and students understand some of the most conceptually and technically difficult areas of tax law. Tim's book on the taxation of financial arrangements, published by the Canadian Tax Foundation, is viewed by policy makers worldwide as the definitive authority on the subject, setting out a principled path to carving out the debt component of financial instruments and subjecting it to neutral accrual taxation. In a closely related area, his detailed analysis of the difficulties confronting policy makers who seek a neutral application of the goods and services tax (GST) to financial supplies is considered to be foundational work in the field, and his proposal to remove the tax from business-to-business supplies has been adopted directly in New Zealand and via an indirect mechanism in Singapore. Tim's work on the general anti-avoidance rule is cited time and again as a key treatment of the topic, while his proposal to extend thin capitalization rules to outbound investment has been adopted in Australia. Tim's comprehensive analysis of the Canadian pseudo-imputation system opens the door to a much-needed reconsideration of the system. The more challenging the subject matter, the deeper Tim investigated and methodically dissected the topic to arrive at reasoned recommendations for reform. Tim's work will continue to be read, cited, and applied in practice for many years.

KEYWORDS: GAAR ■ GST ■ FINANCIAL SERVICES ■ THIN CAPITALIZATION ■ DEBT-EQUITY ■ DEBT SUBSTITUTE

CONTENTS

Introduction	518
Consistency in Diversity	519
Financial Instruments and Arrangements in the Income Tax	523
Interest Fungibility	527
Thin Capitalization and Exploitation of the Debt-Equity Distinction	528
Imputation	529
GST and Financial Intermediation	531
GAAR	533
The Legacy	537

INTRODUCTION

Soon after Tim Edgar's doctoral thesis on the taxation of financial instruments was passed unanimously by his examiners from Harvard and UCLA, with (unusually) no recommendations for additions, modifications, or other substantial changes, the work was published as a book by the Canadian Tax Foundation.¹ This 645-page book was to become one of Tim's most influential, circulated far beyond the normal reach of the Foundation's publications. Copies of it would be found on the desks

1 Tim Edgar, *The Income Tax Treatment of Financial Instruments: Theory and Practice*, Canadian Tax Paper no. 105 (Toronto: Canadian Tax Foundation, 2000).

of tax policy officials around the globe and would be used time and again by tax designers, as nations adopted comprehensive income tax regimes for financial arrangements. The reports of Tim's thesis examiners included only one note of possible ambivalence—an observation that the thesis was very long.

Length was a hallmark of Tim's scholarship. The abstracts for his papers in this journal (granted that these abstracts are provided in Canada's two national languages) often stretched to a fourth page,² and the papers themselves ran up to 75 pages long,³ the size of a small monograph. The depth of Tim's scholarship is also reflected in the number of his publications. In addition to publishing, alone or with other authors, 44 journal articles and chapters, Tim co-authored seven editions of a casebook, acted as general editor for a leading looseleaf tax service, and contributed to or co-edited the Current Tax Reading feature in this journal for almost three decades.

Tim's interests spanned the entire gamut of tax law and policy. The more complex and challenging the area, the more it attracted his attention. Common to several of the areas in which he worked were financial instruments and financial arrangements. The more intricate the instrument or arrangement, the more Tim enjoyed working with them; hedges, futures, derivatives, hybrids, and synthetics were the starting point for some of his best-known publications.

Four topics related to instruments and arrangements account for a notable proportion of his research output: (1) the optimal income tax rules for financial instruments, (2) the most effective responses to avoidance engineered through mismatches between interest expenses and recognized gains, (3) the role of thin capitalization rules in addressing international tax minimization, and (4) the ideal treatment of financial arrangements in a goods and services tax (GST). A fifth research area explored by Tim was the development of a better imputation system. A sixth area, for which he is widely cited, was the design and use of general anti-avoidance rules (GAARs).⁴

CONSISTENCY IN DIVERSITY

While much of Tim's work falls into these six research categories, he produced other significant publications that cover a diverse array of important tax policy issues. A consistent feature of these papers is the extent to which Tim digs into the nuances

2 Tim Edgar, "The Classification of Corporate Securities for Income Tax Purposes" (1990) 38:5 *Canadian Tax Journal* 1141-88.

3 Tim Edgar, "Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage" (2003) 51:3 *Canadian Tax Journal* 1079-1158. This paper also featured a four-page abstract.

4 A number of Tim's papers were co-authored. In this paper, for the sake of simplicity, I refer to all papers in which Tim was involved—whether as a single author or a co-author—as "Tim's paper." The notes provide the details regarding co-authors, who deserve credit (or criticism), along with Tim, for the publications reviewed in this article.

and subordinate issues that can affect policy choices. A good illustration of this phenomenon is a chapter that he wrote on the expenses that should be allowed as deductions when individuals' taxable income is being calculated.⁵ The chapter looks at the debates over the borderline between deductible outgoings necessarily incurred in the derivation of gross income and non-deductible personal consumption expenses. The cost of child care is a prime example of such a borderline expenditure, falling on one side of the line or the other depending on one's perspective.

The conventional legal arguments look at whether such an expense is incurred directly in the course of deriving gross income (in which case it is a deductible expense) or is incurred in order to put the taxpayer in a position to carry out income-earning activities (in which case it is a personal non-deductible consumption expense). Similar arguments, Tim noted, are made in respect of commuting expenses versus the cost of travel between places of work, and higher education expenses versus continuing education costs that individuals incur to remain in practice or to achieve promotion at work. In applying the strict legal tests, courts tend to characterize the expenses as personal expenses that put taxpayers in a position to derive gross income rather than expenses incurred in the course of deriving that income.

The conventional policy arguments over the deductibility of child-care expenses are somewhat different, focused primarily on questions of volition: Are child-care expenses a consequence of work needs or of a working person's consumption decision to have a child? Under this test, the expense is most often characterized as a personal expense. Proponents of this view do not object to the recognition of child-care expenses in the tax system; they argue, for example, that it is a tax expenditure to facilitate re-entry into the workforce and to promote equal gender participation in the formal economy. They argue for targeted and equitable tax expenditures, usually settling on tapering refundable credits as the most effective and fairest of these.

Both the legal and policy analysis here is far too simplistic, Tim suggested. The stay-at-home parent derives significant untaxed imputed labour income by providing household child-care expenses directly; in a model income tax, this income, too, would be taken into account. A deduction for the working parent might lead to equitable outcomes as between the two types of parents. On the other hand, the family in which both parents work may have more valuable untaxed imputed income from leisure time, which could throw off any balance achieved by making the costs deductible expenses. The issues, as Tim's work inevitably reveals, are far more nuanced than is generally recognized, and solutions satisfying all aims can be elusive.

5 Tim Edgar, "The Concept of Taxable Consumption and the Deductibility of Expenses Under an Ideal Personal Income Tax Base," in Richard Krever, ed., *Tax Conversations: A Guide to the Key Issues in the Tax Reform Debate: Essays in Honour of John G. Head* (London: Kluwer Law, 1997), 293-363.

At the same time, Tim suggested that in some cases, it may be preferable to look past distracting technical issues and adopt a simple and blunt instrument to address a problem, if the problem is one of taxpayers exploiting policy solely to minimize tax. An example is found in Tim's analysis of tax-minimization arrangements deliberately engineered to deliver charitable deductions for gifts of art that is valued at far more than its acquisition cost.⁶ In this article, Tim considers carefully proposals for targeted responses to each element of the schemes but concludes that the ultimate motive (reducing taxes for the sake of reducing taxes) justifies a far simpler response—namely, denying the benefit crucial to the success of the scheme: the gift deduction.

Tim's papers, with only a few exceptions—for example, an early comparison of capital gains taxes across many jurisdictions, which went no further than to suggest that one particular rule looked “curious”⁷—evaluated policy decisions and set out their shortcomings and virtues by reference to benchmark principles. In an article that tested proposed changes to the deemed 21-year realization rule for trusts against higher-level tax objectives, for example, Tim was able to identify convincingly aspects that were “overly generous” and others that were unnecessarily “harsh or restrictive.”⁸ Similarly, his suggestions for the optimal tax treatment of returns to outbound debt and inbound debt in a small open economy were constructed entirely with the goal of distortion-free local capital markets.⁹

Tim's ability to peel away layers of conventional but simplistic assumptions and conclusions is well illustrated in his seminal study of international tax competition and arbitrage.¹⁰ Tax competition, to the extent that it leads to a shifting of the place of investment, yields actual efficiency losses. Tax arbitrage, conversely, is more likely to lead mostly to revenue losses with little efficiency loss, because taxpayers achieve the capital allocation they seek but exploit the inconsistent treatment of economically equal but legally very different arrangements in order to avoid tax on the investment returns. Tim developed and recommended different responses as he worked through the implications of different types of international tax minimization.

One premise underlying Tim's distinction between tax competition and tax arbitrage is undermined, to some extent, by his proposed responses to the problem of international tax arbitrage. The premise is that the location of actual capital may

6 Daniel Sandler and Tim Edgar, “The Tax Expenditure Program for Charitable Giving: Kicking a Gift Horse in the Teeth” (2003) 51:6 *Canadian Tax Journal* 2193-2214.

7 Brian J. Arnold and Tim Edgar, “Taxation of Capital Gains in Australia, New Zealand, the United Kingdom and the United States” (1995) 21, supplement *Canadian Public Policy* S58-76.

8 Tim Edgar, “Deemed Realization of Trust Property: Proposed Amendments to the 21-Year Rule” (1992) 11:3 *Estates and Trusts Journal* 207-43, at 240-42.

9 Ewen McCann and Timothy Edgar, “The International Income Taxation of Portfolio Debt in the Presence of Bi-Directional Capital Flows” (2006) 4:1 *eJournal of Tax Research* 5-24.

10 Edgar, “Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage,” *supra* note 3.

change in response to tax competition. Equally likely, however (if not more so), is that investors will direct capital on the basis of pre-tax rates of return, looking for infrastructure, labour forces, and large markets, for example, and then will shift intangible property and rely on intragroup transactions to divert profits through transfer pricing to lower-tax jurisdictions. One of Tim's solutions to the problem of revenue lost through arbitrage arrangements—the replacement of separate accounting that incorporates wholly artificial, notional arm's-length prices with a simple expense formulary apportionment regime to align expenses with actual economic activity—is equally apt for tax competition distortions.

The rationale for formulary apportionment was set out clearly in Tim's critique of an Organisation for Economic Co-operation and Development (OECD) thought bubble on allocating income to branches. In the course of his analysis, Tim hit upon the fundamental flaw with the traditional water's-edge methodology that is based on hypothetical arm's-length prices for transactions between parts of multinational enterprises: the reality is that no business would actually delegate to an unrelated enterprise activities that give rise to the most difficult transfer-pricing cases.¹¹ The transactions arise precisely because they take place within a single economic enterprise.

Tax scholars regularly evaluate the efficacy and fairness of tax expenditures by reference to direct expenditure alternatives, but it is rarer to see negative tax expenditures analyzed by reference to direct regulatory alternatives. As explicit deviations from neutral consumption taxation, excise taxes intended to modify the price of harmful goods or services such as alcohol, tobacco, and petroleum products by incorporating an element of their social costs into the retail price should be prime candidates for negative tax expenditure analysis. Tim took on the challenge by looking at three possible excise taxes aimed at controlling excessively risky behaviour by financial institutions, comparing the three proposals with the alternative of regulation.¹² He showed that bank leverage taxes can generate desirable behavioural responses, that higher taxes on returns to risk taking are not needed if bank leverage taxes are used, and that, when the goal is to control overly risky behaviour, regulation is probably better suited than a tax on bonus or performance-based compensation.

Tim took care to distinguish between acceptable and abusive tax expenditures delivered via tax shelters. The former support particular types of investment promoted by the legislature, and a government using tax concessions to subsidize designated activities should welcome the use of tax shelters to funnel cash to the intended beneficiaries and tax benefits back to the investors. An abusive tax shelter, in contrast, is one in which the tax benefits flowing back to the investor are greatly

11 Tim Edgar and David Holland, "Source Taxation and the OECD Project on the Attribution of Profits to Permanent Establishments" (2005) 37:6 *Tax Notes International* 525-39.

12 Tim Edgar, "Corrective Taxation, Leverage, and Compensation in a Bloated Financial Sector" (2014) 33:3 *Virginia Tax Review* 393-428.

exaggerated in terms of the actual value of the taxpayer's investment, with a proportion—often most—of the so-called investment actually comprising funds for which the investor is not actually at risk. Of the different options available to attack the exploitation of abusive shelters, at-risk rules are the most effective response, Tim concluded, and he offered the Canadian rules as an appropriate starting point for designing measures in countries yet to tackle the problem.¹³

FINANCIAL INSTRUMENTS AND ARRANGEMENTS IN THE INCOME TAX

At the core of much of Tim's research is the optimal tax treatment, in both the income tax and the GST, of financial instruments and arrangements. His published work on the taxation of returns to financial investments began with an inquiry into the meaning of "interest" on debt for tax-law purposes.¹⁴ The timing rules applicable to interest—particularly in formats other than simple interest such as compounding interest or original issue discount—were, at the time Tim first wrote about them, accurately described by him as a "complex patchwork quilt."¹⁵ This lack of uniformity was attributable, in part, to reliance on the legal definition of "interest" when the term was being interpreted in the legislation. The legal meaning of interest, Tim explained, is a transplanted notion developed by the courts for purposes unrelated to the measurement of economic gain as an indicator of ability to pay taxes. The time was ripe, he suggested, for a different approach in tax law, one that measured and recognized accruing anticipated returns on debt investments as derived annually.

This work led almost intuitively to a broader question: If anticipated accruing gains on debt should be recognized annually, where is the line to be drawn between anticipated gains on financial investments, whether or not they are explicitly labelled as interest, and gains (or losses) wholly attributable to uncontrolled market forces? At an early stage, tax laws adopted rules to recharacterize convertible debt as equity and redeemable preference shares as debt.¹⁶ By the turn of the 21st century, however, as Tim noted time and again in his writing, tax planners had learned to construct both synthetic debt and equity by combining a host of separate instruments and arrangements, including hedges and options, and an array of new obligations and rights. It was no longer possible to simply identify particular instruments

13 Tim Edgar, "At-Risk Rules as a Legislative Response to 'Abusive' Personal Tax Shelters" (2001) 7:4 *New Zealand Journal of Taxation Law and Policy* 291-321.

14 Tim Edgar, "The Concept of Interest Under the Income Tax Act" (1996) 44: 2 *Canadian Tax Journal* 277-347.

15 Tim Edgar, "Deduction of Loan Losses and Financing Expenses by Moneylenders," in *Report of Proceedings of the Forty-Sixth Tax Conference*, 1994 Conference Report (Toronto: Canadian Tax Foundation, 1995), 16:1-52, at 16:52.

16 These rules are reviewed in Edgar, "Corporate Income Tax Coordination as a Response to International Tax Competition and International Tax Arbitrage," supra note 3.

and deem them to be either debt or equity; the tax system had to do as the parties did and consider the combination of arrangements together to see the actual economic effect, in terms of risk, of a multi-element arrangement.

The ability of planners to devise financial arrangements that have the legal attributes of one form and the commercial or economic attributes of another form became one of Tim's core areas of research over a period of almost two decades. Tim's studies of financial instruments and arrangements fall into two broad camps. In one type of study, Tim focuses on the principles that should govern the design of a legislative regime that aims to separate debt and equity elements in arrangements composed of both; in the other type, he focuses on attacking avoidance arrangements in respect of particular types of instruments.

Tim's central work in respect of the broad design issues is his internationally recognized book on financial instruments, published by the Canadian Tax Foundation.¹⁷ As noted earlier, the work was based on his doctoral thesis and soon after publication could be found on the desks of tax designers around the world. A law review paper of Tim's that was published at the same time, ostensibly aimed at Australian policy makers but equally applicable to their counterparts across the globe, provided a shorter summary of the key points,¹⁸ as did a response to published comments on his work.¹⁹ The thesis and book derived from a string of publications that started with a commissioned book chapter published in 1997,²⁰ which was followed by a paper on the topic, presented the same year at the Canadian Tax Foundation's Corporate Management Tax Conference.²¹

This work is anchored in a simple principle: gains on debt instruments (whatever their legal form) yielding expected returns should be assessed on an annual accrual basis, and gains on shares (again, whatever their legal form) that depend on market gyrations should be assessed on a realization basis. His fundamental research showed how financial arrangements such as hybrid and synthetic instruments could be dissected to reveal debt and equity components and how appropriate tax rules could apply to returns from each type of investment.

17 Edgar, *The Income Tax Treatment of Financial Instruments: Theory and Practice*, supra note 1.

18 Tim Edgar, "The Taxation of Financial Arrangements (TOFA) Proposals: A Modest and Defensible Agenda for Reform" (2000) 23:2 *University of New South Wales Law Journal* 288-98.

19 Tim Edgar, "Response: A Defensible and Workable Approach to the Income Tax Treatment of Financial Instruments" (2002) 50:1 *Canadian Tax Journal* 249-60.

20 Tim Edgar, "The Debt-Equity Distinction Underlying the Taxation of Financial Instruments: Past Practice and Future Policy Directions in Australia and Canada," in John G. Head and Richard Krever, eds., *Taxation Towards 2000* (Sydney: Australian Tax Research Foundation, 1997), 393-435.

21 Tim Edgar, "The Tax Treatment of Interest and Financing Charges in a World of Financial Innovation: Where Should We Be Going?" in *Current Issues in Corporate Finance*, 1997 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1998), 10:1-57.

Tim's grand vision of a principled, comprehensive, and consistent distinction between debt and equity returns in income tax law has yet to be accepted by policy makers. Owing to a range of political, administrative, and conceptual constraints, even the most ambitious reform initiative will fall short of a model that fully reflects the principles Tim espoused. Tim's evaluation of one set of legislated rules provides useful insights into the problems and issues that remain or are made more visible by a broader regime for taxing gains derived from financial instruments.²²

Attempts to legislate comprehensive responses to the problem are rare. More common are piecemeal and ad hoc responses to different schemes and arrangements as they are identified by tax authorities. The consequence of what Tim termed the "general failure"²³ to develop tax rules based on benchmark principles—and the resulting differences in the income tax treatment of interest, dividends, and capital gains—has been the creation of opportunities for arbitrage and tax minimization. The problems have been exacerbated by the growth of alternative structures designed to create after-tax gains with no economic transaction apart from mismatches on different sides of a single transaction. Tim recognized the need for responses to the tax minimization that results from this general failure, and he devoted considerable effort to studying appropriate responses in the absence of a broader principled solution.

Tim's proposed responses to tax avoidance based on financial arrangements varied depending on the nature of the arrangement. An element of risk exposure inconsistent with legal form is the primary attribute shared by two types of arrangements, the first being transactions targeted by older anti-avoidance measures such as "wash sale" rules, "dividend stop-loss" rules, and securities lending rules; and the second being problematic newer instruments and arrangements such as derivative forward agreements, synthetic disposition transactions, and synthetic equity structures. Tim was skeptical of the "legal language" approach used to date in anti-avoidance measures; his preferred solution was rules that characterized arrangements by reference to objective economic tests that established clear risk-exposure borderlines.²⁴

Tim proposed a variety of responses tailored to the specifics of each arrangement, distinguishing straightforward cases of risk transfer—which create a post-tax profit from arrangements that effectively offset each other in economic terms but yield different tax treatments—from those that may yield an actual financial benefit as well as a tax benefit. Tim suggested that targeted measures such as loss-limitation

22 Tim Edgar, "The Taxation of Financial Arrangements (TOFA) Legislation: Is There Work Left To Be Done?" in Chris Evans and Richard Krever, eds., *Australian Business Tax Reform in Retrospect and Prospect* (Pyrmont, NSW: Thomson Reuters, 2009), 341-66.

23 Tim Edgar, "Some Lessons from the Saga of Weak-Currency Borrowings" (2000) 48:1 *Canadian Tax Journal* 1-34, at 3.

24 Tim Edgar, "Risk-Based Overrides of Share Ownership as Specific Anti-Avoidance Rules" (2015) 63:2 *Canadian Tax Journal* 397-465.

rules may be appropriate for cases yielding tax benefits alone (he endorsed a rule based on a “reasonable expectation of profit” test),²⁵ while reliance on broader anti-avoidance rules may be necessary where a financial transaction is tax motivated but can also show a financial benefit.²⁶

Tim’s description of the “complex patchwork quilt” of rules currently used to recognize interest in its different forms applies equally well to the inconsistent array of debt-equity borderlines in tax laws. Often, the outcome is the result of legislative inaction, which leaves courts and administrators to interpret commercial arrangements on the basis of private-law principles with no connection to tax policy. Sometimes, however, the inconsistency is the result of deliberate intervention by the legislature. One example of such intervention cited by Tim is the special rules adopted for “distress preferred shares” and small business development bonds—financial arrangements that are deliberately excluded from principled instrument recharacterization rules.²⁷ The deliberate failure to treat these instruments in a manner consistent with their actual economic substance constitutes a tax expenditure that yields a particularly inefficient and poorly targeted subsidy. If there is a case for government intervention, better instruments can be found than this tax concession, Tim suggested.

One arrangement that received considerable attention during the period in which Tim wrote was the income trust, a vehicle specifically established to exploit the distinct tax treatment of returns to debt and equity through “redundant securities that are used strictly for the tax saving that they access.”²⁸ The preferable response to income trusts, Tim suggested, was a targeted rule that defines as equity investments securities that endow holders with all the benefits of the equity for which they are substituted.²⁹ The conclusion was reinforced by his illustration (which used the example of stapled securities) of how alternative anti-avoidance rules could be circumvented.³⁰

25 Tim Edgar, “Policy Forum: Interest Deductibility Restrictions—Expecting Too Much from REOP?” (2004) 52:4 *Canadian Tax Journal* 1130-72.

26 Tim Edgar and Amir Aghdaei, “Using the Income Tax System as Your Hedge Counterparty” (2013) 28:2 *Australian Tax Forum* 317-75.

27 Tim Edgar, “Distress Preferred Shares and Small Business Development Bonds: A Tax Expenditure Analysis” (1994) 42:3 *Canadian Tax Journal* 659-708.

28 Tim Edgar, “The Trouble with Income Trusts” (2004) 52:3 *Canadian Tax Journal* 819-52, at 824.

29 Tim Edgar, “Canadian Income Trust Saga: Over, or Headed for a Junk Bond Phase?” (2007) 45:8 *Tax Notes International* 755-67.

30 Reuven Avi-Yonah, Tim Edgar, and Fadi Shaheen, “Stapled Securities—‘The Next Big Thing’ for Income Trusts? Useful Lessons from the US Experience with Stapled Shares” (2007) 55:2 *Canadian Tax Journal* 247-88.

INTEREST FUNGIBILITY

The fundamental premise on which an income tax is built is the measurement of net economic gains, the yardstick of ability to pay. The determination of economic betterment requires taxpayers to deduct from their gross revenue the expenses incurred in deriving those receipts. For the most part, expenses can be tied directly to particular receipts. The notable exception to this general rule is the allocation of interest on borrowed funds used in the course of business or investment. While most expenses yield access to particular goods or services whose use can then be traced, interest is incurred to have access to money, the most fungible of all assets. It is impossible to track each dollar borrowed and, arguably, would be pointless even if it could be done, since taxpayers can easily shift funding sources in order to seemingly align borrowed funds with income-earning activities and equity funds with other investments.

The sensible solution, which is used in most jurisdictions, is to accept that taxpayers are allowed to deduct interest on debt provided that they can show there is an amount invested in taxable activities that is equal to the amount borrowed. A problem arises, however, when borrowed funds are invested in assets that yield both current income and capital gains realized on the disposition of the property, as is the case with, say, rental properties yielding rental income or shares yielding dividend income. Taxpayers seeking an overall profit from the investment expect the combined current income and accruing capital gains to exceed the interest expenses on funds borrowed to fund the acquisition of the asset. The interest may exceed the current income portion of the return, however, with the excess deduction available to shelter other income, including labour or business income.

Many jurisdictions had failed to address the problem of negative gearing or negative leveraging, as it is sometimes called, where interest expenses exceed currently recognized income gains.³¹ The conventional tax policy conclusion is that interest incurred to derive accruing capital gains should be capitalized so that it is recognized at the same time the gains are recognized. This can be accomplished by the use of passive loss rules that limit deductions for interest expenses each year to the amount of investment income earned that year, with the excess interest expense carried forward and available for deduction in future years in which there is sufficient investment income, including capital gains, to absorb the deductions. Tim endorsed this approach as a preferred response to the problem.³²

31 Tim Edgar, "The Tax Treatment of Interest Under the Basic World Tax Code" (1993) 7:5 *Tax Notes International* 347-55.

32 Brian J. Arnold and Tim Edgar, "Interest Deductibility," in Roy D. Hogg and Jack M. Mintz, eds., *Tax Effects on the Financing of Medium and Small Public Corporations* (Kingston, ON: Queen's University, John Deutsch Institute for the Study of Economic Policy, 1992), 59-78, used as the foundation for Brian J. Arnold and Tim Edgar, "Deductibility of Interest Expense" (1995) 43:5 *Canadian Tax Journal* 1216-44.

The opportunities arising from the fungibility of borrowed funds are illustrated well in the case of a company or partnership that uses its own funds and borrowed funds both to make investments and pay expenses incurred in business operations and to fund distributions to shareholders or partners. Interest paid on borrowed funds used to fund dividends or partnership distributions is not incurred in the course of deriving income or in the course of operating a business for the purpose of deriving income. Equally clearly, however, it is not a “personal” expense of the company or partnership and, to this extent, should arguably be recognized as a deductible outgoing. Moreover, given the fungibility of money, it is a legitimate assumption that the company or partnership used its own funds to make distributions and then borrowed to replace the distributed funds. Tim agreed with the Canadian government that in these circumstances, a deduction for the interest is appropriate.³³

The challenge of matching interest expenses with assessable income is particularly acute where a taxpayer derives exempt foreign-source income or, via foreign subsidiaries, income that will not be taxed until long in the future, if ever. This was an issue that Tim explored in a number of papers. Tim regarded the mismatch between deductible interest and untaxed or indefinitely deferred taxation of income derived through a subsidiary as a “serious structural deficiency,”³⁴ concluding in these cases that apportionment rules linked to interest deductions are appropriate.³⁵ An alternative approach that he explores elsewhere—one that is compatible, as noted below, with the apportionment rule—is the use of thin capitalization rules for both inbound and outbound debt.

THIN CAPITALIZATION AND EXPLOITATION OF THE DEBT-EQUITY DISTINCTION

Derived directly from Tim’s interest in corporate finance and financial interest was his apprehension about international and domestic thin capitalization and allied arrangements. The problem, as Tim pointed out time and again, is the different treatment of debt and equity, with the latter subject to one level of tax and the former subject to a partial imputation credit unrelated to the tax actually paid by the company on its profit.

A range of schemes have been and are being used to recharacterize investments to exploit the debt-equity distinction. The differential treatment has prompted thin capitalization of Canadian subsidiaries by foreign investors and thin capitalization

33 Brian J. Arnold and Tim Edgar, “The Draft Legislation on Interest Deductibility: A Technical and Policy Analysis” (1992) 40:2 *Canadian Tax Journal* 267-303.

34 Tim Edgar and Brian J. Arnold, “Reflections on the Submission of the CBA-CICA Joint Committee on Taxation Concerning the Deductibility of Interest” (1990) 38:4 *Canadian Tax Journal* 847-85, at 882.

35 Tim Edgar, “The Corporate Interest Deduction and the Financing of Foreign Subsidiaries” (1987) 4:4 *Australian Tax Forum* 491-528.

of domestic companies investing abroad and locally. Typical of Tim's approach to solving tax problems, his analysis of these arrangements started not with the manifestation of the problem—thin capitalization—but, rather, with the root causes and, significantly, the wide variations in investor characterization that affects the causes and, consequently, the solutions. He points out, for example, that a reasoned response to the problem should distinguish between direct foreign investment, for which tax is a concern secondary to labour supply, infrastructure, and market, and portfolio investors, concerned only with their after-tax returns.³⁶ The latter group, representing completely mobile capital, is able to push back to the borrowers withholding taxes or other imposts levied on interest paid to non-resident investors. Optimal tax theory suggests that interest paid to foreign direct investors can be fully taxed, while no tax should be levied on portfolio lenders.

Because interest expenses are deductible in most cases, the only tax levied on foreign direct investors will be an interest withholding tax, in all cases far less than the income tax levied on company profits, which is most often coupled with a further withholding tax on those profits when they are repatriated as dividends. The incentive for thin capitalization is obvious. Thin capitalization rules, denying deductions for interest on debt that is deemed to be excessive under the rules, are an equally obvious response, one found across advanced economies.

Several aspects of the Canadian rules struck Tim as odd. In a jurisdiction in which some of the largest investors, pension funds, are completely exempt from tax, it would be logical, Tim suggests, to extend the rules to domestic investors. It would be equally logical, Tim notes, to extend the rules to interests in partnerships and trusts. And, finally, it would be logical to apply them to both inbound and outbound investment in order to prevent domestic investors from using fully deductible debt to fund foreign investments that often yield untaxed returns.³⁷

It is, however, not the only solution. Subjecting tax-exempt bodies, such as pension funds, to tax and shifting from Canada's pseudo-imputation system (which provides non-refundable credits for a notional tax) to a true imputation system (in which credits are provided for actual tax paid by a company) would establish parity between returns on debt and equity, removing any need for thin capitalization rules for domestic investors in respect of domestic investments.

IMPUTATION

The Canadian imputation system is a remarkably unique phenomenon, a creature of political compromises on the selective implementation of reforms proposed by

36 Tim Edgar, "The Thin Capitalization Rules: Role and Reform" (1992) 40:1 *Canadian Tax Journal* 1-54.

37 Tim Edgar, Jonathan Farrar, and Amin Mawani, "Foreign Direct Investment, Thin Capitalization, and the Interest Expense Deduction: A Policy Analysis" (2008) 56:4 *Canadian Tax Journal* 803-69; Tim Edgar, "Outbound Direct Investment and the Sourcing of Interest Expense," in Arthur J. Cockfield, ed., *Globalization and Its Tax Discontents: Tax Policy and International Investments* (Toronto: University of Toronto Press, 2010), 60-83.

the Carter commission³⁸ and responses to international pressures that are built on the foundation of a company income tax riddled with tax expenditures. The juxtaposition of these factors and the many after-the-fact attempts to come up with plausible technical rationales for the “investor welfare” elements of the program fascinated Tim from an early stage in his career and prompted a number of papers. Tim’s analysis is comprehensive, reviewing every element of the imputation system and setting out the technical rationale offered and the tax expenditure explanation for the concessional elements of the rules.³⁹ For example, the restriction of imputation credits to resident taxpayers appears to be an illogical rule intended to encourage Canadians to invest in Canadian companies by providing a higher after-tax return than can be realized by non-resident investors, thus allowing Canadians to outbid non-residents investing on the basis of actual economic performance. Substituting Canadian investment for foreign investment in this way may actually reduce the opportunities for productivity gains and efficiency gains that would follow a truly competitive market for capital.

Successful models for full imputation systems that address all of the so-called technical rationalizations for the Canadian rules can be found elsewhere, lending support to the suggestion that the Canadian design is best analyzed as a set of seemingly badly targeted tax expenditures—although, as Tim suggested, this is not an unambiguous conclusion.⁴⁰ One of the most significant factors supporting the “tax expenditure” characterization is the complete absence of any correlation between tax paid by a company and credits provided to shareholders in Canada’s so-called imputation system. Tim analyzed in depth the merits and possible drawbacks of one solution, the former (operative at the time Tim wrote about it) UK advanced corporation tax (ACT) system, which ensured that every dollar (or pound, in the UK case) of imputation credit is matched by a dollar of company tax paid on the profits from which dividends are paid. Tim concluded that the ACT would be a model imputation system in many respects but would not be appropriate for Canada, given the probability that Canada’s tax treaties would require it to pay refunds to foreign shareholders.

Interestingly, Tim did not consider the alternative franking system that is used in countries such as Australia and New Zealand, which also limits imputation credits to actual company tax paid on distributed profits but avoids the international

38 Canada, *Report of the Royal Commission on Taxation*, vols. 1-6 (Ottawa: Queen’s Printer, 1966-67).

39 His most detailed analysis is set out in Tim Edgar, “Financial Instability, Tax Policy, and the Tax Expenditure Concept” (2010) 63:3 *SMU Law Review* 969-1031.

40 Tim Edgar, “Integration Canadian Style: Comments on the Dividend Tax Credit and the Recommendation of the Ontario Fair Tax Commission” (1994) 9:16 *Tax Notes International* 1231-54; Kirk A. Collins and Tim Edgar, “The Carter Report’s Corporate Income Tax Proposals: Why They Were Rejected and an Assessment of the Current Canadian System as an Imperfect Alternative,” in Kim Brooks, ed., *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013), 115-53.

problem. In Australia's case, this is done by exempting franked (that is, already fully taxed) profits from withholding tax so that the only tax payable by non-residents is withholding tax on unfranked dividends that are paid from untaxed profits (and thus are not entitled to any credits). In this way, non-resident shareholders have the same entitlement to dividend tax credits as resident investors—zero on unfranked dividends. Since franked dividends (paid from fully taxed profits) are exempt from withholding tax, non-residents have no basis for claiming that treaties require Australia to provide them with imputation credits.

Significantly, in a jurisdiction such as Australia, where pension funds are subject to tax, the benefits of imputation credits are available to lower-income persons who have employer-paid deposits in pension funds (compulsory under Australian law), thus precluding one of the criticisms levelled at the Canadian system: that imputation benefits accrue mostly to higher-income investors.

GST AND FINANCIAL INTERMEDIATION

An issue that captured Tim's attention for well over a decade was the optimal treatment of financial intermediation—the services of a bank—in a GST. Unlike the cost of most other supplies, where an explicit fee is charged for services provided by a supplier, the cost of financial intermediary services is an implicit cost, embedded in the spread between interest paid to depositors and that charged to borrowers. Although it was once suggested that the intermediation service provides no consumption benefit to borrowers,⁴¹ the key proponent of this view later recanted,⁴² and it is now generally agreed that a financial intermediary service provides a valuable service to both depositors and borrowers.

Tim's analysis, not surprisingly, digs deep into the economics of the industry, leading him to a number of conclusions that some might find surprising. He suggests, for example, that concerns over the opportunities for manipulation that arise if pure intermediary services are untaxed and all other financial services are taxed may be exaggerated, given the competitive pressures that mitigate these opportunities.⁴³ The experience of jurisdictions such as South Africa, which exempts pure intermediary services and subjects most other financial services to full taxation, lends some support to his conclusion.

Tim was also concerned with the efficiency consequences—the social cost of the inefficient allocation of resources—that result from the vertical integration prompted by the current Canadian rule that treats financial supplies as exempt

41 Harry Grubert and James Mackie, "Must Financial Services Be Taxed Under a Consumption Tax?" (2000) 53:1 *National Tax Journal* 23-40 (<http://dx.doi.org/10.17310/ntj.2000.1.02>).

42 Harry Grubert and Richard Krever, "VAT and Financial Services: Competing Perspectives on What Should Be Taxed" (2012) 65:2 *Tax Law Review* 199-239.

43 Ewen McCann and Tim Edgar, "VAT Treatment of Interest and Financial Services with Competitive Banking and Insurance Sectors" (2003) 30:8 *Tax Notes International* 791-808.

supplies.⁴⁴ It is often argued that because the rule leaves banks with no right to claim input tax credits on acquisitions, the banks have an incentive to source inputs internally. While the efficiency costs of vertical integration are, to be sure, a legitimate concern, a different concern has prompted other jurisdictions to provide to financial institutions making exempt supplies some relief, namely the impact of vertical integration on competition. The present system favours large institutions that are able to construct their own (for example) software support and administrative support systems, which provide these institutions with tax-free services while smaller institutions, with limited economies of scale, are forced to outsource these acquisitions, incurring unrecoverable GST in the process. In a jurisdiction with a significant concentration of banks facing limited competition, any tax rule that imposes higher costs on smaller competitors should be a concern.⁴⁵

Tim revisited a number of times the question of how a GST based on a credit-invoice model could apply to financial intermediary supplies that were provided with no explicit price attached. The challenge is to design a system that would ensure that non-business borrowers incurred the same tax on financial intermediary services as they did on other consumption acquisitions, while registered businesses were relieved of a tax burden on supplies they received. One proposal found in Tim's 2001 paper on the subject addressed the second goal. Tim suggested that zero-rating intermediary supplies to registered businesses would be the simplest way to remove tax from bank-to-business supplies, a proposal that was subsequently adopted by New Zealand, with Singapore achieving an arguably similar outcome via a different mechanism.

One important issue considered in a number of Tim's papers on the subject of GST and financial supplies was the theoretical arguments and practical considerations raised by different cash flow models for taxing financial services.⁴⁶ The focus of Tim's work, and that of the many scholars whose works he studied, was on borrowers—the persons receiving loans that could be used to procure goods or services intended for personal consumption or business use. For every dollar borrowed, however, there must be a dollar deposited on the other side of the financial intermediation arrangement. Absent from most of the literature in the field is a recognition of the importance of designing a GST solution that also treats the deposit or lending side of GST transactions appropriately. There is no consumption

44 Tim Edgar, "Exempt Treatment of Financial Intermediation Services Under a Value-Added Tax: An Assessment of Alternatives" (2001) 49:5 *Canadian Tax Journal* 1133-1219.

45 It is for this reason that Australia, for example, allows financial institutions to partially claim input tax credits on the acquisition of a select list of inputs.

46 Tim Edgar, "The Search for Alternatives to the Exempt Treatment of Financial Services Under a Value Added Tax," in Richard Krever and David White, eds., *GST in Retrospect and Prospect* (Wellington, NZ: Thomson Brookers, 2007), 131-61, and Tim Edgar, "Comment: Is the Comprehensive Application of Cash-Flow Taxation Necessary To Integrate Financial Services into an Invoice/Credit VAT?" in Rita de la Fera, ed., *VAT Exemptions: Consequences and Design Alternatives* (Alphen aan den Rijn, the Netherlands: Wolters Kluwer, 2013), 357-63.

by lenders or depositors; rather, they have chosen to defer consumption in a way that allows borrowers to accelerate their consumption before they have resources available to fund acquisitions. By definition, a charge for services that is based on the spread between depositors and borrowers will be borne to some extent by both parties. For the depositors, the cost is the cost of savings, not consumption, and in a benchmark GST system, the supply would be a zero-rated supply, not an exempt (input taxed) supply.

GAAR

Another key topic addressed in Tim's publications is the role of a GAAR in a modern income tax. Just as the adoption of the Charter of Rights and Freedoms in 1982 fundamentally altered Canadians' understanding of the limits of provincial and federal powers under the Canadian Constitution, the adoption of GAAR in 1988 has profoundly changed Canadians' perceptions of tax avoidance and the limits of otherwise sanctioned tax-effective behaviour.

Tim published two substantial works on GAAR: a 37-page chapter in a book on anti-avoidance in Canada, following two Supreme Court of Canada decisions on GAAR;⁴⁷ and, a year later, a comprehensive 72-page article in the *Virginia Tax Review*⁴⁸ that built on and incorporated substantial parts of the earlier work. Several years later, in the *Canadian Tax Journal*, he penned a short introduction to a Policy Forum feature on GAARs.⁴⁹

The first of these publications, which provided a catalogue of different types of tax avoidance and analyzed the possible role of a GAAR in respect of each, had a limited impact; dealing with a parochial Canadian issue and appearing in a volume by a local Canadian publisher, the work was never likely to have a significant international circulation. In contrast, the article in the *Virginia Tax Review*, which built on and greatly expanded the ideas set out in the book chapter, has been read and used by many scholars. Many citations of the article have been tangential references in non-tax articles that cite it for its descriptions of economic and legal principles.⁵⁰

47 Tim Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule," in David G. Duff and Harry Erlichman, eds., *Tax Avoidance in Canada After Canada Trustco and Mathew* (Toronto: Irwin Law, 2007), 221-58.

48 Tim Edgar, "Building a Better GAAR" (2008) 27:4 *Virginia Tax Review* 833-905.

49 Tim Edgar, "Policy Forum: Editor's Introduction—The General Anti-Avoidance Rule at 25" (2014) 62:1 *Canadian Tax Journal* 111-12.

50 Examples of the latter include the following: Matthew Castelli, "Fracking and the Rural Poor: Negative Externalities, Failing Remedies, and Federal Legislation" (2015) 3:2 *Indiana Journal of Law and Social Equality* 291-304, at 288, note 58, supporting an explanation of a "negative externality"; Ross C. Paolino, "Upon Further Review: How NFL Network Is Violating the Sherman Act" (2009) 16:1 *Sports Lawyers Journal* 1-46, at 17, quoting an explanation of "price elasticity"; and Tsilly Dagan and Talia Fisher, "Rights for Sale" (2011) 96:1 *Minnesota Law Review* 90-140, at 127, note 155, used as a reference to the notion of "allocational and distributive tax expenditures."

Other citations are found in articles on tax issues other than avoidance and a GAAR, to distinguish the issues addressed in those papers from the question of tax avoidance.⁵¹ The most important citations, however, have been in articles on GAAR, with the papers containing many references to Tim's journal article.⁵²

Tim treated tax avoidance in the same manner he did financial instruments. He first identified the problem to be addressed—tax avoidance—and then set about to dissect the issue to identify its component elements and develop in a scientific manner rules that would counter each element. The approach was developed in his initial book chapter on the subject and then transferred to, and refined in, his journal article.

Tim described three types of tax avoidance in his journal article, though his initial list, in the book chapter, sets out five, including changes in real behaviour

51 For example, Tim's journal article was cited in Emily Ann Satterthwaite, "Tax Elections as Screens" (2016) 42:1 *Queen's Law Journal* 63-105, at 64, note 1, to contrast the subject matter of a paper on explicit legitimate tax elections with the transactional substitutions (avoidance) choices described in the Edgar paper. In a paper by Richard Lavoie on the balancing act required of tax lawyers, Tim's journal article was cited in support of the proposition that GAARs might play a role in inhibiting avoidance; see Richard Lavoie, "Am I My Brother's Keeper? A Tax Law Perspective on the Challenge of Balancing Gatekeeping Obligations and Zealous Advocacy in the Legal Profession" (2013) 44:3 *Loyola University Chicago Law Journal* 813-64, at 862, note 214. The article was cited as support for Edgar's assertion that a lump-sum tax is the ideal tax in David Hasen, "Some Consequences of Governmental Provision of Rival Goods" (2014) 34:2 *Virginia Tax Review* 319-55, at 332, note 41, and as support by analogy for a conclusion that tests based on "reasonableness" can be useful in tax law in Lisa Philipps, "Income Splitting and Gender Equality: The Case for Incentivizing Intra-household Wealth Transfers," in Kim Brooks, Åsa Gunnarson, Lisa Philipps, and Maria Wersig, eds., *Challenging Gender Inequality in Tax Policy Making: Comparative Perspectives* (Oxford, UK: Hart Publishing, 2011), 235-54.

52 It is cited, for example, in Rifat Azam, "Minimum Global Effective Corporate Tax Rate as General Anti-Avoidance Rule" (2017) 8:1 *Columbia Journal of Tax Law* 5-55, at 43, note 163, for the proposition that traditional GAARs are of limited efficacy in combatting international tax avoidance; Benjamin Alarie, "Trebilcock on Tax Avoidance" (2010) 60:2 *University of Toronto Law Journal* 623-42, at 626, for the limited discussion of judicial interpretation in tax-avoidance cases; Henry Ordower, "The Culture of Tax Avoidance" (2010) 55:1 *Saint Louis University Law Journal* 47-128, at 51, for the design, enactment, and function of GAARs in English-speaking countries; Lilian V. Faulhaber, "Sovereignty, Integration and Tax Avoidance in the European Union: Striking the Proper Balance" (2010) 48:2 *Columbia Journal of Transnational Law* 177-241, at 202, on the use of anti-avoidance doctrines by courts; Victor Fleischer, "Regulatory Arbitrage" (2010) 89:2 *Texas Law Review* 227-89, at 256 in the context of a discussion on the different roles of judges and taxpayers; Tambet Grauberg, "Anti-Tax-Avoidance Measures and Their Compliance with Community Law" (2009) 16 *Juridica International* 141-50, at 142, for what a GAAR does; Jinyan Li and Thaddeus Hwong, "GAAR in Action: An Empirical Exploration of Tax Court of Canada Cases (1997-2009) and Judicial Decision Making" (2013) 61:2 *Canadian Tax Journal* 321-66, at 324, noting the work as part of the GAAR literature; John McLaren, "The Distinction Between Tax Avoidance and Tax Evasion Has Become Blurred in Australia: Why Has It Happened?" (2008) 3:2 *Journal of the Australasian Tax Teachers Association* 141-63, at 146-47, in support of the proposition that

and tax evasion.⁵³ Tax evasion comprises illegal actions such as non-disclosure of receipts and fraudulent claims for deductions—activity conventionally classified as criminal evasion as opposed to abusive, but legal, tax avoidance. Tax avoidance is entirely legitimate behaviour—undertaking a transaction or adopting a structure that enjoys a deliberately intended reduction in tax burden, such as a tax concession. The economy as a whole may suffer excess burden or deadweight losses from the distorted behaviour,⁵⁴ but the taxpayer, by a voluntary behaviour choice, has presumably enjoyed a personal net fiscal benefit as intended by the legislature.

Tim described the three remaining types of tax avoidance as tax avoidance “in law”:⁵⁵ transactional substitution, the creation of tax attributes, and the transfer of tax attributes.

Transactional substitution does not involve a change in “real” behaviour—the taxpayer carries out the commercial arrangement always intended—but, rather, a change in the arrangement’s form or structure in order to shift from one tax rule to another. Instead of lending money by way of a deep discount loan, for example, the taxpayer enters into a repo arrangement involving a purchase of an asset combined with a required repurchase at a higher price by the “borrower.” Instead of making a loan, the taxpayer extends funds and receives redeemable preference shares, and so on.

The “creation of tax attributes”—the second type of avoidance identified by Tim—refers to transactions with appearances for tax purposes that do not reflect their overall substance. A lease premium labelled “consideration” for locational goodwill is merely a form of prepaid rent, for example.

Tim’s third category—“transferred tax attributes”—refers to arrangements that are used to shift tax benefits from one taxpayer to another. An example of transferred tax attributes is a sale-and-leaseback transaction by a taxpayer that is in need of debt financing and holding assets that could be used as collateral for a loan. If the taxpayer is unable to fully utilize tax concessions such as accelerated depreciation that are available from ownership of the collateral assets, it can substitute a sale-and-leaseback arrangement for a loan with collateral to transfer the tax concession to a lender that is able to use it.

judicial doctrines alone cannot solve the problem of avoidance; Brian M. Studniberg, “Minding the Gap in Tax Interpretation: Does Specificity Oust the General Anti-Avoidance Rule Post-*Copthorne*?” (2012) 38:1 *Queen’s Law Journal* 209-57, at 242, setting out the argument that the GAAR should be designed in light of the institutional competencies of the judiciary.

53 Edgar, “Designing and Implementing a Target-Effective General Anti-Avoidance Rule,” *supra* note 47, at 226. The list is sometimes cited not on the basis of its merits but rather as an illustration of how difficult it is to define tax avoidance. See, for example, Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (Cambridge: Cambridge University Press, 2011), at 38.

54 Edgar, “Designing and Implementing a Target-Effective General Anti-Avoidance Rule,” *supra* note 47, at 228.

55 Edgar, “Building a Better GAAR,” *supra* note 48, at 870.

The starting point for Tim's analysis was an assumption that he could mathematically find the points at which the benefits-versus-risk scale tipped toward avoidance and there was a possibility, if not a probability, that taxpayers would engage in avoidance arrangements. A model GAAR would then be aimed only at taxpayers in likely-to-avoid environments.

Tim trod carefully when recommending GAAR refinements, conceding risks and difficulties with each proposal. Use of an "economic substance" test, he said, might do no more than "muddy further the statutory morass that has congealed around" the distinction between acceptable and abusive tax avoidance.⁵⁶ Still, he suggested, such a test could play a role in combatting particular types of avoidance if targeted effectively.⁵⁷

GAARs that use a "primary business-purpose" test (a description that would include the Canadian GAAR) suffer from a defect, Tim claimed—namely, the phenomenon of "over-inclusiveness" that, ironically, weakens the scope of the provision as courts read it down, to a point at which it suffers from "under-inclusiveness." But this test, too, Tim argued, can play a role in a well-designed GAAR.

Tim's model GAAR is thus based on theories of different types of tax avoidance, and it consequently requires courts using different interpretive approaches when evaluating different types of transactions in light of the GAAR. The Achilles heel of such a GAAR, perhaps, is that it authorizes courts to brush aside taxpayer's legal arrangements while leaving the judiciary to decide when it is appropriate to do so. Whatever the test might be, it ultimately remains an adjudicator's responsibility to determine when the test is met.

Consider the current GAAR, for example: the application of the rule depends on a finding by a court that the primary reason for an arrangement was tax avoidance, not a bona fide commercial objective. The primary purpose of almost all transactions, however, is commercial if the elements of the impugned scheme are considered in their entirety—the Duke of Westminster wants to pay his gardener and have his trees trimmed;⁵⁸ a trucking company wants to borrow money from a bank;⁵⁹ a bank wants to sell the shopping plaza that it acquired on a foreclosure on a delinquent loan.⁶⁰ The commercial benefits of the transactions could be enhanced, quite clearly, if (1) the Duke could pay the gardener from pre-tax income, (2) the trucking company could reduce its interest expense by shifting some unused deductions to the lender, and (3) the foreclosing bank could shift tax losses to reduce its commercial losses on the loan. But a non-commercial primary purpose emerges only if the tax-avoidance transactions are extracted from the larger commercial scheme.

56 Ibid., at 880.

57 Ibid., at 893.

58 *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1 (HL).

59 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54.

60 *Mathew v. Canada*, 2005 SCC 55.

On its own, each step in an avoidance scheme is legitimate and legal. Whether the scheme is an abuse of the law must be determined in the context of the broader commercial arrangement in which it occurs. This is a judgment call, often a very difficult one. A range of views exist on the responsibility and the ability of judges to draw lines in the sand,⁶¹ and it is not unusual for the highest jurists in the land to disagree on whether any particular arrangement amounts to tax avoidance.⁶² Tim does not see this as an insurmountable problem. The principal role of the judiciary, he says, “would be the proper characterization of the fact pattern presented by a particular transaction, with the appropriate policy result following from this characterization.”⁶³ Somehow, the courts will get it right. It’s a nice theory.

THE LEGACY

Tim Edgar’s tax interests were truly catholic; his publications spanned the spectrum of tax policy and tax law. His intended audience was primarily policy makers, and he clearly reached this group. His publications on income tax and financial arrangements, and GST and financial intermediation, in particular, are central reference points for many.

Why did this body of work become so influential? The answer lies in Tim’s remarkable skills at unravelling the most intricate arrangements and technical issues and then using fundamental benchmark principles to evaluate the outcomes. The more complex the subject, the deeper into it Tim would delve in order to expose the subject’s basic elements, which could then be addressed through the use of foundational tax policy concepts.

Tim’s academic prose will no doubt be read and cited long into the future, but his most significant legacy will be the laws that reflect his analysis and proposals. It is a legacy deserving of honour.

61 See, for example, Neil Brooks, “The Responsibility of Judges in Interpreting Tax Legislation,” in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: International Bureau of Fiscal Documentation, 1997), 93–129, arguing that judges should undertake the creative process of law making when there are gaps in the legislation; Kim Brooks, “The Ethical Tax Judge,” in Robert F. van Brederode, ed., *Ethics and Taxation* (Singapore: Springer Nature Singapore, 2020), 397–412 (<https://doi.org/10.1007/978-981-15-0089-3>), arguing that judges should not be bound by constraints of precedent when interpreting tax cases where the result would be inconsistent with the broad objectives of the tax law; and Studniberg, *supra* note 52, arguing the courts should step back and leave it to Parliament to address avoidance problems.

62 In *Lipson v. Canada*, 2009 SCC 1, for example, three Supreme Court of Canada judges dissented from the conclusion of the other four judges.

63 Edgar, “Building a Better GAAR,” *supra* note 48, at 904–5.

GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand

Thaddeus Hwong and Jinyan Li*

PRÉCIS

Les auteurs présentent les résultats d'une étude empirique sur l'application des règles générales anti-évitement (RGAE) en Australie, au Canada et en Nouvelle-Zélande. L'étude s'appuie sur un cadre conceptuel, élaboré par Tim Edgar, qui classe les opérations d'évitement fiscal en trois types (création d'attributs fiscaux, échange d'attributs fiscaux et substitution d'attributs fiscaux) et examine les types d'opérations en relation avec les attributs des juges et dans le contexte plus vaste de la prise des décisions judiciaires. Pour contextualiser l'analyse empirique, les auteurs effectuent une analyse doctrinale des dispositions relatives aux RGAE et de l'interprétation judiciaire des RGAE, et donnent quelques exemples de divergence et de convergence entre les trois pays. Les résultats statistiques accréditent un peu l'affirmation de Tim Edgar selon laquelle la compétence institutionnelle du système judiciaire est limitée lorsqu'il s'agit de reconnaître l'évitement fiscal dans les cas de substitution, et que la RGAE du Canada pourrait être améliorée par l'incorporation d'un critère de réalité économique.

ABSTRACT

The authors report the results of an empirical study on the general anti-avoidance rules (GAARS) in action in Australia, Canada, and New Zealand. The study builds on a conceptual framework, developed by Tim Edgar, that classifies tax-avoidance transactions as falling into three types (tax-attributes creation, tax-attributes trading, and tax-attributes substitution) and considers the transaction types in connection with the attributes of judges and with the broader context of judicial decision making. To contextualize the empirical analysis, the authors provide a doctrinal analysis of both

* Tim Edgar was the original proponent of the project. Jinyan Li is a professor, co-director of the LLM (Tax) program, and director of the LLM (International Business Law) program at Osgoode Hall Law School, York University. Thaddeus Hwong is an associate professor at the Faculty of Liberal Arts & Professional Studies, York University. We thank Brian Arnold for his comments on an earlier draft of this paper, and we thank participants at the conference in Tim Edgar's honour (Re-Imagining Tax for the 21st Century: Inspired by the Scholarship of Tim Edgar, held at Osgoode Hall Law School, Toronto, on February 8, 2019) for their feedback on a draft paper presented at the conference.

the countries' GAAR provisions and the judicial interpretation of GAARS, along with some examples of divergence and convergence among the three countries. The statistical results provide some modest support for Edgar's claim that the judiciary's institutional competence is limited when it comes to identifying tax avoidance in substitution cases and that Canada's GAAR could be improved through the incorporation of an economic substance test.

KEYWORDS: GAAR ■ TAX ATTRIBUTES ■ DUKE OF WESTMINSTER ■ ECONOMIC SUBSTANCE ■ STATUTORY INTERPRETATION

CONTENTS

A Tribute to Tim Edgar	541
Introduction	541
Legislative Features of the Three GAARS	544
History	544
Objective and Effect	545
Design Features	546
"Transaction"	546
Tax Benefit, Tax Avoidance, and Counterfactual	547
Primary (Dominant) Purpose of Transactions	549
Purpose of Statutory Provisions	551
Judicial Attitude	552
Decisions of the Highest Court	552
Canada	553
New Zealand	554
Australia	555
The Legacy of the Duke	557
Relevance of Economic Substance	558
Morality	559
Doctrinal Comparison	559
Examples of Convergence	559
Examples of Divergence	562
Empirical Study	563
Exploring Transaction Types in the Context of Judicial Decision Making	563
Transaction Types	563
Judicial Attributes and Regression Variables	564
The Variables Coded	566
Exploring Influences of the Edgar Typology in Judicial Decision Making	570
Normative Implications for Building a Better GAAR	574
Transaction Types and Institutional Competencies of the Judiciary	575
Role of Statutory Interpretation	576
Incorporating Economic Substance into the Canadian GAAR	577

A TRIBUTE TO TIM EDGAR

Tim Edgar once modestly said he had had only a few epiphanies in his life, and that one of them was his idea about the classification of general anti-avoidance rule (GAAR) cases by transaction types. As he wrote over a decade ago, GAAR cases may be classified in three categories according to whether they feature transactions that attempt to

- 1) create a tax attribute,
- 2) transfer a tax attribute, or
- 3) substitute a lower-taxed transactional form for a higher-taxed transactional form.¹

In 2011, Tim led our first application for funding from the Canadian Tax Foundation to run empirical tests of his typology in connection with judicial decision making in a comparative international context. His view—that the project had the potential to advance knowledge in the area—informs something that he subsequently wrote, as editor of the *Canadian Tax Journal*:

It is probably accurate to suggest that GAAR has altered the contours of tax planning in Canada. That altered landscape may be attributable in part to the fact that the jurisprudence considering the interpretation and application of this provision does not readily yield an especially clear road map, at least in the sense of providing certainty and predictability of result.²

In this paper—made possible by the Foundation’s generous funding support and the diligent work of a number of Osgoode students—we report the empirical results of a comparative empirical study of GAAR cases in Australia, Canada, and New Zealand, and we situate the results in a doctrinal analysis of the respective countries’ GAAR provisions and judicial attitudes toward GAAR. With this paper, we pay tribute to Tim’s inspiring scholarship, dear friendship, and love of tax.

INTRODUCTION

A large body of literature exists on judicial anti-avoidance doctrines and statutory general anti-avoidance rules (GAARs). Yet very little of this literature frames the subject in terms of a general theoretical perspective that offers broad policy lessons

1 Tim Edgar, “Building a Better GAAR” (2008) 27:4 *Virginia Tax Review* 833-906. Also see Tim Edgar, “Designing and Implementing a Target-Effective General Anti-Avoidance Rule,” in David G. Duff and Harry Erlichman, eds., *Tax Avoidance in Canada After Canada Trustco and Mathew* (Toronto: Irwin Law, 2007), 221-56.

2 Tim Edgar, “Policy Forum: Editor’s Introduction—The General Anti-Avoidance Rule at 25” (2014) 62:1 *Canadian Tax Journal* 111-12, at 111.

for the design of GAARs. Notable exceptions are Chorvat;³ Brooks and Head;⁴ Ulph;⁵ Weisbach;⁶ and Edgar.⁷ The existing literature provides little systematic empirical evidence about judicial decision making in tax-avoidance cases and the related effectiveness of judicial anti-avoidance doctrines and statutory GAARs. This literature is primarily doctrinal in nature.

In this paper, we seek to fill this gap by building on Edgar's conceptual framework, using insights gained from an empirical exploration into judicial decision-making in GAAR cases in Australia, Canada, and New Zealand. In our research, we developed a specific dataset that included (1) GAAR cases that were decided over a specified period (from 1989 to 2019) and (2) the attributes of judges who decided the cases. The design of this empirical study builds on some exploratory work of Li and Hwong⁸ that used data analysis to identify key variables in case attributes along with other potentially key explanatory variables (for example, judicial attributes) for judicial decision making in GAAR cases.

According to Edgar's conceptual framework, tax avoidance should be viewed as a negative externality, and its consequential attributes (such as loss of revenue and efficiency) should be eliminated through appropriate policy instruments, such as GAARs. To be target-effective, tax-avoidance transactions should be classified into three types: (1) the creation of tax attributes ("creation type"); (2) the trading of tax attributes ("trading type"); and (3) the substitution of a lower-taxed transaction for a higher-taxed transaction ("substitution type"). Since different types of tax avoidance pose different identification issues, a GAAR provision should be designed to apply differently to different types of transactions. Further, the judiciary has the institutional competence to apply and enforce a GAAR in the case of creation and trading types of transactions, but it is less well equipped to address transactions of the substitution type. Instead of relying on the judiciary's exercise of statutory interpretation to identify prohibited tax-avoidance behaviour, we should rely on the legislature to build a better GAAR on the basis of two different concepts of economic substance:

3 Terrence R. Chorvat, "Tax Shelters, Dutch Books, and the Fundamental Theorem of Asset Pricing" (2007) 26:4 *Virginia Tax Review* 859-78.

4 Michael Brooks and John G. Head, "Tax Avoidance: In Economics, Law and Public Choice," in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD, 1997), 53-91.

5 David Ulph, *Avoidance Policies—A New Conceptual Framework*, Oxford University Centre for Business Taxation Working Paper no. 09/22 (Oxford: Oxford University Centre for Business Taxation, 2009).

6 David A. Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines" (2002) 4:1 *American Law and Economics Review* 88-115 (<https://doi.org/10.1093/aler/4.1.88>).

7 Edgar, "Building a Better GAAR"; and Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule," *supra* note 1.

8 Jinyan Li and Thaddeus Hwong, "GAAR in Action: An Empirical Exploration of Tax Court of Canada Cases (1997-2009) and Judicial Decision Making" (2013) 61:2 *Canadian Tax Journal* 321-66.

(1) economic substance used virtually the same as a primary business purpose test (PPT) for creation and trading types of transactions; and (2) economic substance used virtually the same as a synthetic replication in substitution transactions. The judiciary's interpretive role would thus be reduced, especially in substitution cases. Because substitution types of transactions are designed to take advantage of legislative gaps, they are more effectively addressed by the legislature's building a rule than by the judiciary's engaging in statutory interpretation. The judiciary's institutional competence does not lie in policy analysis or in filling legislative gaps.⁹

To test Edgar's ideas in our research, we divided the cases in the dataset¹⁰ according to transaction types. On the basis of the data, statistical analyses were performed to test for the relationships between judicial decision making and transaction types in light of the case attributes (country, and the political climate of the country when cases were decided) and the judicial attributes (the national political climate when judges were appointed, the years of experience judges had when deciding cases, and the gender of the judges). By and large, the statistical results back up Edgar's hypothesis that judges do a better job of applying GAAR in creation and trading types of cases.

Let us provide some comparative context with respect to the GAARs in the three countries. A GAAR case in Canada begins at the Tax Court of Canada, whose decisions can be appealed to the Federal Court of Appeal (three-judge panel). The Supreme Court of Canada hears a GAAR case only with leave. In Australia and New Zealand, a taxpayer can opt for an administrative tribunal¹¹ or a court to begin a GAAR case, and three levels of federal court are involved. In Australia, these three levels are as follows: (1) Federal Court (single judge), (2) Federal Court (full court [three-judge panel]); and (3) the High Court of Australia.¹² In New Zealand, the three levels are as follows: (1) the High Court (single judge); (2) the Court of Appeal (three-judge panel); and (3) the Supreme Court of New Zealand (New Zealand's

9 Edgar, "Building a Better GAAR," supra note 1.

10 Cases were excluded from this dataset if they were decided before 1989 or were concerned with predominantly procedural matters (such as evidentiary or penalties) or non-income tax matters (such as GST or property tax). Cases heard by tribunals were included only if they provide meaningful descriptions of the facts and consideration of the GAARs. This selection policy was intended to ensure that the cases shed light on the transaction types. For some of the raw data, see the latest updated version of an online data appendix at www.yorku.ca/thwong/edgar.xlsx.

11 Administrative Appeals Tribunal or Small Taxation Claims Tribunal in Australia and Taxation Review Authority in New Zealand.

12 The *Peabody* case illustrates this process. The Australian Tax Office (ATO) invoked part IVA in assessing the taxpayer. The taxpayer lodged an objection to the ATO assessment, which the ATO disallowed. She then asked the ATO to refer it to the Federal Court. Justice O'Loughlin in the Federal Court agreed with the ATO (*Peabody v. Commissioner of Taxation* (1990)). The taxpayer appealed to the full bench of the Federal Court, which found for her (*Peabody v. Commissioner of Taxation*, [1993] FCA 74). The ATO appealed the decision to the High Court, which upheld the Full Court decision (*Federal Commissioner of Taxation v. Peabody*, [1994] HCA 43).

court of last resort, as of 2004).¹³ Like the Supreme Court of Canada, the High Court of Australia and the Supreme Court of New Zealand hear appeals by leave only. The Tax Court of Canada is the only court staffed with judges that have specialized knowledge in taxation. In all three countries, the highest court has decided a very small number of GAAR cases: four by the Supreme Court of Canada—*Canada Trustco* (2005), *Mathew* (2005), *Lipson* (2009), and *Copthorne* (2011));¹⁴ five by the High Court of Australia—*Peabody* (1994), *Spotless* (1996), *Consolidated Press Holdings (CPH)* (1998), *Hart* (2004), and *Mills* (2011));¹⁵ and two by the Supreme Court of New Zealand—*Ben Nevis* (2008) and *Penny* (2009).¹⁶

In order to provide the necessary context to make sense of the results of the data analysis, the second and third sections of this paper provide an overview of the legislative features of the respective GAARs and the respective judicial attitudes toward them. Just as the GAAR provisions in the three countries differ in their technical design and historical evolution, the judicial approaches to interpreting and applying these provisions tend to differ from country to country. In the paper's fourth section, we offer a broad comparison of the GAARs in action, with some examples of similarities and differences. Next, we present the empirical study in terms of descriptive statistics, regression results, and simulated patterns. Finally, we tease out some normative implications of the empirical research, with a view to building a better GAAR.

LEGISLATIVE FEATURES OF THE THREE GAARS

History

The Canadian GAAR is the youngest of the three GAARs. Section 245 of the Canadian Income Tax Act¹⁷ was enacted in 1988 and slightly amended in 2005 and 2016. In Australia, a GAAR was part of the first federal income tax law adopted in 1915.¹⁸ The current GAAR was introduced in 1981 as part IVA of the Income Tax Assessment

13 Prior to 2004, the Privy Council was the final court of appeal.

14 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54; *Mathew v. Canada*, 2005 SCC 55; *Lipson v. Canada*, 2009 SCC 1; *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63.

15 *Peabody*, supra note 12; *Federal Commissioner of Taxation v. Spotless Services Ltd*, [1996] HCA 34; *Federal Commissioner of Taxation v. Consolidated Press Holdings Ltd*, [2001] HCA 32; *Federal Commissioner of Taxation v. Hart & Anor*, [2004] HCA 26; *Mills v. Commissioner of Taxation*, [2012] HCA 51.

16 *Ben Nevis Forestry Ventures Ltd v. Commissioner of Inland Revenue*, [2008] NZSC 115; *Penny v. Commissioner of Inland Revenue*, [2011] NZSC 95.

17 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the ITA”). Unless otherwise stated, statutory references in this chapter are to the ITA.

18 Section 53 of Australian Income Tax, No. 41 of 1915, An Act To Impose a Progressive Tax upon Incomes; royal assent: September 1915. Also cited as Income Tax Act 1915.

Act 1936¹⁹ and was amended in 2013.²⁰ New Zealand may have the world's oldest GAAR: a GAAR was included in the Property Assessment Act 1879,²¹ which was carried forward into section 40 of the Land and Income Tax Act 1954.²² The current GAAR is found in sections BG 1, GA 1 and YA 1 of the Income Tax Act 2007.²³

Objective and Effect

GAARs are not self-executing rules. They are provisions of last resort. They empower the tax administration (the minister of national revenue in Canada, the commissioner of federal taxation in Australia, and the commissioner of inland revenue in New Zealand) to deny the taxpayer tax benefits arising from tax-avoidance transactions. The objective is to counteract unacceptable tax-avoidance arrangements that would, without a GAAR, succeed in avoiding tax by relying on legally valid transactions or forms and on the literal interpretation of tax laws.²⁴

The effect of a GAAR is to legislatively mandate a purposive construction of taxpayers' transactions (as opposed to a construction bound by the legal form or shape of the transactions) and a purposive interpretation of tax law provisions that taxpayers rely on to obtain the desired tax benefit. The Canadian GAAR provision, for example, in defining "avoidance transaction," explicitly refers to the primary purpose of the transaction, and the Supreme Court of Canada acknowledged in *Canada Trustco* that GAAR was "intended to negate arrangements that would be permissible under a literal interpretation of other provisions of the *Income Tax Act*, on the basis that they amount to abusive tax avoidance."²⁵ The Supreme Court of New Zealand (Elias CJ and Anderson J) captured the effect of GAAR in *Ben Nevis* by stating that the provisions of the taxing statute (that is, the specific provisions that exist in addition to GAAR) are to be purposively and contextually interpreted, the substance of an arrangement gauged, and care taken not to resurrect two "allied and dangerous

19 Income Tax Assessment Act 1936, No. 27, 1936 (herein referred to as "the ITAA 1936").

Part IVA includes sections 177A to 177G. For more discussion, see G.T. Pagone, *Tax Avoidance in Australia* (Toronto: Federation Press, 2010), at 22-37.

20 These amendments were contained in the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013, No. 101, 2013; with effect from November 16, 2012 (herein referred to as "the 2013 amendment").

21 Property Assessment Act 1879 (43 Victoriae 1879 No 17).

22 For further discussion, see Craig Elliffe and Andrew Smith, "New Zealand," in Michael Lang et al., eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: IBFD 2016), at 457-72.

23 Income Tax Act 2007, 2007 No. 97 (herein referred to as "the NZ-ITA").

24 The Canadian GAAR authorizes the minister to deny the tax benefits resulting from an avoidance transaction by making a reasonable determination of the appropriate tax consequences. The Australian GAAR allows the commissioner to "destroy" the tax-avoidance arrangements and then "reconstruct" them in order to remove the tax benefits.

25 *Canada Trustco*, supra note 14, at paragraph 13.

myths”—namely (1) that “in tax cases to an extent unknown in other areas of law, form prevails over substance” and (2) that “the substance of a transaction, and the only thing to be regarded, is its legal effect.”²⁶ An Australian jurist, writing extrajudicially, stated:

The broad thrust of the policy enacted in Part IVA [GAAR] was to incorporate into tax law a general proscription against arrangements entered into for the sole or dominant purpose of obtaining a reduction in the tax that would otherwise be payable. The intention of the provisions is to strike down schemes that can only be explained on the basis of the tax benefits sought.²⁷

Design Features

The GAARs in Canada, Australia, and New Zealand define “tax benefit” and a “tax-avoidance transaction,” and they authorize the government to deny the tax benefit. The purpose of a transaction is built into the definition of “avoidance transaction.” The Canadian GAAR is unique in requiring an additional abuse test and imposing no penalties.²⁸

“Transaction”

The term “transaction” is used in the Canadian GAAR, while “scheme” and “arrangement” are used in the Australian and New Zealand GAARs, respectively. The meanings of these terms are similar and defined very broadly. The Canadian GAAR defines “transaction” to include “an arrangement or event,”²⁹ and a transaction may be part of a series that results in a tax benefit. Australia defines “scheme” to mean “(a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and (b) any scheme, plan, proposal, action, course of action or course of conduct.”³⁰ New Zealand defines “arrangement” to mean “an agreement, contract, plan, or understanding, whether enforceable or unenforceable, including all steps and transactions by which it is carried into effect.”³¹

In practice, the existence of a “scheme” has been litigated in Australia and considered in Canada, but no case in New Zealand seems to turn on the meaning of

26 *Ben Nevis*, supra note 16, at paragraphs 2-4.

27 Pagone, supra note 19, at 22.

28 The Australia GAAR exposes the taxpayer to a penalty of 25 percent (for lack of reasonable care) to 75 percent (for intentional disregard) of the tax shortfall amount (section 177F of ITAA 1936). New Zealand GAAR exposes the taxpayer to 100 percent shortfall penalties (section 141D of the Tax Administration Act (NZ) 1994, 1994 No. 166).

29 ITA section 245(1).

30 ITAA 1936 section 177A.

31 NZ-ITA section YA 1.

“arrangement.”³² In *Peabody*,³³ the Australian Full Federal Court held that where a scheme consists of a series of steps, or a course of action, the commissioner cannot merely isolate one step in the course of action and classify that one step as a scheme. Since the commissioner has the discretion to cancel the tax benefit resulting from a tax-avoidance scheme, the commissioner’s formulation of the scheme is important. In the *Canadian Pacific*³⁴ case, the Federal Court of Appeal said that “the definition of transaction is extended to include circumstances that would not strictly be considered to be a transaction within the normal meaning of that term,” but “that extended definition cannot be interpreted to justify taking apart a transaction in order to isolate its business and tax purposes.”³⁵ The court rejected the minister’s argument that the denominating of the Australian currency of a borrowing transaction was a separate transaction: “[T]he Australian dollar borrowing was one complete transaction and cannot be separated into two transactions by labelling the designation in Australian dollars as a separate transaction.”³⁶

The notion of a “series” of transactions is explicitly relevant to the definition of “avoidance transaction” in the Canadian GAAR. Canadian courts have interpreted “series” broadly, and their interpretation involves a common-law test as to whether “each transaction in the series [is] pre-ordained to produce a final result” and a statutory deeming rule under subsection 248(10) regarding any related transaction that is completed in contemplation of a series.³⁷

Tax Benefit, Tax Avoidance, and Counterfactual

The term “tax benefit” is used in Australia and Canada, while “tax avoidance” is used in New Zealand. Canada and New Zealand define these terms broadly, while Australia has a statutory counterfactual requirement.

Canada defines “tax benefit” to mean “a reduction, avoidance or deferral of tax or other amount payable,” “an increase in a refund of tax,” or “a reduction, avoidance or deferral of tax.”³⁸ New Zealand defines “tax avoidance” to mean “altering the incidence of any income tax,” “relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax,” or “avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax.”³⁹ There is no explicit requirement to identify a hypothetical comparative arrangement.

32 The leading case on the meaning of series is *Copthorne*, supra note 14.

33 Supra note 12.

34 *The Queen v. Canadian Pacific Ltd.*, 2001 FCA 398.

35 Ibid., at paragraph 24.

36 Ibid., at paragraph 26.

37 For example, *Copthorne*, supra note 14, at paragraph 43.

38 ITA subsection 245(1), definition of “tax benefit.”

39 NZ-ITA section YA 1.

In contrast, Australia defines “tax benefit” in more detail and builds in a counterfactual (analogy or hypothetical alternative) element.⁴⁰ Specific types of tax benefits include an amount not being included in assessable income; a deduction being allowed; a capital loss being incurred; and a foreign income tax offset being allowed. The counterfactual element is stated as follows:

[T]he obtaining by a taxpayer of a tax benefit in connection with a scheme shall be read as a reference to:

(a) an amount not being included in the assessable income of the taxpayer of a year of income *where that amount would have been included, or might reasonably be expected to have been included, in the assessable income of the taxpayer of that year of income if the scheme had not been entered into or carried out.*⁴¹

Accordingly, the counterfactual refers to the action with which the taxpayer’s actions are compared. The concept is controversial and was much litigated between 2009 and 2012;⁴² it was the focus of a spate of cases, each of which involved complex commercial structures and transactions. The nature of GAAR proceedings became highly contingent on the outcomes of these cases, because the application of GAAR hinges on the determination of the relevant counterfactual—that is, the determination of what might have happened but didn’t. Taxation according to a GAAR became “taxation by analogy.”⁴³ Australia had what was called a “part IVA outbreak,”⁴⁴ and taxpayers won the majority of the cases. In response to this outbreak, constraints on the use of counterfactuals were introduced in Australia in 2013. New section 177CB(2) and section 177CB(3) state, respectively:

(2) A decision that a tax effect would have occurred if the scheme had not been entered into or carried out must be based on a postulate that comprises only the events or circumstances that actually happened or existed (other than those that form part of the scheme).

40 ITAA 1936 section 177CB.

41 Ibid., section 177C(1)(a) (emphasis added).

42 Examples are *Commissioner of Taxation v. Ashwick (Qld) No 127 Pty Ltd*, [2011] FCAFC 49; *Commissioner of Taxation v. AXA Asia Pacific Holdings Ltd*, [2010] FCAFC 134; *RCI Pty Limited v. Commissioner of Taxation*, [2011] FCAFC 104; *Commissioner of Taxation v. Futuris Corporation Limited*, [2012] FCAFC 32; *Commissioner of Taxation v. Trail Bros Steel & Plastics Pty Ltd*, [2009] FCA 1210; *Commissioner of Taxation v. News Australia Holdings Pty Limited*, [2010] FCAFC 78; *Macquarie Bank Limited v. Commissioner of Taxation*, [2011] FCA 1076; *British American Tobacco Australia Services Limited v. Commissioner of Taxation*, [2010] FCAFC 130; *Commissioner of Taxation v. Citigroup Pty Ltd*, [2011] FCAFC 61.

43 Graeme S. Cooper, *Taxation by Analogy*, Sydney Law School Legal Studies Research Paper no. 13/66 (Sydney: University of Sydney, Law School, August 2013) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2317055).

44 Greenwoods & Freehills Pty, “Part IVA Outbreak,” April 8, 2011.

(3) A decision that a tax effect might reasonably be expected to have occurred if the scheme had not been entered into or carried out must be based on a postulate that is a reasonable alternative to entering into or carrying out the scheme.

There are, thus, two limbs to the counterfactual determination: the “would have” limb and the “might reasonably be expected to have” limb. The “would have” limb involves a comparison of the tax outcomes of the impugned scheme with the outcomes of an alternative, postulated scheme that entirely replaces the impugned scheme. The “might reasonably be expected to have” limb involves comparing the tax outcomes of the impugned scheme with the outcomes of an alternative postulate involving a substituted set of arrangements (this is a recharacterization approach). The commissioner identifies the counterfactual, and the onus is on the taxpayer to rebut it.⁴⁵ Counterfactuals are relevant to determining the existence of a tax benefit and a predominant purpose.⁴⁶

Primary (Dominant) Purpose of Transactions

GAARs apply only to avoidance transactions, which are, generally, transactions entered into for the primary purpose of avoiding tax. The three countries differ in their legislative approaches to identifying tax avoidance. Canada uses a reasonable primary non-tax purpose (commercial or family) test to determine whether a transaction should be excluded from consideration as an avoidance transaction.⁴⁷

New Zealand uses the purpose test to positively identify tax-avoidance arrangements. Section YA 1 of the NZ-ITA defines “tax avoidance arrangement” to mean

an arrangement, whether entered into by the person affected by the arrangement or by another person, that directly or indirectly—(a) has tax avoidance as its purpose or effect; or (b) has tax avoidance as 1 of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.

Thus, if an arrangement has tax avoidance as its sole or dominant purpose or effect, it would be considered a tax-avoidance arrangement.

Australia has the most elaborate legislation on this point. The purpose test is couched in section 177D, which identifies the tax-avoidance schemes to which

45 In practice, it may be difficult for the commissioner to obtain evidence to support the counterfactual (that is, the reconstructed version of events). See Australian Taxation Office, *Law Administration Practice Statement PS LA 2005/24*, “Application of General Anti-Avoidance Rules,” December 13, 2005, at paragraph 112.

46 *Ibid.*, at paragraphs 130–31.

47 ITA subsection 245(3) defines an avoidance transaction to mean any transaction (or any transaction that is part of a series of transactions) that, but for the GAAR provision, would result, directly or indirectly, in a tax benefit, “unless the transaction may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit.”

part IVA applies. It refers to the purpose of a person, as opposed to an arrangement. Under section 177D(1), tax-avoidance schemes are those of which it may be concluded that the person, or one of the persons who entered into or carried out the scheme or any part of the scheme, did so for the purpose of enabling the relevant taxpayer to obtain a tax benefit in connection with the scheme or enabling the relevant taxpayer and other taxpayers each to obtain a tax benefit in connection with the scheme. Section 177D(2) lists eight factors that are to be considered in applying the purpose test:

- (a) the manner in which the scheme was entered into or carried out;
- (b) the form and substance of the scheme;
- (c) the time at which the scheme was entered into and the length of the period during which the scheme was carried out;
- (d) the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme;
- (e) any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme;
- (f) any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant taxpayer, being a change that has resulted, will result or may reasonably be expected to result, from the scheme;
- (g) any other consequence for the relevant taxpayer, or for any person referred to in paragraph (f), of the scheme having been entered into or carried out;
- (h) the nature of any connection (whether of a business, family or other nature) between the relevant taxpayer and any person referred to in paragraph (f).

These factors are considered in an attempt to isolate observable facts and circumstances—for example, what was done under the scheme; how it was done; when it was done; how long it took; whether any of the persons involved are related; and what the economic substance is with respect to the change in financial position. In the case of mixed tax-avoidance and business or family purposes, the tax-avoidance purpose must be the dominant one if the application of the Australian GAAR is to be triggered.⁴⁸ These factors can be viewed as creating a codified economic substance test.

The Australian and Canadian GAAR provisions make it clear that the purpose test is based on facts, not on the intent of the taxpayer.⁴⁹ The NZ provision refers to the purpose of the arrangement as opposed to the taxpayer's purpose. In all three countries, it was contemplated that tax avoidance may be one of two or more purposes that the taxpayer has in entering into or carrying out a scheme, and that

48 ITAA 1936 section 177A(5).

49 The wording is "it would be concluded (having regard to the matters [listed in the eight factors])" in section 177D(1) of ITAA 1936, and "it may reasonably be considered" in section 245(3) of the ITA.

GAAR is triggered only if tax avoidance is the taxpayer's primary, dominant, or non-incidental purpose.

Purpose of Statutory Provisions

As a measure of last resort, GAAR functions as a shield to protect (1) the tax base as defined by the charging provisions; (2) the integrity of tax expenditures provisions that grant tax benefits to taxpayers with specific preconditions; and (3) the effectiveness of specific anti-avoidance rules (SAARs). The provisions thus protected can be viewed as "specific" or "primary" provisions in relation to the GAAR provision. If a tax benefit desired by the taxpayer is explicitly sanctioned by a primary provision, the GAAR provision clearly would not apply. The GAAR provision is invoked in the absence of such explicit sanction. A critical question is whether the tax benefit should be denied through a purposive interpretation of the primary provision. Discerning legislative intent is an exercise in statutory interpretation.

The courts in Canada, Australia, and New Zealand all seem to apply their respective GAARs to transactions designed to obtain a tax benefit in an "artificial" or "contrived" way, and they do so on the grounds that the use of the primary provisions to gain such a tax benefit is not within Parliament's purpose.⁵⁰ Examples are the Supreme Court of Canada decision in *Mathew*,⁵¹ the High Court of Australia decision in *Hart*,⁵² and the Supreme Court of New Zealand decision in *Ben Nevis*.⁵³ As a matter of statutory interpretation, however, a conceptual difficulty arises with respect to statutory interpretation when it comes to the GAAR provisions relative to a purposive construction of primary provisions. Justice Pagone, writing extrajudicially, pinpoints the difficulty this way: "[H]ow can the [GAAR] provisions ever apply when the primary taxing provisions have failed to achieve their proper and intended purpose when they have been construed and applied according to their purpose?"⁵⁴

The Canadian GAAR has a "misuse and abuse" test, which the Supreme Court of Canada has interpreted as involving a two-step inquiry: (1) to determine the purpose or rationale of the primary provisions with respect to the scheme of the ITA, the

50 "Blatant," "artificial," or "contrived" are, in legal terms, inexact. That inexactness also provides fertile ground for differences of opinion as to whether a particular arrangement is blatant, artificial, or contrived. See Richard Edmonds, "Part IVA & Anti-Avoidance—Where Are We Now?" (2003) 6:3 *Tax Specialist* 96-103.

51 *Mathew*, supra note 14.

52 *Hart*, supra note 15.

53 *Ben Nevis*, supra note 16.

54 Pagone, supra note 19, at 16. See also Brian J. Arnold, "Policy Forum: Some Thoughts on the Supreme Court's Approach to the Determination of Abuse under the General Anti-Avoidance Rule" (2014) 62:1 *Canadian Tax Journal* 113-27, noting at 125: "[I]n my view, there is no other reasonable basis for the distinction that . . . between the ordinary textual, contextual, and purposive approach and the textual, contextual, and purposive approach applied to subsection 245(4)."

relevant provisions, and permissible extrinsic aids; and (2) to determine whether the avoidance transaction defeated or frustrated the legislative purpose or rationale.⁵⁵

The concept of abuse is absent in the New Zealand GAAR provision, but the Supreme Court of New Zealand has adopted a parliamentary contemplation test, which is akin to the Canadian abuse test.⁵⁶ In *Ben Nevis*, Tipping, McGrath, and Gault JJ said:

When, as here, a case involves reliance by the taxpayer on specific provisions, the first enquiry concerns the application of those provisions. The taxpayer must satisfy the court that the use made of the specific provision is within its intended scope. If that is shown, a further question arises based on the taxpayer's use of the specific provision viewed in the light of the arrangement as a whole. If, when viewed in that light, it is apparent that the taxpayer has used the specific provision, and thereby altered the incidence of income tax, in a way which cannot have been within the contemplation and purpose of Parliament when it enacted the provision, the arrangement will be a tax avoidance arrangement.⁵⁷

The notion of abuse is largely irrelevant in Australian GAAR cases. The judicial focus is mostly on determining the dominant purpose of a scheme through a consideration of the eight factors.

JUDICIAL ATTITUDE

When GAAR is drafted as a broadly worded standard as opposed to a specific rule, its effect depends on judicial interpretation. GAAR in action can be much narrower than GAAR on paper, depending on the judicial attitude toward the *Duke of Westminster*⁵⁸ principle—that is, the principle that taxpayers have the right to minimize taxation. This principle is grounded in (1) a more literal interpretation of the primary provisions of taxing statutes and (2) respect for the legal form and shape of transactions.

Decisions of the Highest Court

The GAAR decisions of the highest courts in Canada, Australia, and New Zealand have not been overruled or modified through legislative amendment.⁵⁹ Judicial attitude can thus be gleaned from these decisions.

55 See *Canada Trustco*, supra note 14. In that case the court concluded that capital cost allowance (CCA) deductions claimed by the taxpayer from a sale and leaseback transaction were consistent with the object and spirit of the CCA provisions relied upon by the taxpayer notwithstanding that it was an avoidance transaction and that there may not have been real financial risk or economic cost.

56 See *Ben Nevis*, supra note 16, at paragraph 45.

57 Ibid., at paragraph 107.

58 *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1.

59 In Australia, part IVA was significantly amended in 2013 in response to the lower courts' interpretation of "tax benefit" and the use of counterfactuals, which was perceived to be

Canada

The Supreme Court of Canada applied GAAR in *Mathew*, *Lipson* and *Copthorne*, but not in *Canada Trustco*. The court found the transactions in *Canada Trustco* to be “not so dissimilar from an ordinary sale-leaseback.”⁶⁰ In *Mathew*, the loss-shifting transactions carried out through the use of partnerships were found to be abusive, because the purpose of one partnership was “simply to realize and allocate the tax losses, without any other significant partnership activity”⁶¹ and the “abusive nature of the transactions is confirmed by the vacuity and artificiality of the non-arm’s length aspect of the initial relationship” between the initial partnership and the loss-making company.⁶² In the transactions in *Lipson*, the taxpayer’s wife borrowed money to buy from the taxpayer shares in the family corporations so that, in effect, the taxpayer could deduct interest on the couple’s home mortgage loan by taking advantage of an attribution rule (a SAAR to prevent income splitting). The majority of the court found the transactions abusive, because their effect was to use an anti-avoidance rule to achieve tax avoidance.⁶³ In *Copthorne*, the taxpayer sought to increase the paid-up capital by restructuring the vertical parent-subsidiary relationship of two Canadian corporations into a horizontal sister-sister relationship in order to avoid the cancellation of paid-up capital in the subsidiary upon a vertical amalgamation. The higher paid-up capital would be paid to the non-resident shareholder tax-free as opposed to being paid as a dividend that is subject to withholding tax. The court found the step in the series of transactions that led to the restructuring to be abusive because it was “primarily for a tax purpose and . . . done in a manner found to circumvent a provision of the *Income Tax Act*.”⁶⁴

According to the Supreme Court of Canada, GAAR “is a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer.”⁶⁵ An avoidance transaction is subject to GAAR if it achieves an outcome that the provision was intended to prevent or it defeats the underlying rationale of the provision. The minister, according to the court, “must clearly demonstrate that the transaction is an abuse of the Act, and the benefit of the doubt is given to the taxpayer.”⁶⁶

limiting the scope of GAAR and creating unwarranted uncertainties; see the 2013 amendment, supra note 20. In Canada, GAAR was amended in 2004 to overrule a Tax Court of Canada decision, in *Fredette v. The Queen*, 2001 DTC 621, that the GAAR did not apply to tax regulations.

60 *Canada Trustco*, supra note 14, at paragraphs 78 and 80.

61 *Mathew*, supra note 14, at paragraph 61.

62 *Ibid.*, at paragraph 62.

63 *Lipson*, supra note 14, at paragraph 42.

64 *Copthorne*, supra note 14, at paragraph 121.

65 *Ibid.*, at paragraph 66.

66 *Ibid.*, at paragraph 72.

New Zealand

The Supreme Court of New Zealand applied GAAR in both of its decisions. *Ben Nevis* concerned a complex 50-year forestry investment tax-shelter scheme under which investors (the taxpayers) sought to claim from the outset significant annual tax deductions for amortized licence fees and insurance premiums that, in theory, were not actually payable until near the maturation of the scheme and that, in practice, were unlikely to be payable even then. The taxpayers argued that the deductions were permitted by the specific provisions in the NZ-ITA and that the scheme was thus consistent with Parliament's purpose (not "beyond Parliamentary contemplation") and therefore not subject to GAAR. In applying GAAR, the majority explained:

The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose. If that is so, the arrangement will not, by reason of that use, be a tax avoidance arrangement. If the use of the specific provision is *beyond Parliamentary contemplation*, its use in that way will result in the arrangement being a tax avoidance arrangement.⁶⁷

Ben Nevis established the "Parliamentary contemplation" test. The arrangement adopted by the taxpayer in *Ben Nevis* was not of a kind that Parliamentary contemplated when it enacted the specific provisions upon which the taxpayers had relied. In addition, the arrangement was contrived.

Penny applied the same test to the ordinary use, by taxpayers, of the corporate form or trust form in order to benefit from the lower corporate tax rate. This case concerned taxpayers (surgeons) who transferred their medical practice to a company owned by a trust and paid themselves a salary of less than 20 percent of the profits generated by the practice. As a result, the professional income was taxed at the corporate rate rather than the top personal tax rate. The court confirmed that the taxpayers were free to use the corporate or trust structure. The court also found, however, that the use of this structure, when it is combined with the payment of an "artificially" low salary for the purpose of obtaining a tax advantage, is "beyond parliamentary contemplation" and thus subject to GAAR.⁶⁸

The *Penny* case has no counterpart in Canada. The Canada Revenue Agency (CRA) has not invoked GAAR to deny the tax benefits of using private corporations. The decisions in *Ben Nevis* and *Canada Trustco* hinge on the meaning of "cost." The Supreme Court of Canada was of the view that "cost" in the relevant provisions should not be reread as "money at risk" and should have a legal meaning.⁶⁹ The Supreme Court of New Zealand took an economic approach: when "there was no

67 *Ben Nevis*, supra note 16, at paragraph 109 (emphasis added).

68 *Penny*, supra note 16, at paragraph 33.

69 *Canada Trustco*, supra note 14, at paragraphs 74-75 and 81.

real risk in the whole thing,” the deduction “cannot have been within the contemplation of Parliament when it enacted” the specific provision.⁷⁰ Further, the court stated that “[w]hile the law treats the relevant costs as incurred, . . . the Court is permitted, when considering the question of tax avoidance, to examine the commercial nature of the incurred cost and any factors that might indicate that the expenditure will never be truly incurred.”⁷¹

Australia

The High Court of Australia applied GAAR in *Spotless*, *CPH*, and *Hart*, but not in *Peabody* and *Mills*. *Peabody*⁷² concerned a series of transactions designed to float the shares of an operating company after a minority shareholder’s interest was bought by the majority shareholder. The taxpayer was a beneficiary of a family trust that was the majority shareholder. To lower the cost of financing, a shell company was used to purchase the shares from the minority shareholder with Aus\$8.6 million raised through issuing redeemable preference shares to a bank. These preference shares were redeemed (and capital returned to the bank) when the trust loaned Aus\$8.6 million to the shell company with proceeds from the public float. This loan was subsequently forgiven by the trust. Among the purposes of this structuring were (1) the avoidance of a capital gains tax if the trust bought the shares from the minority shareholder and then sold them at a higher price to the public; (2) lower cost of financing through the payment of “dividends” to the bank instead of interest; and (3) respecting the minority shareholder’s desire for confidentiality. The commissioner assessed the taxpayer for the capital gains tax. The court found that GAAR did not apply because the decision to finance the purchase of the minority shares through the shell company was a rational commercial decision.

The transactions in *Mills*,⁷³ which were described as “stapled securities,” consisted of a stapled unsecured note issued by the NZ branch of the Commonwealth Bank of Australia and preference shares issued by the bank. The NZ branch paid distributions on the securities without the bank’s paying Australian income tax on the source of funding. The question was whether the security holders, such as Mr. Mills, could obtain an imputation credit (which is akin to the Canadian dividend tax credit). The answer hinged on the characterization of the security as equity. The commissioner denied the imputation credits on the grounds that the dominant purpose in using stapled securities was to generate an imputation credit while the bank did not pay Australian income tax on the source of funding. On consideration of all relevant factors and circumstances, the court held that, although it could be concluded that the bank had a purpose of enabling security holders to obtain an imputation benefit, that purpose was incidental to the bank’s purpose of

70 *Ben Nevis*, supra note 16, at paragraph 148.

71 *Ibid.*, at paragraph 128.

72 *Supra* note 12.

73 *Mills*, supra note 15.

raising tier 1 capital to meet the regulatory requirement. Since tax avoidance was not the dominant purpose, GAAR did not apply.

In *Spotless*,⁷⁴ the taxpayer deposited Aus\$40 million of surplus funds in the Cook Islands, earning a rate of interest that was about 4 percent lower than the interest rate that could have been obtained by investing the funds in Australia. The taxpayer claimed that the interest income was exempt from Australian tax pursuant to a specific provision of the ITAA, the basis for the claim being that the interest had been subject to withholding tax in the Cook Islands. The majority of the High Court of Australia found that the dominant purpose of the transaction was to obtain the tax exemption—the commercially unattractive interest rate was more than offset by the tax exemption. The mere fact that a transaction can be justified as a rational commercial decision will not of itself be sufficient to avoid the operation of GAAR. A broader commercial objective apart from tax will not prevent the operation of GAAR. The court rejected a dichotomy between rational commercial decisions and tax planning.⁷⁵ In consequence, part IVA was upheld by the court as applicable in cases where tax objectives explain the structure of what is otherwise a wholly commercial, and otherwise fiscally permissible, outcome.

In *CPH*,⁷⁶ the taxpayer took preparatory steps to avoid the application of a deduction-quarantining provision under which the domestic interest deduction on funds borrowed to make foreign investment is limited to the amount of foreign-source income. The consolidated group of companies considered a takeover of a UK target, using borrowed funds. To avoid the quarantining rule, CPH borrowed Aus\$450 million in Australia and lent the money to an Australian subsidiary (Sub1), incurring interest expense. Sub1 used the money to subscribe for redeemable preference shares in another Australian subsidiary (Sub2). Sub2 used the funds to subscribe for shares in a UK subsidiary, which then lent the money to a Singapore company that would then invest in the ultimate vehicle to be used for the takeover bid. The takeover did not actually take place. The commissioner invoked GAAR to deny CPH the interest deduction, arguing that steps involving Sub1 and Sub2 were inserted for tax reasons. The court agreed with the commissioner and applied GAAR.

The *Hart*⁷⁷ case concerned the application of GAAR to a so-called “split loan” facility. The taxpayers borrowed from a bank to acquire their principal residence, and interest was not deductible. Later, they decided to buy a new residence and rent out the first residence. The change of use of the first residence enabled the interest to be deductible. To refinance their existing home and borrow money for the new property, the taxpayers took a split loan. Under the terms of the split loan, a loan (Aus\$298,000) was notionally divided into two “accounts”—the investment loan account and the home loan account. The taxpayers had the option of directing

74 *Spotless*, supra note 15.

75 *Ibid.* (Brennan CJ, Dawson, Toohey, Gaudron, Gummow, and Kirby JJ).

76 *CPH*, supra note 15.

77 *Hart*, supra note 15.

that all monthly payments be applied toward the home loan account, that interest unpaid on the investment loan account be capitalized, and that compound interest be debited to that account. The split-loan facility had the twin effects of (1) paying off the home loan faster and at a lower total interest cost and (2) deferring and thus increasing the interest cost on the investment loan account. The commissioner disallowed the taxpayers' deduction of the interest that was accruing but unpaid on the original amount of the investment loan account. The court agreed with the commissioner and held that the manner in which the scheme was entered into strongly suggested that the taxpayers entered into that scheme for the dominant purpose of obtaining a tax benefit.⁷⁸

The Legacy of the Duke

The GAAR provisions of Canada, Australia, and New Zealand can be said to use the *Duke of Westminster* principle as a foil. This is most obvious in the case of the Australian GAAR, which, as Morse and Deutsch have observed, “pushes against the formal choice principle . . . and invalidates transactions where a taxpayer chooses a contrived ‘Plan B’ approach over a more natural ‘Plan A’ course of action.”⁷⁹

The highest courts in the three countries have displayed somewhat different attitudes toward the role of the *Duke of Westminster* principle. The Supreme Court of Canada regards the principle as “a legitimate and accepted part of Canadian tax law” that is attenuated only by GAAR,⁸⁰ and even Justices Binnie and Deschamps of the Supreme Court have expressed concern about “how healthy is the Duke of Westminster.”⁸¹

In contrast, the High Court of Australia and the Supreme Court of New Zealand regard the *Duke of Westminster* as largely irrelevant. For example, the High Court of Australia stated in *Spotless*:

Part IVA [GAAR] is to be construed and applied according to its terms, not under the influence of “muffled echoes of old arguments” concerning other legislation. In this Court, counsel for the taxpayers referred to the repetition by the Privy Council in *Commissioner of Inland Revenue v Challenge Corporation* of the statement by Lord Tomlin in *Inland Revenue Commissioners v Duke of Westminster* that “(e)very man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be.” Lord Tomlin spoke in the course of rejecting a submission that in assessing surtax under the Income Tax Act 1918 (UK) the Revenue might disregard legal form in favour of “the substance of the matter.” His remarks have no significance for the present appeal. Part IVA is as much a part of the statute under

78 Ibid., at paragraph 68.

79 See Susan C. Morse and Robert Deutsch, “Tax Anti-Avoidance Law in Australia and the United States” (2015) 49:2 *International Lawyer* 111-48, at 125.

80 *Canada Trustco*, supra note 14, at paragraphs 31 and 13.

81 *Lipson*, supra note 14, at paragraph 54.

which liability to income tax is assessed as any other provision thereof. In circumstances where s 177D applies, regard is to be had to both form and substance (s 177D(b)(ii)).⁸²

The Supreme Court of New Zealand has made no reference to the *Duke of Westminster* in its GAAR decisions and has stated that “English decisions provide limited direct assistance” in interpreting a statutory GAAR.⁸³ The court emphasized that “there must be a weapon able to thwart technically correct but contrived transactions set up as a means of exploiting the Act for tax advantages.”⁸⁴

Relevance of Economic Substance

With respect to the relevance of economic substance in GAAR cases, the Supreme Court of Canada has taken the narrowest approach. In *Canada Trustco*, for example, the court stated that the explanatory notes to the GAAR provision elaborate that the provisions of the ITA “are intended to apply to transactions with real economic substance”⁸⁵ but that “s. 245(4) does not consider a transaction to result in abusive tax avoidance merely because an economic or commercial purpose is not evident.”⁸⁶

In contrast, the High Court of Australia accepted that GAAR was intended to be an “effective general measure against those tax avoidance arrangements that . . . are blatant, artificial or contrived”⁸⁷ as evidenced by, among other factors, a lack of economic substance. The Supreme Court of New Zealand firmly endorses the economic substance approach and stated in *Ben Nevis*:

In considering these matters, the courts are not limited to purely legal considerations. They should also consider the use made of the specific provision in the light of the commercial reality and the economic effect of that use. The ultimate question is whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament’s purpose.⁸⁸

The “purposive interpretation” doctrine also emboldens courts in New Zealand to look through the legal form of the arrangements for the economic substance:

82 *Spotless*, supra note 15, at paragraph 9.

83 *Ben Nevis*, supra note 16, at paragraph 110.

84 *Penny*, supra note 16, at paragraph 47.

85 *Canada Trustco*, supra note 14, at paragraphs 48-49 and 56.

86 *Ibid.*, at paragraph 57. The Supreme Court of Canada, *ibid.*, was clear that “the GAAR was not intended to outlaw all tax benefits; Parliament intended for many to endure” and that the “central inquiry is focussed on whether the transaction was consistent with the purpose of the provisions of the *Income Tax Act* that are relied upon by the taxpayer.”

87 *Hart*, supra note 15, at paragraph 86, per Callinan J.

88 *Ben Nevis*, supra note 16, at paragraph 109.

As Parliament's purpose in enacting specific provisions is axiomatically targeted at the most commonplace and conventional issues which arise, anything that indicates an unusual or contrived application of a provision is also likely to indicate that the provision was not used in the way Parliament thought it would be. If enough of these abnormalities are present, and are also accompanied by tax advantages, then it is a fair conclusion that the use is outside Parliamentary contemplation and the GAAR applies.⁸⁹

Morality

The three countries' highest courts are unanimous on the irrelevance of morality, and they make it clear that applying GAAR is an exercise in statutory interpretation. Accordingly, the courts' role is to interpret both the broad wording of the GAAR provisions and the technically detailed primary provisions. The High Court of Australia has made no reference to morality in its GAAR decisions. The Supreme Court of Canada has said that "determining the rationale of the relevant provisions of the Act should not be conflated with a value judgment of what is right or wrong nor with theories about what tax law ought to be or ought to do."⁹⁰ The Supreme Court of New Zealand has stated that judges should not be distracted by "intuitive subjective impressions of the morality" of certain arrangements.⁹¹

DOCTRINAL COMPARISON

The substantial similarities among the three countries' common-law traditions and GAAR provisions would seem to suggest that ample room exists for convergence in their high courts' GAAR decisions. However, the judicial approaches to interpreting and applying GAAR are not exactly the same, which leaves room for divergence in the courts' decisions. On the basis of the decisions canvassed above and certain decisions from the lower courts in the three countries, we offer below some examples of convergence and divergence. We have chosen these examples on the basis of a broad consideration only, given that many other factors may well explain the case outcomes.

Examples of Convergence

One area of convergence is the courts' concern about taxpayers' using contrived and artificial, albeit legal, means to achieve an economic outcome, thus avoiding tax liability and thereby shifting the economic burden to other taxpayers. Among the four types of arrangements mentioned below, sales and lease-back transactions were found to be not subject to GAAR, presumably because these transactions do no more than shift the benefit of a tax consequence from one taxpayer to another in

89 Craig Elliffe and Jess Cameron, "The Test for Tax Avoidance in New Zealand: A Judicial Sea Change" (2010) 16 *New Zealand Business Law Quarterly* 440-60, at 451.

90 *Copthorne*, supra note 14, at paragraph 70.

91 *Ben Nevis*, supra note 16, at paragraph 102.

the arrangement, and are therefore revenue-neutral from a tax policy perspective.⁹² The other three types of transactions resulted in revenue losses.

Loss-generating cases have been found to be subject to GAAR. In Canada, the Federal Court of Appeal applied GAAR in three separate loss-generating cases: *1207192 Ontario Limited*,⁹³ *Triad Gestco*,⁹⁴ and *Global Equity*.⁹⁵ These cases involved stock dividends that shifted value from common shares to preferred shares and thereby gave rise to a loss on the common shares. The losses were capital in nature in the first two cases, and business losses in the third case. The courts found that the object, spirit, and purpose of the relevant provisions were to allow only the recognition of “true capital losses incurred outside the same economic unit”⁹⁶ or of business losses that “must be grounded in some form of economic or business reality.”⁹⁷ In Australian cases such as *Howland-Rose*,⁹⁸ *Vincent*,⁹⁹ *Puzey*,¹⁰⁰ and *Calder*,¹⁰¹ the natural counterfactual is that a loss-generating transaction would not take place. For example, *Puzey* concerned a so-called tax-effective investment in a sandalwood project. The taxpayer combined an amount of his own funds with an amount borrowed through the scheme, and he secured, by participation in the scheme, a tax deduction sufficient to cover the amount invested. In effect, the tax deduction was the source of the investment.¹⁰² The government has won numerous cases related to tax shelters wholly unrelated to the businesses of Australian taxpayers. The Supreme Court of New Zealand decision in *Ben Nevis* is a loss-generating case.

Loss-trading cases have also produced some convergence in the decisions of the three countries’ courts. Canadian cases such as *Mathew*,¹⁰³ *Birchcliff Energy Ltd.*,¹⁰⁴

92 This observation was inspired by remarks by G.T. Pagone, “Part IVA: The General Anti-Avoidance Provisions in Australian Taxation Law” (2003) 27:3 *Melbourne University Law Review* 770-99, at 798-99.

93 *1207192 Ontario Limited v. Canada*, 2012 FCA 259; leave to appeal to the Supreme Court of Canada dismissed March 28, 2013.

94 *Triad Gestco Ltd. v. Canada*, 2012 FCA 258; aff’g 2011 TCC 259.

95 *Canada v. Global Equity Fund Ltd.*, 2012 FCA 272.

96 *Triad Gestco*, supra note 94, at paragraph 55 (TCC).

97 *Global Equity*, supra note 95, at paragraph 62.

98 *Howland-Rose v. Commissioner of Taxation*, [2002] FCA 246 (expenditure on research into the development of products made from tea tree oil was not deductible as the expenditure was not capable of being identified with the derivation of any assessable income).

99 *Vincent v. Commissioner of Taxation*, [2002] FCAFC 291 (mass-marketed cattle-breeding scheme).

100 *Puzey v. Commissioner of Taxation*, [2003] FCAFC 197 (sandalwood plantation).

101 *Calder v. Commissioner of Taxation*, [2005] FCAFC 254 (holding part IVA applicable to excessive deductions for advance fee and interest payments made out of borrowed round-robin funds).

102 Significantly, however, this transaction was found to involve full-recourse loans—in other words, the taxpayer could be called upon to repay the loan in the future.

103 *Mathew*, supra note 14.

104 *Birchcliff Energy Ltd. v. Canada*, 2019 FCA 151; leave to appeal to the Supreme Court of Canada dismissed November 14, 2019.

Oxford Properties,¹⁰⁵ and *594710 British Columbia*¹⁰⁶ suggest that tax-avoidance transactions aimed at trading losses (or profit) are abusive and subject to GAAR. An NZ example is the *Miller*¹⁰⁷ case, in which business profits were shifted to companies with existing losses through a scheme that was found to be “highly artificial.”

Another issue giving rise to convergence among the courts is the issue of deductibility of interest on money borrowed to purchase a principal residence. It is not surprising that the top courts in both Canada and Australia applied GAAR to transactions designed to obtain the tax deduction through tax-avoidance arrangements. The *Lipson* case involved transactions known as “*Singleton* with a spousal twist.”¹⁰⁸ Although the *Singleton* type of financing (that is, using borrowed money to replace equity in a law firm’s capital account and purchasing a home with the equity amount) was found unanimously not to be subject to GAAR, the spousal twist was found by the majority in the Supreme Court of Canada to be abusive because the attribution rules were intended to prevent income shifting between spouses, and that intention was frustrated. In *Hart*, the split loan arrangement for a mortgage to finance a rental property and a residence was found to be subject to GAAR. These cases do not mean, however, that there is convergence among the three countries’ courts with respect to interest deductibility in general.

The GAAR has not applied to cases involving sale and lease-back arrangements: *Eastern Nitrogen*¹⁰⁹ and *Metal Manufactures*,¹¹⁰ in Australia; and *Canada Trustco*, in Canada. The highly leveraged cross-border transactions in *Canada Trustco* were found to be not dissimilar to standard sale and lease-back transactions and thus immune from GAAR. In the Australian cases, after considering the eight criteria for determining the dominant tax-avoidance purpose, the courts held that the most influential purpose of the taxpayer (which sold the assets and leased them back) was not to obtain a tax benefit but, rather, to obtain “a very large financial facility on the best terms reasonably available.”¹¹¹ These decisions were regarded as providing “authority for the proposition that Part IVA should not apply in circumstances

105 *Canada v. Oxford Properties Group Inc.*, 2018 FCA 30.

106 *Canada v. 594710 British Columbia Ltd.*, 2018 FCA 166.

107 *Miller v. Commissioner of Inland Revenue*, [2001] 3 NZLR 316 (PC).

108 *Lipson*, supra note 14, at paragraph 59. In this case, Mrs. Lipson took a loan from a bank on the condition that she would repay the loan the next day. She used the borrowed money to purchase shares of the family corporation from Mr. Lipson, who used the proceeds to purchase a family home. The Lipsons obtained a mortgage on the house, and Mrs. Lipson used the proceeds of the mortgage to repay the loan. Mrs. Lipson incurred interest expenses at an amount greater than the dividends received from the family corporation. Mr. Lipson, taking advantage of attribution rules, deducted the interest, in effect.

109 *Eastern Nitrogen Ltd v. Commissioner of Taxation*, [2001] FCA 366.

110 *Commissioner of Taxation v. Metal Manufactures Ltd*, [2001] FCA 365.

111 *Eastern Nitrogen*, supra note 109, at paragraph 119.

where a tax benefit has been obtained through a form where the form itself serves commercial objectives other than the tax benefit.”¹¹²

Examples of Divergence

On a number of GAAR-related questions, the courts in the three countries diverge. The use of “do-nothing” counterfactuals (that is, how would the taxpayer have been taxed if it had “done nothing,” or had not engaged in the avoidance transaction) is quite important in Australia, but not in Canada or New Zealand. Some Australian cases, especially those that predate the 2013 amendment, denied GAAR applications based on do-nothing counterfactuals on the grounds that the alternative transaction (higher-tax option) was so unlikely that it would not possibly have occurred. One example is the *RCI Pty* case.¹¹³ In this case, an Australian taxpayer corporation was a member of a group that undertook an internal restructuring intended to, among other goals, establish a central group finance company in the Netherlands. As part of the restructuring, RCI received a dividend from a US subsidiary, which reduced the value of the shares of the US subsidiary. After receiving the dividend, RCI transferred those shares to a related company in Malta, resulting in no taxable gains for Australian tax purposes. The commissioner contended that the capital gain that RCI would have realized from the transfer of the shares in the absence of the dividend was a tax benefit. But the taxpayer prevailed in the courts with its argument that no tax benefit existed because, if the taxpayer had faced a tax liability of Aus\$172 million, it would not have entered into the internal restructuring transaction in the first place.¹¹⁴

Canadian and NZ cases do not contain specific counterfactual analysis. However, the notion of the do-nothing alternative was considered by Canadian courts in cases such as *Univar Canada*¹¹⁵ and *Coptborne*. In *Coptborne*, which involved a vertical amalgamation, the court’s consideration of the do-nothing counterfactual supported the finding that the transaction had produced a tax benefit.¹¹⁶ In *Univar Canada*, the Tax Court of Canada found, through consideration of the do-nothing alternative,

112 Pagone, *supra* note 92, at 785.

113 *RCI Pty*, *supra* note 42.

114 *Ibid.*, at paragraph 150: “[I]n our view, if the scheme in either of its manifestations had not been entered into or carried out, the reasonable expectation is that the relevant parties would have either abandoned the proposal, indefinitely deferred it, altered it so that it did not involve the transfer by RCI of its shares in JHH(O) [US subsidiary] to RCI Malta or pursued one or more of the other alternatives referred to in the Information Memorandum; but they would not have proceeded to have RCI transfer its shares in JHH(O) to RCI Malta at a tax cost of \$172 million. On this view, RCI did not obtain the tax benefit it was alleged by the Commissioner to have obtained in connection with the scheme.”

115 *Univar Canada Ltd. v. The Queen*, 2005 TCC 723; rev’d 2017 FCA 207.

116 *Coptborne*, *supra* note 14, at paragraph 35.

that no tax benefit existed.¹¹⁷ The Federal Court of Appeal suggested in *Univar Canada* that alternative transactions may be relevant in the abuse analysis.¹¹⁸

Another example of a GAAR issue on which the three countries diverge is the use of private corporations or trusts to divert income. In Australia and New Zealand, where an individual assigns income to an entity, GAAR has applied unless the “tax advantages are subordinate to other commercial reasons for channeling personal services income through an intermediary”¹¹⁹ or the individual receives a reasonable level of salary.¹²⁰ In Canada, SAARs such as the indirect payment rules under subsection 56(2) were invoked in cases such as *McClurg*¹²¹ and *Neuman*,¹²² and there are no GAAR cases in which the tax benefit of using private corporations or trusts has been denied.

Treaty-shopping cases are found only in Canada. The minister invoked GAAR, without success, to deny treaty benefits in *MIL Investments*¹²³ and *Alta Energy*.¹²⁴ In *Alta Energy*, after establishing the rationale of the relevant treaty provisions of the Luxembourg Convention on the basis of the provisions’ textual meaning, the Federal Court of Appeal held that the treaty-shopping structure was not abusive. The court remarked that “the rationale for the relevant provisions of the Luxembourg Convention can be found in the text of these provisions”¹²⁵ and that, “[s]ince the provisions operated as they were intended to operate, there was no abuse.”¹²⁶

EMPIRICAL STUDY

Exploring Transaction Types in the Context of Judicial Decision Making

Transaction Types

The dataset contains the attributes of the cases as well as the judges who decided them. The size of the dataset is very modest: 99 Canadian cases decided by 65 judges

117 *Univar Canada*, supra note 115, at paragraph 43 (TCC): “[T]he only alternate arrangement that can be considered is the possibility of the alleged avoidance transaction not having occurred. Had the shares of Barbadosco not been acquired by the Appellant, there would be no tax otherwise payable which could be avoided, reduced or deferred. The acquisition of such shares by the Appellant does not change that.”

118 *Ibid.*, at paragraph 19 (FCA).

119 See Morse and Deutsch, supra note 79, at 126, note 144; and *Federal Commissioner of Taxation v. Mochkin*, [2003] FCAFC 15.

120 *Penny*, supra note 16.

121 *McClurg v. Canada*, [1990] 3 SCR 1020.

122 *Neuman v. MNR*, [1998] 1 SCR 770.

123 *Canada v. MIL (Investments) SA*, 2007 FCA 236.

124 *Canada v. Alta Energy Luxembourg SARL*, 2020 FCA 43.

125 *Ibid.*, at paragraph 69.

126 *Ibid.*, at paragraph 80.

(48 male and 17 female); 96 Australian cases decided by 70 judges (62 male and 8 female); and 28 New Zealand cases decided by 50 judges (43 male and 7 female).

Each case is classified, according to Edgar's typology, as a creation type, a trading type, or a substitution type. The classification of a case is not always clear-cut. Some cases may fall into two categories. For example, the transactions in *Lipson* could equally be the creation type or the substitution type. We opted for the latter categorization because a viable higher-tax alternative existed for that type. Overall, the substitution type accounts for over 50 percent of total cases (see table 1).

Judicial Attributes and Regression Variables

To empirically explore the question whether identification of the transaction type helps predict how judges will decide GAAR cases, the dataset includes information about the judges who decided them, so that the data about the cases and the data about the judges can be linked. An exploratory research approach grounded in logistic regression analysis was adopted.

The unit of analysis was the votes cast by the judges, coded as either "for the government" or "not for the government." The binary variable of votes was used as the dependent variable. Transaction type was used as the independent variable. In addition, four categorical variables and one continuous variable were used as the covariates. In setting up the independent variable and the covariates, one category of each categorical variable was designated as the base category serving as the basis of comparison for other categories of the same variable. These five categorical variables were set up as follows:

1. the transaction type in each case (the substitution type as the base category versus the creation type and the trading type);¹²⁷
2. the jurisdiction in which each case was decided (New Zealand as the base category versus Australia and Canada);
3. a rough proxy of the country's national political climate at the time each case was decided (times when conservatives were in power as the base category versus times when liberals were in power);¹²⁸

127 The classification of a case as a creation, trading, or substitution decision was not always clear-cut. Some cases may fall into two categories. For example, the transactions in *Lipson*, supra note 14, could be a creation type and a substitution type. We opted for the latter because of a viable higher-tax alternative existed.

128 Because the dataset includes only GAARs decided by the federal courts in Canada and Australia, and because New Zealand is a unitary state, the government in power refers to the national level only. The conservatives refer to the Progressive Conservative Party of Canada; its subsequent incarnation, the Conservative Party of Canada in Canada; The Liberal Party of Australia, in Australia; and The New Zealand National Party in New Zealand; the liberals refer to The Liberal Party of Canada in Canada, The Australian Labor Party in Australia, and The New Zealand Labour Party in New Zealand.

TABLE 1 Cases by Transaction Types

	Creation		Trading		Substitution			
		Percent of total		Percent of total		Percent of total		
Total number of cases	223		65	29%	32	14%	126	57%
		Percent of total		Of all cases in favour of government		Of all cases in favour of government		Of all cases in favour of government
In favour of government	128	57%	50	39%	23	18%	55	43%
	Number of cases	Percent of total	Number of cases	Of cases of country	Number of cases	Of cases of country	Number of cases	Of cases of country
New Zealand	28	13%	13	46%			15	54%
Canada	99	44%	22	22%	21	21%	56	57%
Australia	96	43%	30	31%	11	11%	55	57%
		Of cases in favour of government		Of cases in favour of government of country		Of cases in favour of government of country		Of cases in favour of government of country
New Zealand	25	89%	11	44%			14	56%
Canada	48	48%	16	33%	15	31%	17	35%
Australia	55	57%	23	42%	8	15%	24	44%

4. a rough proxy of the country's national political climate at the time when each judge was appointed (judges appointed when conservatives were in power as the base category versus judges appointed when liberals were in power); and
5. the gender of each judge (male judges as the base category versus female judges (given the nature of the raw data available, only male and female gender categories were coded)).

The continuous covariate was the judicial experience of each judge, as represented by the number of years that the judge had accumulated on the bench at the time when a case was decided. Judicial experience is measured from when the judge was first appointed as a judge.

The Variables Coded

A total of 455 votes were cast in the three groups of cases, of which 252 (55 percent) were in substitution cases, 135 (30 percent) in creation cases, and 68 (15 percent) in trading cases. The distribution reflects the dominance of votes in substitution cases in Australia and Canada. The New Zealand dataset, which records no vote in a trading case, shows a 51-49 split between votes in creation and substitution cases.

In terms of the gender of judges, in New Zealand, male judges cast 63 (88 percent) of the total votes, as table 2 shows.

Table 2 also shows that 66 of 72 votes (92 percent) were cast for the government. Of the 66 votes, 33 (or 50 percent) were cast by judges appointed when conservatives were in power, and 23 (or 35 percent) were cast by male judges who cast their votes in substitution cases that were decided when conservatives were in power.

In Canadian cases, 94 (50 percent) of 187 votes were cast in substitution cases, while the rest of the votes were split between 45 trading cases (24 percent), and 48 creation cases (26 percent). Male judges cast 132 (71 percent) of the 187 votes. As shown in table 3, 105 (or 56 percent) of 187 votes were cast for the government. Of 94 votes in the substitution cases, 66 (70 percent) were cast not for the government, while most votes in trading cases (39 of 45: 87 percent) and creation cases (38 of 48: 79 percent) were cast for the government. Among the votes cast not for the government in substitution cases, male judges who decided cases when liberals were in power in the federal government accounted for 30 of 66 votes (46 percent). Among the votes cast for the government in trading cases, male judges who decided cases when liberals were in power in the federal government accounted for 23 of 39 (59 percent). Among the votes cast for the government in creation cases, male judges who decided cases when conservatives were in power accounted for 20 of 28 (53 percent).

In Australian cases, 123 of 196 votes (62.8 percent) were cast in substitution cases, while 50 of the 196 (25.5 percent) were cast in creation cases, and 23 (11.7 percent) in trading cases. Male judges cast 169 the 196 votes (86 percent). As shown in table 4, 110 of 196 votes (56 percent) were cast for the government.

Of the 123 votes in the substitution cases, 66 (54 percent) were cast not for the government, and that is the opposite of votes in other cases—39 of 50 (78 percent)

TABLE 2 Votes Cast by New Zealand Judges by Transaction Types, Politics, and Gender

Transaction type	Appointed when _____ were in power in the federal government	Votes cast when _____ were in power in the federal government	Votes cast not for the government			Votes cast for the government		
			Male	Female	Total	Male	Female	Total
Substitution	Conservatives	Conservatives				16	1	17
		Liberals				3		3
	Liberals	Total				19	1	20
		Conservatives	1	1	2	7	2	9
		Liberals				4		4
Creation	Conservatives	Total	1	1	2	11	2	13
			1	1	2	30	3	33
	Liberals	Conservatives				3	1	4
		Liberals	2	1	3	8	1	9
		Total	2	1	3	11	2	13
Total	Conservatives	Conservatives	1		1	9	2	11
		Liberals				9		9
	Liberals	Total	1		1	18	2	20
			3	1	4	29	4	33
			4	2	6	59	7	66

TABLE 3 Votes Cast by Canadian Judges by Transaction Types, Politics, and Gender

Transaction type	Appointed when _____ were in power in the federal government	Votes cast when _____ were in power in the federal government	Votes cast not for the government			Votes cast for the government		
			Male	Female	Total	Male	Female	Total
Substitution.....	Conservatives	Conservatives	9	6	15	7	2	9
		Liberals	16	4	20	4	2	6
	Liberals	Total	25	10	35	11	4	15
		Conservatives	9	5	14	4	2	6
		Liberals	14	3	17	6	1	7
Creation.....	Conservatives	Conservatives	23	8	31	10	3	13
		Liberals	48	18	66	21	7	28
	Liberals	Total	1	1	2	9	3	12
		Conservatives	2	1	3	1	2	3
		Total	3	2	5	10	5	15
Trading.....	Conservatives	Conservatives	1	2	3	11	9	20
		Liberals	1	1	2	1	2	3
	Liberals	Total	2	3	5	12	11	23
		Conservatives	5	5	10	22	16	38
		Total	3	3	6	3	3	6
Total.....	Conservatives	Conservatives	3	1	4	31	10	39
		Liberals	3	3	6	74	33	105
	Liberals	Total	2	1	3	18	7	23
		Conservatives	5	1	6	3	2	5
		Total	58	24	82	74	33	105

TABLE 4 Votes Cast by Australian Judges by Transaction Types, Politics, and Gender

Transaction type	Appointed when _____ were in power in the federal government	Votes cast when _____ were in power in the federal government	Votes cast not for the government			Votes cast for the government																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																					
			Male	Female	Total	Male	Female	Total																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
Substitution	Conservatives	Conservatives Liberals	6 24	2 10	8 34	10 8	1 4	11 12																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Total	30	12	42	18	5	23																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Liberals	Conservatives Liberals	11 11	1 1	12 12	24 8	2 8	26 8																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																		
	Total		22	2	24	32	2	34																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
	Total		52	14	66	50	7	57																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
Creation	Conservatives	Conservatives Liberals	1 3	1	2 3	10 7	1 1	11 8																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Total	4	1	5	17	2	19																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Liberals	Conservatives Liberals	5 1		5 1	16 3		16 4																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																		
	Total		6		6	19	1	20																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
	Total		10	1	11	36	3	39																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
Trading	Conservatives	Conservatives Liberals	1		1 1	2 3		2 3																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Total	1	1	2	5		5																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
		Liberals	Conservatives Liberals	3 3		3 4	8 1		8 1																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																		
	Total		6	1	7	9		9																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
	Total		7	2	9	14		14																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																			
Total																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																											

were cast for the government in creation cases; and 14 of 23 (61 percent) for the government in trading cases. Among the votes cast not for the government in the substitution cases, male judges who decided cases when liberals were in power accounted for 35 of the 66 votes (53 percent). Among the votes cast for the government in the creation cases, male judges who decided cases when conservatives were in power accounted for 26 of the 39 votes (67 percent). Among the votes cast for the government in the trading cases, male judges who decided cases when conservatives were in power accounted for 10 of the 14 votes (71 percent).

The votes in the cases were cast by 185 judges of varying years of experience on the bench when they decided a case, ranging from six who had just been appointed and one who had had 35 years on the bench. Figure 1 displays the distribution of judicial experience in box plots.

In total, the median experience of the 185 judges when they decided the cases was about 11 years. Half of them—from the 25th percentile to the 75th percentile—had been on the bench from 6 to 16 years. The experience of the 50 NZ judges ranged from newly appointed to 33 years on the bench, with a median of 14 years of experience. Half of these NZ judges had been on the bench from 8 to 18 years. The 65 Canadian judges' experience on the bench ranged from newly appointed to 35 years on the bench, with a median of 12 years' experience. Half of these judges had been on the bench from 8 to 17 years. The experience of the 70 Australian judges ranged from newly appointed to 26 years, with a median of 9 years. Half of these Australian judges had been on the bench from 4.5 to 15 years.

In sum, although judges of the three countries, considered as three different groups, appeared to share a similar profile of experiences when cases were decided, and although most of them were male, they appeared to decide cases of different transaction types (according to the Edgar typology) differently. In particular, the NZ picture appears to look quite different from the Canadian and Australian pictures. In New Zealand, for example, most of the votes cast in substitution cases were for the government, while in Canada and Australia, most of the votes cast in substitution cases were not for the government. That said, the Canadian and Australian pictures look different from each other, too, although the difference is of a more nuanced nature. For example, most of the votes cast for the government in trading cases in Canada were cast when liberals were in power in the federal government, while most of the votes cast for the government in trading cases in Australia were cast when conservatives were in power.

Exploring Influences of the Edgar Typology in Judicial Decision Making

Given that the unit of analysis was the votes cast by the judges and that the analytical approach was to examine judicial voting patterns according to transaction types, we ran three different logistic regression models regressing judicial votes on transaction with robust standard errors. The objective was to compare the influences of transaction types on judicial decision making in three different settings. The results are shown in table 5.

FIGURE 1 Distribution of Judicial Experiences When Cases Were Decided in the Three Countries

Model 1 compared (1) the influence of the creation type of transaction on judicial decision making with the influence of the substitution type (creation versus substitution) and (2) the influence of the trading type of transaction with the influence of the substitution type (trading versus substitution). Compared with votes in substitution cases, votes in creation and trading cases were more likely to be cast for the government, with creation votes more likely to be cast for the government than trading votes. Model 1 did not take into consideration that the votes were cast in different countries and that some judges voted in multiple cases.

Building on model 1, model 2 compared, in different countries, (1) the influences of the creation type with those of the substitution type and (2) the influences of the trading type with those of the substitution type. Compared with votes in substitution cases, votes in trading and creation cases were more likely to be cast for the government, with trading votes more likely to be cast for the government than were creation votes. Model 2 did not take into consideration that some judges voted in multiple cases.

The change in the degree of the influences of trading type and creation type in model 2 relative to model 1 can be attributed to the fact that model 2 took into account that the votes were cast in different countries.

Wider in scope than model 1, model 2 took into consideration the impact of different countries in its examination of the influences of transaction types, and it

TABLE 5 Comparing Influences of Transaction Types in Different Settings

	Model 1	Model 2	Model 3
Creation versus substitution	1.609*** [0.255]	1.403*** [0.273]	1.448*** [0.257]
Trading versus substitution	1.389*** [0.319]	1.892*** [0.371]	1.849*** [0.367]
Canada versus New Zealand		-2.274*** [0.485]	-2.195*** [0.493]
Australia versus New Zealand		-2.053*** [0.478]	-1.923*** [0.483]
Liberals versus conservatives in power when a case was decided		-0.936*** [0.229]	-1.092*** [0.315]
Liberals versus conservatives in power when a judge was appointed			-0.139 [0.287]
Liberals in power when a case was decided by a judge appointed when liberals in power versus other scenarios			0.355 [0.444]
Female versus male			-0.452 [0.274]
Years on the bench			0.0366* [0.0180]
Number of votes	455	455	455

Standard errors in brackets.

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$.

did so by comparing the jurisdiction of Canada with that of New Zealand (Canada versus New Zealand) and the jurisdiction of Australia with that of New Zealand (Australia versus New Zealand). Compared with votes in NZ cases, votes in Canada and Australia were less likely to be cast for the government, with votes in Canadian cases less likely to be cast for the government than votes in Australian cases.

In considering the differences between countries in a comparison of the influences of transaction types, a rough proxy of the national political climate when cases were decided was included in model 2. In comparing how votes were cast when liberals were in power with how they were cast when conservatives were in power (liberals versus conservatives in power when a case was decided), it was found that votes cast when liberals were in power were less likely to be for the government than votes cast when conservatives were in power.

Building on model 2, model 3 compared the influences of the creation transaction type with those of the substitution type, and the influences of the trading type with those of the substitution type, in different countries with different judges.

As in model 2, votes in trading and creation cases were more likely than votes in substitution cases to be cast for the government, with trading votes more likely than creation votes to be cast for the government. Also in model 3, as in model 2, national factors were considered, and the national results in model 3 were similar to those in model 2. Votes in Canada and Australia were less likely than votes in New Zealand to be cast for the government, with votes in Canadian cases less likely to be cast for the government than votes in Australian cases. Votes in cases decided when liberals were in power were less likely to be cast for the government than votes in cases decided when conservatives were in power.

Unlike model 2, model 3 considered four judicial attributes.¹²⁹ The first of these was the national political climate of the country when a judge was first appointed. A rough proxy (liberals versus conservatives in power when a judge was appointed) was used. Votes cast by judges appointed when liberals were in power were less likely to be cast for the government than votes cast by judges appointed when conservatives were in power, but model 3 finds that sheer chance could have been a factor in this pattern.

The second judicial attribute considered was a combination of the national political climate when a case was decided and the national political climate when a judge was appointed. A special scenario—liberals in power when a case was decided by a judge appointed when liberals were in power versus other scenarios—was considered. Votes cast by liberal-appointed judges deciding cases when liberals were in power in the federal government were more likely to be cast for the government, relative to other scenarios, but model 3 finds that sheer chance could have been a factor in this pattern.

The third attribute considered was the gender of judges. Votes cast by female judges were less likely than votes cast by male judges to be for the government, but model 3 finds that sheer chance may have been a factor in this pattern. The influence of gender could become more prominent when more female judges are appointed. Male judges dominated the judiciary in each country. Female judges seem to have voted just like their male counterparts insofar as more of them voted for the government than not for the government, except in Australia. In Australia, 100 of the 169 votes cast by male judges were cast for the government, while 69 were cast not for the government. But of the 27 votes cast by female judges, only 10 were cast for the government, with 17 cast not for the government. Because of the small number of votes cast by female judges in this comparative context, the fact that more votes by female judges were cast not for the government in such a case could not have changed any general voting patterns. But if there had been more female judges, at least in Australia, the general voting patterns could have looked quite different.

129 The analysis in model 3 was set up to recognize that some judges cast more than one vote, and each vote she or he cast was cast by the same judge. In other words, this full model clustered on individual judges, taking into the repeated-measures consideration of the fact that a judge who cast more than one vote was the same individual who cast those votes.

The fourth judicial attribute considered was the judges' years on the bench. Votes cast by judges with more years on the bench were more likely to be for the government than were votes cast by judges with fewer years on the bench, and model 3 finds that the influence of judicial experience is not random.

The modelling in our study, culminating in the full model shown in model 3, illustrates the essence of Edgar's typology of transaction types. The selected data show that judges in different countries appeared to have decided tax-avoidance cases of different transaction types differently. Female and male judges with different numbers of years on the bench deciding cases in environments with different political undercurrents might have decided cases differently, but such patterns could be owing to chance. The focus of the above exposition is not on the details, such as the actual magnitude of the effects in the logistic regressions; the focus, rather, is the hints the typology can offer as to the direction of judicial decision making. Such hints can be expanded and transformed into a visualization of what judicial decision making might look like in different hypothetical settings.

Using model 3, simulations were performed to sketch out hypothetical judicial voting patterns. Figure 2 shows the simulated patterns in substitution, creation, and trading cases, in different countries under different national political climates, decided by judges whose judicial experience varied in length.

Three conjectures are visualized according to the simulated voting patterns based on model 3. First, in all three countries, judges with differing degrees of judicial experience are expected to be more likely to vote for the government in trading cases than in creation cases, and the judges are expected to be more likely to vote for the government in creation cases than in substitution cases. Second, across all transaction types, judges in some countries, such as New Zealand, are expected to be more likely to vote for the government than judges in other countries (such as Australia) with the same number of years on the bench, and judges in countries such as Australia are expected to be more likely to vote for the government than judges in countries like Canada who have the same number of years on the bench. Third, the two conjectures above are expected to hold even in the context of different political undercurrents—for example, regardless of whether liberals or conservatives are in power in the federal government when a case is decided. One extrapolation from these conjectures could be stated as follows: judges from the three countries that are at the same point in their respective judicial careers may be expected to be more likely to vote for the government in trading cases than in creation cases, and to be more likely to vote for the government in creation cases than in substitution cases.

NORMATIVE IMPLICATIONS FOR BUILDING A BETTER GAAR

The statistical results offer some modest insights that might be of use in advancing Edgar's conceptual framework for building a better GAAR. Considered together with the doctrinal analysis in the foregoing sections of this paper, these insights have some normative implications.

FIGURE 2 Simulated Judicial Voting Patterns Based on Model 3

Transaction Types and Institutional Competencies of the Judiciary

The GAAR provisions in Canada, Australia, and New Zealand do not identify tax avoidance by transactional types. They are drafted as a standard to be used in overriding the application of primary provisions relied on by the taxpayer in obtaining a tax benefit. In applying the standard, the judiciary must (1) characterize the legal relationships created by the parties to the relevant transactions, (2) characterize the purpose of the transaction(s) as primarily tax-driven or not, and (3) finally interpret and apply the relevant statutory provisions that supposedly provide the tax benefit accessed by the tax-driven transaction(s). The history of the GAAR provisions in these three countries suggests that they were enacted primarily to force a reluctant judiciary to engage in “what is a more explicitly policy-based approach to the statutory interpretation exercise in a tax-avoidance context.”¹³⁰

Our empirical results show that judges in Canada and Australia applied GAAR (votes cast for the government) in more cases involving tax-attributes creation and tax-attributes trading than in transactional substitutional cases: Canada—16/22 in creation cases, 15/21 in trading cases, but 17/56 in substitution cases; Australia—23/30 in creation cases, 8/11 in trading cases, but 24/55 in substitution

130 Edgar, “Building a Better GAAR,” *supra* note 1, at 878.

cases. The result in New Zealand shows that judges mostly rule for the government in creation cases (11/13) and substitution cases (14/15). There were no NZ trading cases in the dataset.

Although this evidence does not directly speak to the institutional competency of the judiciary in identifying tax avoidance in tax-attributes creation and tax-attributes trading cases, it suggests that a greater proportion of the cases brought forward by the government were validated by the courts. The institutional competency of the judiciary in characterizing the fact pattern presented by a particular transaction and applying the appropriate tax consequences of such characterization does not seem to be affected by gender.¹³¹ In other words, GAAR was more effective in these two types of transactions. One possible explanation for this result is that more “perfect” information is available to judges when they are deciding whether a tax attribute is created or traded, and this is the case because the impugned statutory provisions are more susceptible to general statutory interpretation (that is, the type of statutory interpretation the judiciary is charged to do in other areas of the law). The same is not true of substitution cases, in which the taxpayer takes advantage of gaps or legislative deficiencies. The judges in these cases, in order to apply GAAR, must perform some policy-making functions through the exercise of statutory interpretation.

The statistical result seems to lend support to Edgar’s claim that the legislature and executive branches have more institutional competency than the judiciary when it comes to responding to the transactional substitution type of cases and should provide “a legislative means to identify (relatively easily) the range of problematic tax-avoidance transactions without relying on the courts to perform this necessary function in an interpretative role.”¹³²

Role of Statutory Interpretation

GAAR was meant to force the judiciary to interpret tax law provisions in such a manner as to balance (1) taxpayers’ right to choose transactional forms and shape to minimize taxation under the *Duke of Westminster* principle and (2) the government’s right to protect the public interest by neutralizing the negative externalities of tax avoidance.

The empirical evidence suggests that the judiciary in New Zealand was more willing to apply GAAR than the judiciary in Australia and Canada, which seems to suggest that GAAR can be effective through reliance on the judiciary’s “unshackled” exercise of statutory interpretation. The difference between the Canadian approach, which requires both a taxpayer’s tax-avoidance purpose and Parliament’s purpose, and the Australian approach, which emphasizes the taxpayer’s purpose, may explain why judges in Canada were less likely to apply GAAR. In other words, the statutory requirement that judges characterize both the taxpayer’s purpose and Parliament’s

131 It is a mystery to us, though, why the judges in New Zealand appeared to have behaved differently in applying the GAAR in substitution cases.

132 Edgar, “Building a Better GAAR,” *supra* note 1, at 904.

purpose makes it more difficult for GAAR to apply in Canada than in Australia. The required twinning of legislative purpose and taxpayer's purpose in the triggering of the Canadian GAAR may give the Supreme Court of Canada reason to say that the *Duke of Westminster* principle co-exists with GAAR, in spite of the fact that the traditional judicial doctrines that underlie the principle (that is, characterizing transactions and interpreting statutory provisions without consideration of the business purpose of the taxpayer and the purpose of Parliament) were the very reasons for the enactment of GAAR.

To make the Canadian GAAR more effective, especially in respect of transactional substitution cases, Canada can consider following the NZ model, by dropping the abuse test; or the Australian model, by adopting a statutory economic substance test. The GAAR's success rate was 25/28 in New Zealand, 55/96 in Australia, and 48/99 in Canada. However, the Australian experience demonstrates the challenges of applying the economic substance test in substitution cases. By requiring the identification of a counterfactual and the eight factors in substitution cases, the Australian GAAR ignores the fact that such transactions may not have counterfactuals because these transactions tend to be innovative, involving hybrid transactions or synthetic replication of higher-taxed transactions. There is some validity in Tim Edgar's claim that it is "utterly hopeless to leave it to the judiciary to articulate a behavioral prohibition . . . in its identification of prohibited transactions" because "trained as lawyers, and not public policy analysts, judges (and the lawyers appearing before them) simply do not have the institutional competence to execute this important task."¹³³

Incorporating Economic Substance into the Canadian GAAR

Given the history of GAAR and judicial behaviour, it is unlikely that Canada will remove the statutory abuse test and adopt the NZ model. To make the Canadian GAAR more effective in targeting transactional substitution cases, we second Edgar's idea of incorporating an economic substance test and making it easier for judges to apply GAAR. In essence, the idea was to use the economic substance test in two nuanced ways: (1) as a primary business purpose test for the creation and trading transactions; and (2) as tantamount to a synthetic replication of a higher-taxed transaction in substitution cases. The primary business purpose test would be similar to the eight-factor test in the Australian GAAR. The synthetic replication notion was apparently akin to the Australian counterfactual approach.

The building of statutory economic substance tests into GAAR would be consistent with the notion that tax laws are meant to apply to transactions with economic and commercial substance, and with the judicial consensus that the vacuity and artificiality of transactions attract the application of GAAR. Such a GAAR would be more like a SAAR in specifically prescribing the prohibited transactions and reducing the need for judicial exercise in statutory interpretation.

133 Ibid., at 837.

Statutory interpretation would still play a role in characterizing the type of avoidance transactions and applying the economic substance test. In the context of creation and trading cases, if a transaction's primary purpose is found to be obtaining a tax benefit, the next step for the courts is to determine whether that benefit is explicitly sanctioned by the specific provisions relied on by the taxpayer in obtaining the tax benefit. Typically, such provisions would be tax expenditure provisions that set out eligible conditions for the tax relief in the form of deductions, exemptions, or deferrals. In substitution cases, the absence of economic substance alone is sufficient to trigger GAAR, and there is no need for the courts to use GAAR to fill the legislative gaps through the exercise of statutory interpretation. However, if a substitution transaction involves the creation or transfer of a tax attribute, statutory interpretation is required to establish whether such creation or transfer of tax attributes is intended to be a means of providing a tax relief.

Applying the statutory economic substance tests to the four Supreme Court GAAR cases would result in no change to the outcomes of *Mathew*, *Lipson*, and *Copthorne*. In *Mathew*, the tax-attribute trading transaction lacked economic substance, and the benefit of loss deduction by the taxpayer was not explicitly sanctioned by any provisions of the ITA. In *Lipson* and *Copthorne*, a higher-taxed alternative (non-deduction of the mortgage interest in *Lipson* and elimination of the paid-up capital in a subsidiary upon a vertical amalgamation in *Copthorne*) would be the counterfactual and used to deny the tax benefit arising from the substituted transactions. On the other hand, the outcome of *Canada Trustco* might have been different if the economic substance tests had been applied. The transactions in *Canada Trustco* are substitution transactions involving the creation of a tax attribute—that is, deduction of the capital cost allowance (CCA). Because of the specified leasing property rules that treat, in effect, a sale-leaseback transaction as a financing transaction, with the exception of several types of property, such as trailers, the transactions in *Canada Trustco* substituted a lending transaction for tax purposes with a sale-leaseback transaction, thus qualifying for the CCA. Accordingly, the CCA tax attribute can be considered to be the result of the avoidance transaction.¹³⁴

In conclusion, our doctrinal and empirical analysis of the GAAR provisions in action in Canada, Australia, and New Zealand provides some modest support for Tim Edgar's conceptual framework. If GAAR could be amended to incorporate specific economic substance tests to target different types of avoidance transactions, greater certainty and predictability in the application of the rule would result.

134 Specified leasing rules in section 1100(1.1)-(1.13) of the regulations.

General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's "Building a Better GAAR"

David G. Duff*

PRÉCIS

Outre l'exigence de la réalisation d'un avantage fiscal, l'application de la plupart des règles générales anti-évitement modernes repose sur deux éléments : ce qu'on appelle un « élément subjectif » qui tient compte de l'objet de l'opération entreprise ou de l'entente conclue donnant lieu à l'avantage fiscal; et un « élément objectif » qui tient compte du but ou de l'objet des dispositions pertinentes pour déterminer si l'avantage fiscal résultant de l'opération ou de l'entente est ou non compatible avec ce but ou cet objet.

Bien que ces deux éléments soient présents dans la plupart des RGAE modernes, la fonction de chaque élément dans ces règles et la relation entre eux sont souvent mal comprises. D'autres questions non résolues concernent les rôles du caractère artificiel et de la substance économique dans l'application de ces règles, et la relation, le cas échéant, entre ces concepts et les éléments « subjectif » et « objectif » des règles. Une dernière série de questions concerne l'incertitude que les RGAE peuvent engendrer, la capacité des juges à appliquer ces règles et principes de manière cohérente et constante, et la compatibilité de ces règles et principes avec la règle de droit.

Cet essai aborde ces questions en examinant l'article de Tim Edgar « Building a Better GAAR ». La partie I examine la justification d'une règle ou d'un principe général anti-évitement, en faisant valoir que cette règle ou ce principe représente non seulement une réponse politique utile aux conséquences néfastes de l'évitement fiscal (l'argument conséquentialiste que le professeur Edgar a fait sien), mais qu'il peut également se justifier d'un point de vue non conséquentialiste voulant qu'il protège l'intégrité des dispositions visées et respecte ainsi la règle de droit. La partie III s'appuie sur cette analyse pour examiner la conception d'une règle ou d'un principe général anti-évitement, en soutenant que cette règle ou ce principe devrait être codifié sous la forme d'une règle explicite, qu'il devrait inclure des éléments subjectif et objectif comme les

* Professor of Law and Director, Tax LLM Program, Peter A. Allard School of Law, University of British Columbia. This essay develops and expands on remarks presented at Re-Imagining Tax for the 21st Century: A Conference Inspired by the Scholarship of Tim Edgar, Osgoode Hall Law School, Toronto, on February 8-9, 2019. I am grateful to the organizers of the conference, particularly Jinyan Li, for inviting me to participate in this event to honour Tim's legacy, and above all to Tim himself—a friend and colleague, whose work on GAAR encouraged me to develop my own thinking on the subject.

exigences en matière d'objet et de détournement ou d'abus dans la RGAE canadienne, et qu'il devrait se fonder sur les concepts de caractère artificiel et de substance économique qui s'appliquent respectivement aux éléments subjectif et objectif de la règle. La partie IV présente la conclusion.

ABSTRACT

In addition to the requirement of a tax benefit or advantage, the application of most modern general anti-avoidance rules (GAARs) turns on two elements: a “subjective element,” which considers the purpose for which the transaction or arrangement resulting in the tax benefit or advantage was undertaken or arranged; and an “objective element,” which considers the object or purpose of the relevant provisions to determine whether the tax benefit resulting from the transaction or arrangement is consistent with this object or purpose.

Although these two elements are present in most modern GAARs, the function of each element within these rules and the relationship between them are often poorly understood. Other unresolved issues concern the roles of artificiality and economic substance in the application of these rules, and the relationship, if any, between these concepts and the “subjective” and “objective” elements of the rules. A final set of issues involves the uncertainty that GAARs may engender, the ability of judges to apply these rules and principles in a coherent and consistent manner, and the compatibility of these rules and principles with the rule of law.

The author addresses these issues by reflecting on Tim Edgar’s article “Building a Better GAAR.” The first part of the paper considers the rationale for a general anti-avoidance rule or principle, arguing that such a rule not only represents a useful policy response to the harmful consequences of tax avoidance (the consequentialist argument that Professor Edgar espoused), but also may be justified on the non-consequentialist grounds that it protects the integrity of the provisions at issue and thereby upholds the rule of law. In the second part of the paper, the author builds on this analysis to consider the design of a general anti-avoidance rule or principle, arguing that it should be codified in the form of an explicit rule, should include subjective and objective elements such as the “purpose” and “misuse or abuse” requirements in the Canadian GAAR, and should be informed by concepts of artificiality and economic substance that apply to, respectively, the subjective and objective elements of the rule.

KEYWORDS: AVOIDANCE ■ ANTI-AVOIDANCE ■ GAAR ■ GENERAL ANTI-AVOIDANCE RULE

CONTENTS

Introduction	581
Rationale	584
Consequentialist Arguments	584
Non-Consequentialist Arguments	589
Design	591
Codification	591
Subjective and Objective Elements	593
Purpose Test	593
Misuse or Abuse Test	602
Conclusion	610

INTRODUCTION

In addition to the existence of a tax benefit, which is generally quite easy to establish,¹ application of the Canadian general anti-avoidance rule (GAAR) turns on two elements: (1) a purpose test that excludes transactions that may reasonably be considered to have been undertaken or arranged primarily for bona fide non-tax purposes,² and (2) a misuse or abuse test providing that GAAR applies only to transactions that may reasonably be considered to result directly or indirectly in a misuse of specific provisions of the ITA or other relevant enactments or an abuse having regard to these provisions read as a whole.³ These two elements appear in most other modern GAARs,⁴ including the United Kingdom's general anti-abuse rule enacted in 2013,⁵ and

1 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA"), subsection 245(1), defining a "tax benefit" as "a reduction, avoidance or deferral of tax or other amount payable under this Act or an increase in a refund of tax or other amount under this Act" including where these tax consequences result from the application of a tax treaty. Although this language suggests that a tax benefit should be assessed in comparison to a "benchmark" transaction or arrangement that might reasonably have been undertaken or arranged but for the existence of the tax benefit, the Supreme Court of Canada lowered the threshold for a tax benefit in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 20, stating that a deduction always results in a tax benefit "since a deduction results in [the] reduction of tax." According to the Federal Court of Appeal, on the other hand, a tax attribute like paid-up capital must be realized in the form of a reduction in tax before it constitutes a tax benefit under the ITA: *Wild*, sub nom. *1245989 Alberta Ltd. v. Canada (Attorney General)*, 2018 FCA 114. As well, where the tax benefit results from a series of transactions, the characterization of this series can also be at issue, although, here again, the Supreme Court of Canada has lowered the threshold to some extent by adopting a broad interpretation of the extended definition of a series of transactions in subsection 248(1) to include related transactions completed before or after an ordinary series. See, for example, *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraphs 42–64.

2 ITA subsection 245(3).

3 ITA subsection 245(4).

4 For a recent survey, see Michael Lang et al., eds., *GAARs—A Key Element of Tax Systems in the Post-BEPS World* (Amsterdam: IBFD, 2016). Two notable exceptions are the New Zealand GAAR, which dates back to the 19th century but was substantially amended in 1974, and the Australian GAAR, which also dates back to the 19th century but was substantially amended in 1981. In New Zealand, courts have effectively created a misuse or abuse test through a "parliamentary contemplation test" that asks "whether the impugned arrangement, viewed in a commercially and economically realistic way, makes use of the specific provision in a manner that is consistent with Parliament's purpose." See *Ben Nevis Forestry Ventures Ltd v. Commissioner of Inland Revenue*, [2008] NZSC 115, at paragraph 109. For a useful discussion of the New Zealand GAAR, see Craig Elliffe, "Policy Forum: New Zealand's General Anti-Avoidance Rule—A Triumph of Flexibility Over Certainty" (2014) 62:1 *Canadian Tax Journal* 147–64. In Australia, a narrow exception from the definition of a "tax benefit" excludes the non-inclusion of income, the allowance of a deduction, the incurring of a capital loss or allowance, or a foreign tax credit that is "attributable to the making of an agreement, choice, declaration, election or selection, the giving of a notice or the exercise of an option expressly provided for" in the tax legislation—provided that "the scheme was not entered into or carried out by any person for the purpose of creating any circumstance or state of affairs the existence

(Notes 4 and 5 are continued on the next page.)

the principal purpose test (PPT) in the Organisation for Economic Co-operation and Development (OECD) model convention and the multilateral instrument (MLI),⁶ as well as general anti-avoidance principles (GANTIPS) such as the OECD's "guiding principle" on tax treaty abuse, on which the PPT is based,⁷ and the anti-abuse principle developed by the European Court of Justice and subsequently codified in a European Council Directive laying down rules against tax-avoidance practices that directly affect the functioning of the internal market.⁸

of which is necessary to enable the declaration, agreement, election, selection, choice, notice or option to be made, given or exercised, as the case may be." See Income Tax Assessment Act 1936, No. 27, 1936, (herein referred to as "the Australian GAAR"), sections 177C(2)(i) and (ii). For a useful comparison of the Canadian and Australian GAARs, see Julie Cassidy, "To GAAR or Not To GAAR—That Is the Question: Canadian and Australian Attempts To Combat Tax Avoidance" (2005) 36:2 *Ottawa Law Review* 259-313.

- 5 Finance Act 2013 (UK), 2003, c. 29 (herein referred to as "the UK GAAR"), sections 206 to 215, which applies to "tax arrangements that are abusive" and in which a "tax arrangement" is defined as an arrangement if, having regard to all the circumstances, it would be reasonable to conclude that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangement, and a tax arrangement is considered to be "abusive" if "the entering into or carrying out of the [tax arrangement] cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances including—(a) where the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions, (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and (c) whether the arrangements are intended to exploit any shortcomings in those provisions." See Judith Freedman, "Designing a General Anti-Abuse Rule: Striking a Balance" (2014) 20:3 *Asia-Pacific Tax Bulletin* 167-73, at 170.
- 6 Article 29(9) of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Condensed Version* (Paris: OECD, November 2017) (herein referred to as "the OECD model convention"); and article 7(1) of Organisation for Economic Co-operation and Development Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting, released on November 24, 2016 (herein referred to as "the MLI"). According to this provision, a benefit under the convention "shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."
- 7 According to this principle, "the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions." This principle was added to paragraph 9.6 of the commentary on article 1 of Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital* (Paris: OECD, January 2003) (herein referred to as "the 2003 OECD model convention"). The same text appears in paragraph 61 of the commentary on article 1 of the current OECD model convention.
- 8 See article 6(1) of European Union, Council Directive 2016/1164/EU of 12 July 2016, Laying Down Rules Against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market, OJ L 193/1, July 19, 2016, which provides that Member States shall,

As a result, like most modern GAARs and GANTIPs, the Canadian GAAR includes a "subjective element" concerning the purpose of the transaction or arrangement that results in a tax benefit, and an "objective element" regarding the misuse or abuse of relevant provisions.⁹ While the first element demands an inquiry into the purposes for which the transaction was undertaken or arranged in order to determine the extent to which tax considerations played a role, the second involves an interpretive exercise to determine whether the tax benefit resulting from the transaction or arrangement is (or is not) consistent with the object, spirit, or purpose of the relevant provisions.¹⁰

Although these two elements are present in most modern GAARs and GANTIPs, the function of each element within these rules and principles and the relationship between these elements is often poorly understood. Some commentators, for example, have questioned the need for the first element,¹¹ while others have challenged the scope of the second.¹² Other unresolved issues concern the roles of

for the purpose of calculating corporate tax liability, "ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances." As explained by Rita de La Feria, "EU General Anti-(Tax) Avoidance Mechanisms," in Glen Loutzenhiser and Rita de la Feria, eds., *The Dynamics of Taxation: Essays in Honour of Judith Freedman* (Oxford, UK: Hart, 2020), this directive codifies the principles established in leading judgments of the European Court of Justice, including in particular *Halifax plc*, *Leeds Permanent Development Services Ltd.*, *County Wide Property Investments Ltd. v. Commissioners of Customs & Excise*, Case C-255/02; [2006] ECR I-1609; and *Cadbury Schweppes plc*, *Cadbury Schweppes Overseas Ltd. v. Commissioners of Inland Revenue*, Case C-196/04; [2006] ECR I-7995. For further discussions of these cases, see Rita de la Feria, "Prohibition of Abuse of (Community) Law—The Creation of a New General Principle of EC Law Through Tax" (2008) 45:2 *Common Market Law Review* 395-442; and Judith Freedman, "The Anatomy of Tax Avoidance Counteraction: Abuse of Law in a Tax Context at Member State and European Union Level," in Rita de la Feria and Stefan Vogenauer, eds., *Prohibition of Abuse of Law: A New Principle of EU Law?* (Oxford, UK: Hart, 2011), 365-80 (<http://dx.doi.org/10.5040/9781472565570.ch-025>). The use of the acronym GANTIP rather than GAAP to characterize these principles was proposed by Judith Freedman in order to avoid confusion with the acronym for generally accepted accounting principles. See Judith Freedman, "Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle" [2004] no. 4 *British Tax Review* 332-57.

9 The language of "subjective" and "objective" elements appears in the European Court of Justice decision in *Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas*, Case C-110/99; [2000] ECR I-11569. As explained in text accompanying *infra* notes 85-112, the so-called "subjective element" is properly assessed objectively.

10 *Canada Trustco*, *supra* note 1, at paragraph 55.

11 See, for example, Michael Lang, "Cadbury Schweppes' Line of Case Law from the Member States' Perspective," in *Prohibition of Abuse of Law*, *supra* note 8, at 435-58 (<http://dx.doi.org/10.5040/9781472565570.ch-030>).

12 Tim Edgar, "Building a Better GAAR" (2008) 27:4 *Virginia Tax Review* 833-905. A condensed version of this article also appears as Tim Edgar, "Designing and Implementing a Target-Effective General Anti-Avoidance Rule," in David G. Duff and Harry Erlichman, eds., *Tax Avoidance in Canada After Canada Trustco and Mathew* (Toronto: Irwin Law, 2007), 221-58.

artificiality and economic substance in the application of GAARs and principles, and the relationship, if any, between these concepts and the subjective and objective elements. A final set of issues involves the uncertainty that GAARs and principles may engender, the ability of judges to apply these rules and principles in a coherent and consistent manner, and the compatibility of these rules and principles with the rule of law.

In this paper, I address these issues by reflecting on Tim Edgar's article "Building a Better GAAR,"¹³ which was published shortly after the Supreme Court of Canada's first GAAR decisions in *Canada Trustco* and *Matthew*.¹⁴ In the first part of the paper, I consider the rationale for a general anti-avoidance rule or principle, arguing that such a rule not only represents an important policy response to the harmful consequences of tax avoidance (the consequentialist argument that Professor Edgar espoused), but also may be justified on the non-consequentialist grounds that it protects the integrity of the provisions at issue and thereby upholds the rule of law. In the second part of the paper, I build on this analysis to consider the design of a general anti-avoidance rule or principle, arguing that it should (1) be codified in the form of an explicit rule, (2) include subjective and objective elements such as the purpose and misuse or abuse requirements in the Canadian GAAR, and (3) be informed by concepts of artificiality and economic substance that apply to, respectively, the subjective and objective elements of the rule.

RATIONALE

Most arguments in favour of general anti-avoidance rules and principles emphasize the adverse effects of tax avoidance on tax revenues, economic efficiency, fairness, and tax compliance, and the advantages of a broad standard to limit tax avoidance in addition to more detailed provisions and specific anti-avoidance rules. In addition to these consequentialist arguments, a non-consequentialist rationale for general anti-avoidance rules and principles emphasizes the integrity of the provisions that could otherwise be circumvented by transactions that are undertaken or arranged in order to obtain tax benefits. Below, I review these consequentialist and non-consequentialist arguments, concluding that collectively they form a compelling argument for general anti-avoidance rules and principles as a general overlay on specific tax provisions.

Consequentialist Arguments

As Professor Edgar notes, the "most obvious consequential attribute" of tax avoidance is the revenue losses attributable to the substitution of lower-taxed transactions or arrangements for higher-taxed alternatives.¹⁵ Not surprisingly, therefore, concerns

13 Ibid.

14 *Canada Trustco*, supra note 1; and *Matthew v. Canada*, 2005 SCC 55 (sometimes cited sub nom. *Kaulius v. The Queen*, 2005 DTC 5538 (SCC)).

15 Edgar, "Building a Better GAAR," supra note 12, at 844.

about revenue losses are often identified as a primary reason to introduce or strengthen measures such as statutory GAARs to combat tax avoidance.¹⁶

From a consequentialist perspective, however, the fact that tax avoidance reduces government revenues is not itself a good reason to limit this behaviour. On the contrary, some have argued that to the extent that government spending is excessive, at least some tax avoidance may be desirable as a way to reduce the size of government.¹⁷ Similarly, it could be argued that tax avoidance improves the overall efficiency or fairness of the tax system where governments replace forgone revenues from an avoided tax with revenues from a more efficient or otherwise more attractive tax.¹⁸ As a result, the consequentialist argument for anti-avoidance measures to prevent revenue losses necessarily turns either on the assumption that the size of government is optimal or suboptimal and that the tax system is efficient, or on the conclusion that tax avoidance is an inferior way to regulate government spending and promote a better tax system, compared with more direct methods of pursuing these objectives. Whatever one may think about the size of government and the efficiency of the current tax system, it seems reasonable to conclude that tax avoidance is not the best way to address these issues.¹⁹

In addition to revenue losses, tax avoidance can be economically costly, distorting the allocation of economic resources,²⁰ encouraging investments in activities that may be marginally profitable at best,²¹ and diverting scarce resources from productive activities and investments to "the development, marketing, implementation and

-
- 16 See, for example, South African Revenue Service, *Discussion Paper on Tax Avoidance and Section 103 of the Income Tax Act, 1962 (Act No. 58 of 1962)* (Pretoria: SARS, November 2005), at 9. For a relatively recent report that estimates the global revenue loss from corporate tax avoidance at \$500 billion, see Alex Cobham and Petr Janský, *Global Distribution of Revenue Loss from Tax Avoidance: Re-Estimation and Country Results*, WIDER Working Paper no. 2017/55 (Helsinki: United Nations University World Institute for Development Economics Research, March 2017).
 - 17 See, for example, Gary S. Becker and Casey B. Mulligan, "Deadweight Costs and the Size of Government" (2003) 46:2 *Journal of Law and Economics* 293-340. It is, of course, also possible that government spending is deficient or financed excessively by debt instead of taxation, in which case revenue losses from tax avoidance would only exacerbate these problems.
 - 18 See the discussion in David A. Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines" (2002) 4:1 *American Law and Economics Review* 88-115, at 110-13, emphasizing efficiency concerns rather than fairness considerations.
 - 19 See, for example, Joel Slemrod, "My Beautiful Tax Reform," in Alan J. Auerbach and Kevin A. Hassett, eds., *Toward Fundamental Tax Reform* (Washington, DC: American Enterprise Institute, 2005), 135-48, at 136, arguing that there are better ways to achieve spending restraint than "purposely running an inefficient tax system"; and Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," supra note 18, at 111, arguing that tax avoidance is "often an inefficient method of repealing the tax."
 - 20 See *Discussion Paper on Tax Avoidance*, supra note 16.
 - 21 Peter Groenewegen, "Distributional and Allocational Effects of Tax Avoidance," in David Collins, ed., *Tax Avoidance and the Economy* (Sydney: Australian Tax Research Foundation, 1984), at 23.

subsequent defence of impermissible tax avoidance schemes.”²² Moreover, where revenue losses lead to a reduction in worthwhile government expenditures, an inappropriate increase in government debt, or the collection of revenues from other, less efficient taxes, tax avoidance can result in indirect or second-order efficiency costs as well as direct efficiency costs.²³ In each case, anti-avoidance measures can help reduce these efficiency costs by deterring economically wasteful investments in tax-avoidance activities and improving the efficiency of the tax as a means of raising revenue.²⁴ For this reason, consequentialist arguments for general anti-avoidance rules and doctrines typically emphasize efficiency considerations as well as revenue concerns.²⁵

A third consequentialist argument for anti-avoidance measures such as GAARS concerns the distributional impact of tax avoidance, which is affected not only by the reduced taxes that are paid by taxpayers who are willing and able to avoid taxes, but also by lower government spending, increased government borrowing, and/or increased taxes paid by other taxpayers who are less willing or able to avoid taxes.²⁶ To the extent that tax and spending policies are intended to accomplish a measure of distributive fairness, tax avoidance undermines these distributive goals, resulting in an unfair shifting of the tax burden (typically to less affluent and less mobile taxpayers) and a less equitable distribution of economic resources more generally.²⁷ For this reason, as Professor Edgar also emphasizes, the adverse impact of tax avoidance on “the pattern of income/wealth distribution” is an additional justification for a statutory GAAR.²⁸

22 *Discussion Paper on Tax Avoidance*, supra note 16, at 11-12, citing Joel Slemrod and Shlomo Yitzhaki, “The Cost of Taxation and The Marginal Efficiency Cost of Funds” (1996) 43:1 *International Monetary Fund Staff Papers* 172-98.

23 As Professor Edgar explains, where tax avoidance involves the imperfect substitution of a lower-taxed transaction or arrangement for a higher-taxed alternative, the economic costs of this behaviour are both direct and indirect; where a lower-taxed transaction or arrangement is a perfect substitute for the higher-taxed alternative, on the other hand, first-order costs are absent and the economic costs of tax avoidance involve only second-order costs attributable to reduced government expenditures or the collection of revenues from less efficient taxes. Edgar, “Building a Better GAAR,” supra note 12, at 842-51.

24 See, for example, Weisbach, “An Economic Analysis of Anti-Tax-Avoidance Doctrines,” supra note 18, at 93, explaining that anti-avoidance doctrines reduce the ability of the taxpayer to shift into tax-avoidance activities, thereby reducing the marginal elasticity of the tax and improving its efficiency as a method of raising revenue.

25 See, for example, David A. Weisbach, “Ten Truths About Tax Shelters” (2002) 55:2 *Tax Law Review* 215-54, at 222-25, analogizing tax planning to a negative externality that has no social benefit; and Edgar, “Building a Better GAAR,” supra note 12, at 853, who also argues that tax avoidance has the characteristics of a negative externality.

26 See, for example, Québec, Finance Québec, *Working Paper Aggressive Tax Planning* (Québec: Finance Québec, January 2009), at 21 (herein referred to as *Aggressive Tax Planning*).

27 See, for example, Reuven S. Avi-Yonah, “Globalization, Tax Competition and the Fiscal Crisis of the Welfare State” (2000) 113:7 *Harvard Law Review* 1573-1676, at 1578.

28 Edgar, “Building a Better GAAR,” supra note 12, at 852.

Another consequentialist argument for anti-avoidance measures such as GAARs is the corrosive effect that tax avoidance can have on tax compliance generally.²⁹ As David Weisbach explains, to the extent that social norms play an important role in taxpayers' voluntary compliance with tax laws, such that "whether your neighbor pays taxes affects whether you pay taxes," the avoidance of some taxes by some taxpayers could easily lead to the avoidance of many taxes by many taxpayers.³⁰ As a result, as the Quebec Department of Finance observes, "[l]ike a vicious circle, the perceived unfairness and injustice in such a system are such as to discourage . . . taxpayers to comply with the law, and consequently, increase the chances of damaging the integrity of the system."³¹ For this reason, Weisbach regards reduced tax compliance as the "most important" cost of tax avoidance, justifying anti-avoidance measures as a necessary response.³²

That these consequentialist considerations may justify measures to limit tax avoidance, however, does not explain why anti-avoidance measures should include general anti-avoidance rules or principles that apply to transactions and arrangements after the fact, as opposed to detailed legislation and specific anti-avoidance rules that reduce or eliminate opportunities for tax avoidance in advance. Indeed, to the extent that tax avoidance depends on the existence of gaps and inconsistencies in tax legislation, the minimization of these gaps and inconsistencies through structural reforms is presumably a more effective policy response than reliance on a GAAR.³³ As well, where particular avoidance strategies are easily anticipated, specific anti-avoidance rules aimed at these strategies are often more effective than a GAAR.

In the real world, however, all tax systems have gaps and inconsistencies, and the complexity of tax legislation and the transactions and arrangements to which it applies makes it virtually impossible to anticipate and foreclose all possible avoidance techniques before they are deployed. Although gaps and inconsistencies may reflect poor tax policy decisions, they are also the inevitable consequence of having to rely on legal concepts and proxies to measure economic outcomes such as income or

29 See, for example, Statement of Harold R. Handler, on behalf of the Tax Section, New York State Bar Association, before the Committee on Finance (27 April 1999), cited in United States, Department of the Treasury, *The Problem of Corporate Tax Shelters—Discussion, Analysis and Legislative Proposals* (Washington, DC: Department of the Treasury, July 1999), at 3.

30 See, for example, Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 111. For a useful introduction to the theoretical and empirical literature on the effect of "tax morale" on tax compliance, see Benno Torgler, *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis* (Cheltenham, UK: Edward Elgar, 2007).

31 Finance Québec, *Aggressive Tax Planning*, *supra* note 26, at 21.

32 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 111.

33 See, for example, Graeme S. Cooper, "International Experience with General Anti-Avoidance Rules" (2001) 54:1 *SMU Law Review* 83-130, at 85, explaining that a GAAR is "implausible as a solution to structural problems in the tax system, and it is inappropriate as a means of dealing with murky lines and fuzzy categories that are drawn in the text of [tax] law."

consumption that are difficult to define perfectly and observe accurately,³⁴ and they also result from legitimate considerations in the design of any tax system such as reducing complexity, accommodating liquidity concerns, promoting social and economic policy objectives, and recognizing different tax policy choices made by different jurisdictions.³⁵ In addition, even where gaps and inconsistencies result from poor tax policy choices, these policies are often difficult or impossible to change on account of political considerations that necessarily shape the real world of tax policy making.³⁶

Finally, since it is impossible to foresee and prevent all tax avoidance before it occurs, the effectiveness of detailed legislation and specific anti-avoidance rules in reducing tax avoidance is necessarily limited,³⁷ unless this legislation were to apply retroactively, which would make tax rules grossly unpredictable and undermine important values associated with the rule of law.³⁸ As well, even if policy makers could anticipate all potential tax-avoidance strategies, the formulation of specific anti-avoidance rules to address all of these strategies would be enormously costly and would greatly increase the length and complexity of tax legislation,³⁹ thereby increasing the costs of tax administration and compliance as well as the likelihood of additional avoidance opportunities attributable to this “legislative layering.”⁴⁰ For

34 See, for example, Weisbach, “An Economic Analysis of Anti-Tax-Avoidance Doctrines,” *supra* note 18, at 91, referring, for example, to the realization requirement for recognizing taxable income.

35 Chris Evans, “Containing Tax Avoidance: Anti-Avoidance Strategies,” in John G. Head and Richard Krever, eds., *Tax Reform in the 21st Century, A Volume in Memory of Richard Musgrave* (Alphen aan den Rijn, the Netherlands: Kluwer Law International, 2009), 529–60, at 536.

36 See, for example, Claire Crawford and Judith Freedman, “Small Business Taxation,” in James Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, eds., *Dimensions of Tax Design: The Mirrlees Review* (Oxford: Oxford University Press, 2010), 1028–99, at 1086. For a discussion in the Canadian context, see David G. Duff, “Income Taxation of Small Business: Toward Simplicity, Neutrality and Coherence,” in *The Dynamics of Taxation*, *supra* note 8, chapter 4.

37 See, for example, David A. Dodge, “A New and More Coherent Approach to Tax Avoidance” (1988) 36:1 *Canadian Tax Journal* 1–22, at 8.

38 For a brief discussion of efficiency and fairness arguments against retroactive tax legislation, see Benjamin Alarie, “Retroactivity and the General Anti-Avoidance Rule,” in *Tax Avoidance in Canada After Canada Trustco and Mathew*, *supra* note 12, 197–219, at 215–217.

39 See, for example, Stanley S. Surrey, “Complexity and the Internal Revenue Code: The Problem of the Management of Tax Detail” (1969) 34:4 *Law and Contemporary Problems* 673–710, at 707, note 31; and Cooper, *supra* note 33, at 95, arguing that “continuing design tinkering to surround individual provisions with further support will make the legislation too detailed and perhaps ultimately less secure.”

40 Chris Evans, “The Battle Continues: Recent Australian Experience with Statutory Avoidance and Disclosure Rules,” in Judith Freedman, ed., *Beyond Boundaries: Developing Approaches to Tax Avoidance and Risk Management* (Oxford: Oxford University Centre for Business Taxation, 2008), 37–46, at 43.

these reasons, as Weisbach concludes, an optimal approach to preventing tax avoidance is likely to include both specific anti-avoidance rules the application of which is defined *ex ante* and general anti-avoidance rules and doctrines based on a broad standard the application of which is determined *ex post*.⁴¹

Non-Consequentialist Arguments

In addition to these consequentialist arguments, another rationale for general anti-avoidance rules and principles emphasizes legislative intent and the integrity of the provisions that could otherwise be circumvented by transactions or arrangements that defeat the object or purpose of the law. According to Judith Freedman, for example, the key function of a GAAR is "to give full effect to parliamentary intention and prevent the frustration of specific legislation."⁴² Similarly, the Aaronson Report that recommended a GAAR for the United Kingdom concluded that such a provision would "[f]irst and foremost . . . deter (and, where deterrence fails, counteract) contrived and artificial schemes which are widely regarded as an intolerable attack on the integrity of the UK's tax regime . . . [and] make a mockery of the will of Parliament."⁴³ As a result, as David Weisbach himself acknowledges, the essential function of anti-avoidance rules is not to make the tax system more efficient, but "to ensure that duly enacted taxes are collected."⁴⁴

Unlike other arguments for GAARs, these arguments for a statutory GAAR are non-consequentialist in the sense that they refer to normative criteria such as legislative intent and the integrity of the relevant provisions that are internal to the law, not normative goals such as efficiency or equity that are external to the law and pursued through the law.⁴⁵ As a result, they appeal to what Lon Fuller has called the "inner morality of law" rather than the "substantive aims" that are incorporated into law.⁴⁶

For Fuller, the inner morality of law suggests that laws should ideally be general in their application, publicly promulgated, non-retroactive, clear and coherent, non-contradictory, capable of being obeyed, relatively stable over time, and applied in

41 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 93.

42 Judith Freedman, "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 123:1 *Law Quarterly Review* 53-90, at 90.

43 Graham Aaronson, *GAAR Study: A Study To Consider Whether a General Anti-Avoidance Rule Should Be Introduced into the UK Tax System* (London: HM Treasury, November 2011) (herein referred to as "the UK Aaronson report"), at paragraph 1.7(i) (https://webarchive.nationalarchives.gov.uk/20130402163458/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf).

44 Weisbach, "An Economic Analysis of Anti-Tax-Avoidance Doctrines," *supra* note 18, at 112.

45 See generally Mark P. Gergen, "The Common Knowledge of Tax Abuse" (2001) 54:1 *SMU Law Review* 131-47.

46 Lon L. Fuller, *The Morality of Law* (New Haven, CT: Yale University Press, 1969), at 42.

accordance with the law as declared.⁴⁷ Properly understood as aspirational aims rather than categorical imperatives,⁴⁸ these criteria express what Fuller calls an “ideal of legality”⁴⁹ according to which “a system of rules for governing human conduct must be constructed and administered if it is to be efficacious and at the same time remain what it purports to be.”⁵⁰ For this reason, they are widely regarded as core constituents of the rule of law and necessary prerequisites to individual freedom and human dignity.⁵¹

From this perspective, it is often argued that general anti-avoidance rules and principles contradict the rule of law because they rely on vague and uncertain standards to distinguish between unacceptable tax avoidance and legitimate tax minimization.⁵² A related concern is that the application of these standards is determined retrospectively after an impugned transaction or arrangement has already occurred, making it difficult for taxpayers to plan their affairs with certainty as to the taxes that these transactions or arrangements will attract.

One response to these objections is that values of individual freedom and human dignity must be balanced against other values such as fairness and efficiency, such that general anti-avoidance rules and principles may be justified even if they contradict the rule of law.⁵³ More persuasively, I believe, non-consequentialist arguments

47 Ibid., at 46-91.

48 Ibid., at 104, describing the inner morality of law as “chiefly a morality of aspiration, rather than duty.”

49 Ibid., at 147.

50 Ibid., at 97.

51 See, for example, Joseph Raz, “The Rule of Law and Its Virtue” (1977) 93:2 *Law Quarterly Review* 195-211, at 204, explaining that the rule of law contributes to individual freedom by allowing persons to make plans and act upon them without subsequent legal disruption, thereby respecting human dignity by respecting the rights of individuals to shape their own futures.

52 See, for example, Rebecca Prebble and John Prebble, “Does the Use of General Anti-Avoidance Rules To Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study” (2010) 55:21 *Saint Louis University Law Journal* 21-45, at 28-30; and Colin Masters, “Is There a Need for General Anti-Avoidance Legislation in the United Kingdom?” [1994] no. 6 *British Tax Review* 647-73, at 671, arguing that a GAAR “violates perhaps the most important and fundamental principle of tax law: that the tax legislation must impose tax in clear and unambiguous terms and that a person must not be taxed unless he comes within the letter of the law.”

53 Prebble and Prebble, *supra* note 52, at 38-41. Indeed, it is sometimes argued that the uncertainty created by these rules and principles is a positive virtue, since it discourages taxpayers from engaging in aggressive tax planning. See, for example, Erik M. Jensen, “Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives” (2012) 57:1 *Saint Louis University Law Journal* 1-58, at 38, suggesting that “some uncertainty is valuable for the tax system” since “it deters taxpayers from getting too close to abusive territory.” Although some uncertainty may be inevitable with a GAAR, introducing

for GAARs suggest that these rules, when properly designed, are not only compatible with the rule of law but actually support the "ideal of legality" to which the rule of law aspires by discouraging and counteracting transactions or arrangements that undermine the integrity of the relevant provisions and contradict their objects and purposes. For this reason, as Mark Gergen explains, although the standards embodied in general anti-avoidance rules and principles are less predictable than detailed rules,⁵⁴ and although their application is necessarily determined *ex post* rather than *ex ante*,⁵⁵ they "mediate between our desire that tax law be coherent and principled and our desire that it be rule-bound" and are thus "a product of a commitment to law by imperfect rules" rather than "an abnegation of the rule of law."⁵⁶ In order to best advance this ideal of legality, however, it is important that a GAAR should be designed in a manner that is consistent with the principles on which this ideal is based.⁵⁷ The next part of this paper is directed toward this task.

DESIGN

Although the rationale for a general anti-avoidance rule or principle may be based on consequentialist or non-consequentialist arguments, the most persuasive rationale undoubtedly includes both. As I explain below, however, non-consequentialist considerations are paramount when it comes to the way in which these rules and principles are properly expressed in law.

Codification

The first issue to address in formulating a general standard to discourage and counteract unacceptable tax avoidance is whether this standard should be judicially defined or codified in the form of an explicit rule. Although this question is obviously academic in jurisdictions like Canada, where courts have refused to adopt broad anti-avoidance principles or doctrines,⁵⁸ there are good reasons why these standards are best codified in domestic tax legislation and international tax treaties instead of being left to judicial formulation.

and designing a GAAR in order to deliberately create legal uncertainty diminishes the value of legal certainty and undermines the rule of law. In addition, there are other and better ways to discourage aggressive tax planning, such as disclosure rules and promoter penalties, which can be carefully designed to ensure their consistency with the rule of law.

54 Gergen, *supra* note 45, at 137.

55 *Ibid.*, at 143.

56 *Ibid.*, at 131.

57 See, generally, Chris Atkinson, "General Anti-Avoidance Rules: Exploring the Balance Between the Taxpayer's Need for Certainty and the Government's Need To Prevent Tax Avoidance" (2012) 14:1 *Journal of Australian Taxation* 1-56.

58 *Stuart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

First, as Judith Freedman has argued, in jurisdictions like Canada and the United Kingdom, in which courts have traditionally held that taxpayers have a quasi-constitutional right to arrange their affairs in order to minimize tax,⁵⁹ a statutory (or treaty-based) general anti-avoidance rule or principle affirms the “constitutional source and authority” of this standard as a legitimate overlay on more specific tax provisions.⁶⁰ Second, as opposed to judicially developed principles and doctrines that are inevitably open-ended and changeable,⁶¹ explicit statutory or treaty rules can provide a clear and consistent framework for applying a general anti-avoidance standard.⁶² Therefore, as the UK Aaronson Report concluded, a general anti-avoidance rule or principle “should be imposed by legislation” in order to be “consistent with the rule of law.”⁶³

For these reasons, it is not surprising that several jurisdictions have introduced statutory GAARs, and that others have codified judicially developed anti-avoidance principles and doctrines.⁶⁴ Nor is it surprising that the OECD has codified the anti-abuse principle that was added to the commentary on the OECD model tax convention in 2003 by adding the PPT to the model convention and the MLI.⁶⁵ Although the rationale for codification may involve consequentialist considerations such as the efficiency of a statutory rule or its impact on tax compliance, the primary reason for codification involves non-consequential considerations regarding legitimacy and legal clarity and consistency.

59 See, for example, *Inland Revenue Commissioners v. Westminster (Duke)*, [1936] AC 1 (HL) (herein referred to as “*Duke of Westminster*”).

60 Freedman, *supra* note 42, at 63.

61 See, for example, the review of the pre-GAAR tax avoidance jurisprudence in the United Kingdom in Freedman, *supra* note 42, at 55-70; the review of the European Court of Justice’s anti-abuse jurisprudence in de la Feria, “EU General Anti-(Tax) Avoidance Mechanisms,” *supra* note 8; and Jenson, *supra* note 53, at 24, noting that a “compelling” argument for codification of the economic substance doctrine in the United States is that courts “had not been consistent in their understanding of the components of that doctrine.”

62 Freedman, *supra* note 42, at 70.

63 UK Aaronson report, *supra* note 43, at paragraph 3.4.

64 See Article 6(1) of Council Directive 2016/1164/EU, *supra* note 8, which codifies the principles established in leading judgments of the European Court of Justice; and section 7701(o) of the Internal Revenue Code of 1986, as amended, which codifies the US economic substance doctrine. For useful reviews of the US economic substance doctrine, arguing it should more clearly include a reference to the object and purpose of the legislation, see Leandra Lederman, “W(h)ither Economic Substance?” (2010) 95:2 *Iowa Law Review* 389-444; and Orly Sulami, “Tax Abuse—Lessons from Abroad” (2012) 65:3 *SMU Law Review* 555-91.

65 See article 29(9) of the OECD model convention and article 7(1) of the MLI, which are based on the “guiding principle” set out in paragraph 9.6 of the commentary on article 1 of the 2003 OECD model convention.

Subjective and Objective Elements

As noted earlier, the Canadian GAAR and most modern GAARs include a subjective element concerning the purpose of the transaction or arrangement that results in a tax benefit, and an objective element regarding the misuse or abuse of the relevant provisions. The following discussion explains the role of each element within an ideal GAAR, the way in which each requirement should be understood, and the extent to which concepts of artificiality and economic substance are relevant to the interpretation and application of these requirements.

Purpose Test

It is not surprising that a GAAR would include a purpose test, requiring that a transaction or arrangement that is subject to the rule have been undertaken or arranged in order to obtain a tax benefit. After all, the very concept of "avoidance" involves a purposeful act to "get around" or "get out of" something.⁶⁶ Synonyms for the word "avoid" include "circumvent," "dodge," "duck," "sidestep," "elude," "escape," "shun," and "eschew"⁶⁷—all of which involve an element of purpose on the part of the person or persons participating in avoidance. As a result, as the Carter commission observed, "motive would seem to be an essential element of tax avoidance."⁶⁸

According to Professor Edgar, a purpose test is integral to the efficiency of a GAAR, prohibiting transactions and arrangements for which marginal social costs in terms of revenue losses, efficiency costs, and distributional impacts exceed marginal private benefits in terms of taxes reduced.⁶⁹ Indeed, on the "plausible assumption" that the marginal social costs of tax avoidance always equal or exceed marginal private benefits,⁷⁰ Edgar argued that "there is no level of tax-avoidance behavior that policymakers should accept, . . . and the policy goal must be the elimination of all tax avoidance"⁷¹—subject to a limited exception for transactions that are explicitly encouraged through tax-incentive provisions.⁷² On this account, he concluded that

66 Microsoft Word Thesaurus.

67 Ibid.

68 Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966) (herein referred to as "the Carter commission"), at 537-38, explaining that a taxpayer "who adopts one of several possible courses because one will save him the most tax *must* be distinguished from the taxpayer who adopts the same course for business or personal reasons." I return to the distinction between the concepts of motive and purpose in text accompanying *infra* notes 85-89.

69 Edgar, "Building a Better GAAR," *supra* note 12, at 852-71.

70 This assumption is premised on the further assumption that tax avoidance is not an effective way to control excessive government spending or promote a more efficient tax system. *Supra* note 19 and accompanying text.

71 Edgar, "Building a Better GAAR," *supra* note 12, at 864.

72 Ibid., at 881.

a GAAR based on a purpose test represents “the expression of a behavioral prohibition that targets the entire range of tax-avoidance transactions whose consequential attributes justify prohibition.”⁷³

In contrast, others have suggested that the purpose for which a transaction is undertaken or arranged is irrelevant to how it should be treated for tax purposes.⁷⁴ According to Judith Freedman, for example, if taxpayers are generally entitled to arrange their affairs in order to minimize tax,⁷⁵ “the relevance of [the taxpayer’s] purpose is hard to discern, since it can be argued that it is the transaction that should be taxed, and the way in which similar transactions are taxed should not vary with the purpose of the taxpayer.”⁷⁶ Michael Lang arrives at a similar conclusion in a different way, arguing that a subjective element is irrelevant to the application of tax legislation if it is properly interpreted in a teleological manner in accordance with its object and purpose.⁷⁷

In response to these arguments, one might begin by noting that many tax provisions make the purpose of a transaction or arrangement an explicit requirement for a particular tax result.⁷⁸ In addition, even if a provision does not include an explicit purpose test, it is arguable that the purpose of a transaction or arrangement may be relevant to the object and purpose of the provision at issue, and should therefore be taken into account in determining whether it applies.⁷⁹ More generally, if

73 Ibid., at 873. Since this formulation would include tax-induced changes in what economists call “real economic behaviour” (such as the decision to work fewer hours or to consume rather than spend) as well as tax-induced responses to structural features of tax law that accord different tax outcomes to different legal relationships (for example, employee versus independent contractor) or organizational forms (for example, incorporated or unincorporated enterprises), it appears to be overbroad. However, Edgar would exclude these behavioural adjustments from the scope of a GAAR on the consequentialist grounds that the informational requirements to determine the efficiency of these behavioural responses to taxation is beyond the institutional competence of the judiciary. Ibid., at 851.

74 See, for example, Walter J. Blum, “Motive, Intent, and Purpose in Federal Income Taxation” (1967) 34:3 *University of Chicago Law Review* 485-544; and Alan Gunn, “Tax Avoidance” (1978) 76:5 *Michigan Law Review* 733-67, at 765, concluding that “the question whether particular conduct was tax-motivated should be irrelevant to the decision whether that conduct should be taxed in a certain way.”

75 See, for example, *Duke of Westminster*, supra note 59.

76 Freedman, “The Anatomy of Tax Avoidance Counteraction,” supra note 8, at 374.

77 Lang, supra note 11, at 449.

78 Obvious examples in the ITA include paragraph 18(1)(a), which limits the deduction of an outlay or expense in computing a taxpayer’s income from a business or property “to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property” and the requirement in subparagraph 20(1)(c)(i) that interest on borrowed money must be “used for the purpose of earning income from a business or property” in order to be deductible in computing the taxpayer’s income from this business or property.

79 This is the interpretive approach that the US Supreme Court adopted in *Gregory v. Helvering*, 293 US 465 (1935), concluding that the “plain intent” of a provision permitting a tax-free

one assumes that tax provisions are typically intended to apply to transactions and arrangements that are carried out for bona fide commercial or personal purposes, not to transactions or arrangements that are undertaken or arranged in order to obtain tax benefits, a purpose test may be an integral aspect of a teleological approach to the interpretation of tax legislation and tax treaties generally.⁸⁰ On this account, therefore, a GAAR that includes a purpose requirement could be construed as an explicit expression of a teleological approach to the interpretation of tax law as a whole.

At the same time, although the modern approach to the interpretation of tax provisions requires that they be construed *in light of* their objects and purposes,⁸¹ this interpretive approach does not allow courts to rely on these objects and purposes to *override* the text of these provisions once they are properly construed in light of their objects and purposes.⁸² On the contrary, as Denis Weber has explained in the context of EU law, once the meaning of a provision is properly construed under ordinary methods of interpretation, principles of legality and legal certainty prohibit "the setting aside of legislation . . . *merely* by invoking the fact that the [tax] advantage is in conflict with the objective of the legislation."⁸³ Where a transaction or arrangement is undertaken or arranged in order to obtain a tax benefit, on the other hand, these principles are legitimately superseded by a general anti-abuse principle, and the object and purpose of the relevant provisions may be relied upon to supplant their meaning as ordinarily construed.⁸⁴ As a result, whether or not a purpose

corporate reorganization was limited to permitting the reorganization of "corporate business," not "an operation having no business or corporate purpose." *Ibid.*, at 469.

80 This is the broader significance of the decision in *Gregory v. Helvering*, *ibid.*, and the foundation of a general "business purpose test" in US tax law. See, for example, *Bazley v. CIR*, 331 US 737 (1947); and *Goldstein v. CIR*, 364 F. 2d 734, at 740 (2d Cir. 1966); certiorari denied 385 US 1005 (1967). See, for example, Brian J. Arnold, "In Praise of the Business Purpose Test," in *Report of Proceedings of the Thirty-Ninth Tax Conference*, 1987 Conference Report (Toronto: Canadian Tax Foundation, 1988), 10:1-34.

81 See, for example, *Stubart*, *supra* note 58, at 578, citing page 87 of E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), according to whom "the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament"; and article 31(1) of the Vienna Convention on the Law of Treaties, signed at Vienna on May 23, 1969, UN doc. A/Conf. 39/27, providing that a treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose."

82 See, for example, Leonard Hoffman, "Tax Avoidance" [2005] no. 2 *British Tax Review* 197-206, at 205, explaining that "[i]t is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there."

83 Dennis Weber, "Abuse of Law in the Context of Indirect Taxation: Why We Need the Subjective Intention Test, When Is Combating Abuse an Obligation and Other Comments," in *Prohibition of Abuse of Law*, *supra* note 8, 395-406, at 398 (emphasis in original).

84 I return to this point at text accompanying *infra* note 144.

test contributes to the efficiency of a GAAR, it is an essential element of a general anti-avoidance rule or principle that is compatible with the non-consequentialist ideal of legality.

From this perspective, it is tempting to regard the subjective element of a GAAR as the tax law equivalent of the *mens rea* requirement in criminal law. As Graeme Cooper explains, however, the purpose test in a GAAR is very different from the intention requirement in criminal law, which depends on a person's conscious mental state, even if this mental state must be inferred through external indicia.⁸⁵ Indeed, although the Carter commission referred to "motive" as an essential element of tax avoidance,⁸⁶ it is notable that modern GAARs use the word "purpose," which emphasizes the aim or object to be attained by a particular action,⁸⁷ rather than "motive," which refers to the reasons why a person engages in a particular action.⁸⁸ As well, modern GAARs generally assess the purposes for which transactions are undertaken or arranged objectively (that is, according to a standard of reasonableness), not subjectively (according to the specific purposes of the persons involved). As a result, the so-called subjective element of a GAAR properly considers the purposes that may reasonably be attributed to the transaction or arrangement, not the subjective intentions of the person or persons who carry it out.⁸⁹

According to the Canadian GAAR, for example, the provision does not apply to transactions that "may reasonably be considered to have been undertaken or arranged . . . for *bona fide* purposes other than to obtain a tax benefit."⁹⁰ As a result, as Brian Arnold and James Wilson explain, the provision asks "not what was in the taxpayer's mind but what a reasonable taxpayer would have considered to be the purpose of the transaction."⁹¹ Similar language appears in the UK GAAR,⁹² as well as the PPT,⁹³ suggesting that the purpose tests in these provisions must also be assessed

85 Graeme Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," in Nigar Hashimzade and Yuliya Epifantseva, eds., *The Routledge Companion to Tax Avoidance Research* (Abingdon, UK: Routledge, 2017), 78-96, at 86.

86 Carter commission, *supra* note 68.

87 See *Concise Oxford Dictionary*, 7th ed., defining "purpose" as "object to be attained."

88 *Ibid.*, defining "motive" as "what induces a person to act."

89 For a contrary view, see David Weisbach, "Ten Truths About Tax Shelters," *supra* note 25, at 251-53, who in my view wrongly equates the purpose requirement in general anti-avoidance rules and doctrines with the concepts of motive and intent.

90 ITA subsection 245(3).

91 Brian J. Arnold and James R. Wilson, "The General Anti-Avoidance Rule—Part 1" (1988) 36:4 *Canadian Tax Journal* 829-87; and "... Part 2," (1988) 36:5 *Canadian Tax Journal* 1123-85, at 1369-1410, and 1157.

92 UK GAAR, *supra* note 5, section 207(1).

93 *Supra* note 6.

objectively, by reference to what a reasonable person would conclude.⁹⁴ Australian courts have adopted an identical approach even in the absence of explicit statutory direction to this effect, concluding that the purpose test in the Australian GAAR is to be applied "by analysis of objective criteria without regard to the actual purpose or motive, ultimate or otherwise, of the relevant scheme participants."⁹⁵ Here too, therefore, the purpose test is assessed objectively, by reference to what "a reasonable person, who implemented the acts actually undertaken by the taxpayer and confederates, [would] have been seeking to accomplish."⁹⁶ In this respect, as Graeme Cooper observes, the purpose test of a GAAR operates much like the "reasonable person" standard in tort law.⁹⁷

Although courts generally look for objective manifestations of subjective purpose when they are required to consider a taxpayer's purpose,⁹⁸ an objective approach is essential for a GAAR, which would be rendered largely ineffective if persons could rely on assertions of subjective non-tax purposes to escape its application.⁹⁹ An objective assessment of the purposes for which a transaction is undertaken or arranged is also consistent with the fact that the function of a GAAR is not to assign moral culpability to the persons involved in a tax-avoidance transaction, but to ensure that the transaction is subject to tax in accordance with the object and purpose of the relevant provisions.¹⁰⁰ As a result, an objective approach to the application of the subjective element is not only essential to the effectiveness of a GAAR but also compatible with non-consequentialist considerations associated with the rule of law.

In addition to this objective approach, some GAARs refer to the purposes of arrangements or transactions themselves,¹⁰¹ rather than the purposes for which transactions were undertaken or arranged (as in the Canadian GAAR)¹⁰² or the purpose of the person or persons who entered into or carried out the transactions (as in

94 See, for example, paragraph 179 of the commentary on article 29 of the OECD model convention, stating that the purposes of an arrangement or transaction "must be objectively considered."

95 *Orica Limited v. Commissioner of Taxation*, [2015] FCA 1399, at paragraph 19.

96 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," supra note 85, at 87.

97 Ibid.

98 See, for example, *Symes v. Canada*, [1993] 4 SCR 695, at 736, stating that courts in these cases should not "be guided only by a taxpayer's statements, *ex post facto* or otherwise," but should instead "look for objective manifestations of purpose" which is "ultimately a question of fact to be decided with due regard for all of the circumstances."

99 Freedman, "The Anatomy of Tax Avoidance Counteraction," supra note 8, at 375.

100 See, for example, *Coptborne*, supra note 1, at paragraph 65, emphasizing that the GAAR should not be interpreted as "implying moral opprobrium regarding the actions of a taxpayer to minimize tax."

101 See, for example, the UK GAAR, supra note 5; and the PPT, supra note 6.

102 ITA subsection 245(3).

the Australian GAAR).¹⁰³ Although it is absurd to imagine that arrangements or transactions can have their own purposes apart from those of the persons who arrange them and carry them out,¹⁰⁴ this language reaffirms the objective nature of the inquiry, and ensures that the GAAR can apply to arrangements and transactions that are arranged by persons (such as tax specialists) other than those who obtain the resulting tax benefits, who may themselves have little or no knowledge of these tax benefits or how they are obtained.¹⁰⁵

Since the effectiveness of a GAAR would be greatly diminished if it were to apply only to transactions or arrangements that are entered into by persons who fully appreciate the resulting tax benefits,¹⁰⁶ an emphasis on the purpose of the transaction or arrangement may be useful, though it would be conceptually more precise to refer to the purposes of the persons involved in arranging or carrying out the transaction or arrangement or the purposes for which the transaction or arrangement was undertaken or arranged (as in the Canadian GAAR). Although some might suggest that it would be unfair to impugn a transaction or arrangement that is entered into by a person who is unaware of the purposes of others,¹⁰⁷ it is important to recall that the application of a GAAR depends not on a taxpayer's mental state or moral culpability but on an objective assessment that the transaction or arrangement itself can reasonably be considered to have been undertaken or arranged in order to obtain a tax benefit. As a result, the application of a GAAR to "innocent" taxpayers is not only necessary to the effectiveness of a GAAR but also justifiable, given the function and effect of a GAAR, which (to repeat) is not to assign moral culpability but to ensure that tax-avoidance transactions or arrangements are subject to tax in accordance with the object and purpose of the relevant provisions.

For this reason, moreover, several GAARs also include objective factors that courts may or must take into account in determining the purposes for which a transaction or arrangement was undertaken or arranged. According to the Australian

103 Australian GAAR, *supra* note 4, section 177D(1).

104 See, for example, Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 88, observing that "arrangements cannot have purposes" and rejecting the idea that "inanimate legal constructs" can have purposes as "linguistic nonsense." Notwithstanding the reference to the purposes of an arrangement or transaction in the PPT, the commentary on this provision in the OECD model convention supports the conclusion that arrangements cannot have purposes, stating that it is important to consider "the aims and objects of *all persons involved* in putting the arrangement or transaction in place or being a party to it" to determine whether the PPT applies. See paragraph 178 of the commentary on article 29 of the OECD model convention (emphasis added).

105 As Cooper explains, for example, "the taxpayer who invests in a marketed tax shelter may well be motivated exclusively by the higher commercial return being promised, oblivious to the fact that tax plays any part in how it arises." See Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

106 *Ibid.*, at 88.

107 *Ibid.*

GAAR, for example, the purpose test is to be applied having regard to eight considerations, including "the manner in which the scheme was carried out," "the form and substance of the scheme," and "the length of the period during which the scheme was carried out."¹⁰⁸ As Graeme Cooper explains, these factors generally involve an element of artificiality, including a lack of commercial substance and other characteristics that "are suggestive of artifice."¹⁰⁹ Although factors such as commercial or economic substance are arguably more relevant to the misuse and abuse requirement of a GAAR,¹¹⁰ the concept of artificiality is consistent with an objective approach to the purpose requirement in a GAAR—an attempt, as Cooper states, "to ground the GAAR in something observable about the features of the transaction or structure, and definitely more concrete than a mere state of mind."¹¹¹ Indeed, it is precisely this function that the concept of artificiality served in the leading European Court of Justice decision on the anti-abuse principle: as an objective factor that supported the court's conclusion that "the essential aim of the transactions concerned is to obtain a tax advantage."¹¹²

As is often noted, of course, tax law is itself artificial,¹¹³ and an element of artificiality is inherent in a multitude of common commercial dealings.¹¹⁴ As a result, as Judith Freedman emphasizes, "[a]rtificiality alone cannot be said to be a hallmark of [tax] avoidance when so much about tax is artificial."¹¹⁵ So long as the relevance of artificiality is limited to the subjective element of a GAAR, however, artificiality *alone* should not cause a GAAR to apply, but only to elicit a further inquiry into the objective element of the GAAR to determine whether the artificial transaction or arrangement contradicts the object and purpose of the relevant provisions.

While the Canadian GAAR does not explicitly refer to artificiality, the 1987 Department of Finance white paper that introduced the rule stated that it was "intended to prevent artificial tax avoidance arrangements,"¹¹⁶ and the original draft

108 Australian GAAR, *supra* note 4, sections 177(D)(2)(a), (b), and (c).

109 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

110 See *infra* notes 150-159 and accompanying text. As explained at *infra* note 155, these factors have been incorporated into the purpose test in the Australian GAAR because it does not contain an explicit misuse or abuse test.

111 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90.

112 *Halifax*, *supra* note 8, at paragraph 75.

113 Gergen, *supra* note 45, at 144.

114 Cooper, "The Role and Meaning of 'Purpose' in Statutory GAARs," *supra* note 85, at 90, referring to sale-leaseback arrangements, repurchase agreements, and financing leases. An excellent example in the Canadian context is a butterfly reorganization, which, as David Dodge noted when the GAAR was first enacted, is highly artificial but explicitly sanctioned by paragraph 55(3)(b) of the ITA. Dodge, *supra* note 37, at 7.

115 Freedman, "Defining Taxpayer Responsibility," *supra* note 8, at 343.

116 Canada, Department of Finance, *Tax Reform 1987: Income Tax Reform* (Ottawa: Department of Finance, June 18, 1987), at 129.

legislation included a general interpretive provision indicating that the purpose of GAAR was “to counter artificial tax avoidance.”¹¹⁷ This interpretive provision was deleted from the final version, however, and replaced by the misuse or abuse requirement, which had not appeared in the original draft.¹¹⁸ As the senior assistant deputy minister of finance noted at the time, since some pre-GAAR cases had interpreted the word artificial to mean “simulated” or “fictitious,”¹¹⁹ a reference to artificiality might have suggested that “a particularly high level of abuse” was required.¹²⁰ For this reason, although some jurisdictions might find it useful for a GAAR to refer to objective factors such as artificiality in order to reinforce the objective nature of the purpose test, this seems inadvisable in the Canadian context. Nonetheless, it could be useful to add a list of objective factors that are indicative of artificiality, such as the participation of accommodating parties, or the creation and termination of a single-purpose entity or relationship within a relatively short period of time, which often suggest that a transaction or arrangement was undertaken or arranged in order to obtain a tax benefit.¹²¹

A final issue with respect to the purpose test in a GAAR concerns the degree to which a tax purpose is required in order to satisfy this test when a transaction or arrangement is undertaken or arranged for tax and non-tax purposes, as is generally the case with most transactions and arrangements.¹²² Although the Canadian GAAR excludes transactions that may reasonably be considered to have been undertaken or arranged “primarily” for purposes other than to obtain a tax benefit,¹²³ some GAARs refer to the “sole” purpose of an arrangement or transaction,¹²⁴ while others refer only

117 Ibid., at 214.

118 Arnold and Wilson, “. . . Part 2,” supra note 91, at 1163.

119 See, for example, *Spur Oil Ltd. v. The Queen*, 81 DTC 5168 (FCA), at 5170, interpreting former subsection 245(1) of the ITA, which disallowed a deduction “in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce” a taxpayer’s income. See also *Des Rosiers v. The Queen*, 75 DTC 5298 (FCTD), suggesting that the rule in former subsection 245(1) was no different than the judicial sham doctrine.

120 Dodge, supra note 37, at 7.

121 For useful examples in the Canadian context, consider the surplus-stripping transactions with accommodating parties in *McNichol et al. v. The Queen*, 97 DTC 111 (TCC) and *RMM Canadian Enterprises Inc. v. The Queen*, 97 DTC 302 (TCC); and the treaty-shopping transactions in *MIL (Investments) SA v. The Queen*, 2006 TCC 460; aff’d 2007 FCA 236; *Alta Energy Luxembourg SARL v. The Queen*, 2018 TCC 152; aff’d 2020 FCA 43.

122 Although purely tax-driven transactions are rare, examples might include some transactions that are undertaken in order to obtain a tax benefit in the form of a deduction, loss, or tax credit that can be used to shelter other income from tax—a category of tax-avoidance transactions that Professor Edgar characterized as “tax-attribute creation” transactions. See text accompanying infra note 168.

123 ITA subsection 245(3).

124 See, for example, Income Tax Act 58 of 1962, section 80A (herein referred to as “the South African GAAR”), which refers to the “sole or main purpose” of an avoidance arrangement.

to "the" purpose of the arrangement or transaction—which is generally interpreted to mean the "dominant" purpose.¹²⁵ Other GAARs (for example, the UK GAAR and the PPT) adopt a lower threshold based on "one of the principal purposes" of the arrangement or transaction¹²⁶—which is generally interpreted as a "significant" or "important" purpose.¹²⁷ As a result, most GAARs include a sole purpose test, a primary (or dominant) purpose test, or a significant (or important) purpose test.¹²⁸

According to Professor Edgar, the consequentialist rationale for a GAAR favours a "predominant or primary purpose" test as a "target effective standard" that "includes the entire range of behavioral adjustments that are characteristic of the concept of tax avoidance in law."¹²⁹ Although not entirely clear, the intuition behind this conclusion appears to be that the marginal social costs of transactions or arrangements that are primarily tax-motivated always exceed their marginal private benefits, while the marginal private benefits of transactions and arrangements that are motivated primarily by non-tax considerations always exceed the marginal social costs attributable to revenue losses, efficiency costs, and distributional impacts.¹³⁰ On this basis, he maintains, "the discontinuity that this test creates is not arbitrary, since small changes in nontax attributes result in a change in tax treatment that is justified in terms of the associated consequential attributes."¹³¹

From a non-consequentialist perspective, on the other hand, the relevant question is not whether a primary purpose test is more or less efficient than a sole purpose test or a significant purpose test but at what point a transaction or arrangement is sufficiently influenced by tax considerations that the object and purpose of the

125 See, for example, the Australian GAAR, *supra* note 4.

126 UK GAAR, *supra* note 5; PPT, *supra* note 6.

127 See, for example, *Lloyds Equipment Leasing (No 1) Ltd v. Revenue & Customs*, [2012] UKFTT 47 (TC), at paragraph 388, which was affirmed by the Court of Appeal in *Revenue and Customs v. Lloyds TSB Equipment Leasing (No 1) Ltd*, [2014] EWCA Civ 1062, at paragraph 52; and *Travel Document Service & Ladbroke Group International v. Revenue & Customs (Rev 1)*, [2018] EWCA Civ 549, at paragraph 48.

128 New Zealand's GAAR is a notable outlier in this respect, applying where an arrangement "has tax avoidance as its purpose or effect" or "[one] of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental," and defining "tax avoidance" to include "directly or indirectly altering the incidence of any income tax." See Income Tax Act 2007, 2007 No. 97, section YA 1. As Michael Littlewood explains, this rule could "produce absurd results" by applying to virtually any transaction that results in a reduction of tax. See Michael Littlewood, "The Possibility of Amending New Zealand's Anti-Avoidance Rule" (2013) 25:3 *New Zealand Universities Law Review* 522, at 527. As a result, the courts in New Zealand have limited the scope of the rule through a broad "parliamentary contemplation test" that excludes arrangements that are consistent with the object and purpose of the legislation. Elliffe, *supra* note 4, at 154-55.

129 Edgar, "Building a Better GAAR," *supra* note 12, at 890-91.

130 *Ibid.*, at 865, figure 1.

131 *Ibid.*, at 891.

relevant provisions may be relied on to deny a tax benefit that would otherwise be obtained if the relevant provisions are construed according to ordinary methods of interpretation. While some tax law scholars argue that this departure from the principle of legal certainty is justified only if the sole or dominant purpose for which a transaction or arrangement is undertaken or arranged is to obtain a tax benefit,¹³² it is not obvious that the presence of a significant or important tax purpose should not be sufficient to trigger this result.¹³³ After all, the GAAR only applies if the objective element of the rule is also satisfied. As a result, although the PPT in the Canadian GAAR has not been a significant impediment to its application, it would not be unreasonable to lower this standard to a standard based on “one of the principal purposes” of the transaction—particularly since this is the standard adopted in the PPT that will modify most of Canada’s tax treaties, and consistency between these tests might be desirable since either provision could apply to the abuse of a tax treaty.¹³⁴

Misuse or Abuse Test

Since the meaning of “avoidance” involves a purposeful act to get around or get out of something, this concept logically includes not only a purposeful act on the part of the person or persons who engage in avoidance, but also “something” that is avoided. Because a GAAR applies as “a provision of last resort” only where a benefit would otherwise be obtained under the provisions of domestic tax legislation or a tax treaty,¹³⁵ it follows that the avoided “thing” to which a GAAR applies is not the provisions themselves, at least as they are ordinarily construed. On the contrary, as the objective element of general anti-avoidance rules and principles suggests, the avoided thing to which these rules and principles apply is the object or purpose of these provisions.¹³⁶

132 See, for example, Eric C.C.M. Kemmeren, “Where Is the EU Law in the OECD BEPS Discussion?” (2014) 23:4 *EC Tax Review* 190-93; and Luc De Broe, “Tax Treaty and the EU Law Aspects of the LOB and PPT Provision Proposed by BEPS Action 6,” in Robert Danon, ed., *Base Erosion and Profit Shifting: Impact for European and International Tax Policy* (Zurich: Shulthess, 2016), 197-253.

133 See, for example, Dennis Weber, “The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) Versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law” (2017) 10:1 *Erasmus Law Review* 48-59.

134 For a detailed analysis of the purpose test in the PPT, see David G. Duff, “Tax Treaty Abuse and the Principal Purpose Test—Part 2” (2018) 66:4 *Canadian Tax Journal* 947-1011, at 975-85.

135 *Canada Trustco*, supra note 1, at paragraph 21.

136 See, for example, *CIR v. Willoughby*, [1997] 4 All ER 65, at 73, per Lord Nolan, explaining that the “hall mark” of tax avoidance is that “the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his liability.” In contrast to this view, Professor Edgar states that tax avoidance “in its broadest (and perhaps most simplistic sense) . . . refers to any

According to the Canadian GAAR, for example, the provision applies to an avoidance transaction only if it may reasonably be considered that the transaction would result in a misuse of relevant provisions of domestic legislation or a tax treaty or an abuse having regard to these provisions read as a whole.¹³⁷ Subsequently included in the GAARs of several other countries,¹³⁸ this misuse or abuse test requires courts to determine whether the tax benefit resulting from the impugned transaction is consistent with the object, spirit, or purpose of the relevant provisions.¹³⁹ The UK GAAR also includes an abuse requirement, which it defines, in an unfortunately convoluted way, as "arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances"—including, among others, "whether the substantive results of the arrangements are consistent with any principles on which those provisions are based (whether express or implied) and the policy objectives of those provisions."¹⁴⁰ In contrast to these provisions, the objective elements in the PPT and the European Council Directive codifying the European Court of Justice anti-abuse principle simply refer to the object and purpose of the relevant provisions.¹⁴¹

However these requirements may be expressed in law, their role within the structure of a general anti-avoidance rule or principle is the same: to draw a line between legitimate tax planning or tax minimization and unacceptable or abusive tax avoidance by means of an interpretive exercise that excludes from the scope of the rule or principle transactions or arrangements that are consistent with the object, spirit, or purpose of the relevant provisions.¹⁴² In this respect, therefore, the objective element of a GAAR applies the teleological interpretive approach that would otherwise

change in behavior that occurs as a response to the change in price of particular activities, assets, or transactions occasioned by the imposition of taxation." Edgar, "Building a Better GAAR," supra note 12, at 843, citing Michael Brooks and John G. Head, "Tax Avoidance: In Economics, Law and Public Choice," in Graeme S. Cooper, ed., *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD, 1997), 53-91, at 71-74. Although acknowledging that "the concept of tax avoidance used in law is a narrower one that consists of an apparently imprecise subset of this broader range of behavioral adjustments," Edgar takes the view that "the identification of tax-avoidance transactions appropriately subject to prohibition has absolutely nothing to do with perceptions of legislative intent." See Edgar, "Building a Better GAAR," supra note 12, at 843 and 882.

137 ITA subsection 245(4).

138 See, for example, Income Tax Act, 1961 (India), section 96(1)(b); Taxes Consolidation Act, 1997 (Ireland), section 811(3)(b); and the South African GAAR, supra note 124, section 80A(c)(ii).

139 *Canada Trustco*, supra note 1, at paragraph 55.

140 UK GAAR, supra note 5, section 207(2).

141 PPT, supra note 6 and Council Directive 2016/1164/EU, supra note 8.

142 See, for example, *Canada Trustco*, supra note 1, at paragraphs 16 and 54-55.

contradict principles of legality and legal certainty,¹⁴³ but is justified when a transaction or arrangement is undertaken or arranged in order to obtain a tax benefit.¹⁴⁴

As a result, as the Supreme Court of Canada has stated, a GAAR is “a legal mechanism whereby Parliament has conferred on the court the unusual duty of going behind the words of the legislation to determine the object, spirit or purpose of the provision or provisions relied upon by the taxpayer.”¹⁴⁵ Judith Freedman makes a similar point, noting that the interpretive exercise required by a general anti-avoidance rule or principle is “an unusual form of interpretation” that “goes beyond” what is normally understood as statutory interpretation.¹⁴⁶ Since the object, spirit, or purpose of tax provisions is not always clear, and since the policies and principles underlying these provisions may be incomplete or inconsistent, this can be a difficult task.¹⁴⁷ Consequently, as the Supreme Court of Canada stated in *Canada Trustco*,¹⁴⁸ the line that the GAAR draws between legitimate tax minimization and abusive tax avoidance is “far from bright.”¹⁴⁹

As an aid to this interpretive exercise, it is often suggested that the commercial or economic substance of a transaction or arrangement should be an important consideration.¹⁵⁰ Indeed, since tax law generally relies on legal concepts in order to assess economic outcomes,¹⁵¹ and since tax-avoidance transactions and arrangements commonly exploit differences between the legal form of these transactions and arrangements and their economic character,¹⁵² it is arguable that the economic

143 See text accompanying supra note 83.

144 See text accompanying supra note 84.

145 *Coptborne*, supra note 1, at paragraph 66, per Rothstein J.

146 Freedman, “The Anatomy of Tax Avoidance Counteraction,” supra note 8, at 375-76.

147 Atkinson, supra note 57, at 40, noting that “tax statutes are often drafted in significant detail, leaving little or no room beyond the express words for an inference as to the purpose of a provision” and that “tax provisions are often unclear, incoherent or lacking of a consistent policy framework, such that it is difficult to discern any underlying parliamentary purpose.”

148 See *Canada Trustco*, supra note 1.

149 *Ibid.*, at paragraph 16.

150 See, for example, Brian J. Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) 52:2 *Canadian Tax Journal* 488-511, at 504-10; and Jinyan Li, “‘Economic Substance’: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance” (2006) 54:1 *Canadian Tax Journal* 23-56.

151 See, for example, Freedman, “Defining Taxpayer Responsibility,” supra note 8, at 343, observing that the tax system is based on legal reality rather than economic reality “because that is the only practical and operable way to construct a tax system.”

152 Consider, for example, the arrangement in *Duke of Westminster*, supra note 59, which converted what was in economic substance a non-deductible salary payment to the Duke’s gardener into what was in legal form a payment under a deed of covenant that was effectively deductible for tax purposes; and the transactions in *Gregory v. Helvering*, supra note 79, which sought to convert what was in economic substance a taxable corporate distribution into what was in legal form a tax-free corporate reorganization.

substance of a transaction or arrangement is always relevant in deciding whether a transaction or arrangement results in a misuse or abuse of the provisions at issue.¹⁵³ Thus, although some tax provisions, such as tax incentive provisions, may contemplate or encourage transactions or arrangements lacking any economic substance in order to promote specific policy objectives, it seems reasonable to conclude that most transactions or arrangements with little or no economic substance contradict the object, spirit, or purpose of most tax provisions.¹⁵⁴

For this reason, several GAARs explicitly refer to commercial or economic substance, or objective factors indicative of economic substance, that may be taken into account in determining whether the GAAR should apply. According to the Australian GAAR, for example, application of the provision should be determined "having regard to" various matters, including "the form and substance of the scheme" and "any change in the financial position of the relevant taxpayer that has resulted, will result, or may reasonably be expected to result, from the scheme."¹⁵⁵ The South African GAAR goes further, stipulating "in the context of business" that the provision applies to a tax-motivated arrangement that "lacks commercial substance,"¹⁵⁶ taking into account "characteristics . . . that are indicative of a lack of commercial substance" such as an inconsistency between "the legal form of [the] individual steps" of an arrangement and "[its] legal substance" or effect "as a whole,"¹⁵⁷ and further stipulating that an avoidance arrangement lacks commercial substance if it would (but for the GAAR) result in a significant tax benefit for a party "but does not have a significant effect upon either the business risks or net cash flows of that party apart

153 See, for example, Arnold, "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule," *supra* note 150, at 507, concluding that "it is difficult to see how transactions could be considered to be abusive if the economic substance of what the taxpayer did cannot be considered"; and Cassidy, "To GAAR or Not To GAAR," *supra* note 4, at 304, concluding that the misuse or abuse test will be "nugatory" if courts "cannot look at the substance of the transaction to determine if there is a misuse or abuse."

154 Tax incentive provisions are an obvious example of tax provisions that may contemplate or encourage transactions with little or no economic substance, but so are other provisions that are not properly characterized as tax incentives, such as provisions that allow transactions to facilitate the consolidation of losses among related entities.

155 Australian GAAR, *supra* note 4, section 177D(2). Since the Australian GAAR does not include an explicit misuse or abuse test, it takes these factors into account in determining the purpose for which a person or persons entered into or carried out the tax-avoidance scheme. Although these factors may be relevant to the purpose test of a GAAR, it is arguable that they are more relevant to the concepts of misuse or abuse. For a similar argument concerning the role of economic substance in the application of the PPT, see Duff, *supra* note 134, at 983 and 993-98.

156 South African GAAR, *supra* note 124, section 80(A)(a)(ii). In this context, the commercial substance test displaces the misuse or abuse test.

157 *Ibid.*, section 80(C)(2)(a). See also *ibid.*, section 80(C)(2)(b), referring to "the inclusion or presence of (i) round trip financing as described in section 80(D); or (ii) an accommodating or tax indifferent party as described in section 80(E); or (iii) elements that have the effect of offsetting or cancelling each other."

from any effect attributable to the tax benefit that would be obtained but for the provisions” of the tax legislation.¹⁵⁸ The UK GAAR adopts a similar but more flexible approach, providing a list of factors that “might indicate that tax arrangements are abusive,” including that the arrangements result in “an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes” or in “deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes”—provided, however, that “it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.”¹⁵⁹

Although the Canadian GAAR does not include any reference to the economic substance of a transaction, or objective factors that might indicate the presence of economic substance, the Department of Finance explanatory notes that accompanied the introduction of the Canadian GAAR in 1988 stated that the misuse or abuse test “recognizes that the provisions of the Act are intended to apply to transactions with economic substance, not to transactions intended to exploit, misuse or frustrate the Act to avoid tax.”¹⁶⁰ For this reason, one might have thought that Canadian courts would rely on this concept as an interpretive aid to the misuse or abuse test in GAAR. In *Canada Trustco*,¹⁶¹ however, the Supreme Court of Canada rejected this approach, concluding that the concept of economic substance “has little meaning in isolation from the proper interpretation of specific provisions of the Act” and can therefore only be “considered in relation to the proper interpretation of the specific provisions that are relied upon for the tax benefit.”¹⁶² On this basis, as Brian Arnold observed in a critical comment on the decision, “unless a provision of the Act on which the taxpayer is relying refers to economic substance, lack of economic substance is not an indication of abuse.”¹⁶³ As a result, although a subsequent Federal Court of Appeal decision appears to have relied on a broad concept of economic

158 Ibid., section 80(C)(1).

159 UK GAAR, *supra* note 5, section 207(4).

160 Canada, Department of Finance, *Explanatory Notes to Legislation Relating to Income Tax* (Ottawa: Department of Finance, June 1988), at clause 186, adding that “tax incentives expressly provided for in the legislation” are not intended to be “neutralized.”

161 *Canada Trustco*, *supra* note 1.

162 Ibid., at paragraph 76, concluding that the taxpayer could deduct capital cost allowance on assets that it had acquired at little or no economic cost pursuant to a complicated series of circular transactions on the grounds that the CCA provisions generally allow deductions based on the legal cost of assets, irrespective of their real economic cost, and depart from this approach only in specifically limited circumstances. In this respect, the court appears to have concluded that the transactions were not abusive on the grounds that they were contemplated by the relevant statutory provisions.

163 Brian J. Arnold, “Policy Forum: Confusion Worse Confounded—The Supreme Court’s GAAR Decisions” (2006) 54:1 *Canadian Tax Journal* 167–209, at 192. For a similar conclusion, see David G. Duff, “The Supreme Court of Canada and the General Anti-Avoidance Rule: *Canada Trustco* and *Mathew*,” in *Tax Avoidance in Canada After Canada Trustco and Mathew*, *supra* note 12, at 36, arguing that the court’s failure to recognize a broad concept of economic

substance to conclude that a series of transactions resulted in a misuse or abuse of specific provisions that do not specifically incorporate language of economic substance,¹⁶⁴ the status of economic substance as an interpretive guide to the Canadian GAAR is highly uncertain.

For this reason, some commentators have suggested that the Canadian GAAR should be amended to include an explicit reference to objective factors such as economic substance in order to provide guidance as to the kinds of considerations that should be taken into account in determining whether a transaction or arrangement results in a misuse or abuse.¹⁶⁵ According to Judith Freedman, this approach "would have a double function of reminding the legislator to consider and spell out the basis of new legislation as well as supplying direction to the courts to enable them to apply the specific legislation before them in the way intended by Parliament."¹⁶⁶ In addition, as with the codification of GAAR itself, explicit reference to objective factors such as economic substance would enhance the legitimacy of these criteria and increase the likelihood that they are applied in a clear and consistent manner. As a result, the addition of these objective factors would not only improve the effectiveness of GAAR, but also contribute to its consistency with a non-consequentialist ideal of legality.

These objective factors could be based in part on those identified in the GAARs of other jurisdictions, particularly those enacted after Canada introduced its GAAR—for example, the UK GAAR, which does not actually use the words "economic substance" but instead identifies objective factors indicating a lack of economic substance, such as "an amount of income, profits or gains for tax purposes that is significantly less

substance is closely related to its narrow interpretation of the concept of an abuse "having regard to" provisions of the ITA and other relevant enactments "read as a whole," which it merged with the narrower concept of a misuse of specific provisions themselves.

- 164 *Triad Gestco Ltd. v. Canada*, 2012 FCA 258, at paragraphs 39 and 41, concluding that a series of transactions that created "a loss on paper only in the sense that no economic loss was suffered" resulted in a misuse and abuse of specific provisions for taxing capital gains on the basis that "the capital gain system is generally understood to apply to real gains and real losses."
- 165 See, for example, Arnold, "The Long, Slow, Steady Demise of the General Anti-Avoidance Rule," *supra* note 150, at 511; and Freedman, "Interpreting Tax Statutes," *supra* note 42, at 75 and 79, observing that "[t]he legislature must take some of the blame" for the decision in *Canada Trustco* "for not spelling out the principles sufficiently in the body of the GAAR, despite referring to economic substance in the explanatory notes to the legislation."
- 166 Freedman, "Interpreting Tax Statutes," *supra* note 42, at 75. Freedman also argues that a GAAR should be accompanied by express statements of the principles underlying detailed legislative provisions that would provide further guidance to the object and purpose of these provisions. *Ibid.*, at 87, stating that "the drafting of specific legislation needs to become more explicit about the underlying principles of the legislation." For more detailed discussions about principles-based approaches to the drafting of tax legislation, see John F. Avery Jones, "Tax Law: Rules or Principles?" [1996] no. 6 *British Tax Review* 580-600; Graeme S. Cooper, "Legislating Principles as a Remedy for Tax Complexity" [2010] no. 4 *British Tax Review* 334-60; and Judith Freedman, "Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited" [2010] no. 6 *British Tax Review* 717-36.

than the amount for economic purposes” or “deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes.”¹⁶⁷ In the Canadian GAAR, as in the UK GAAR, these factors would operate as interpretive guidelines or presumptions, and would be subject to an exception when it is reasonable to consider that the tax benefit was intended or anticipated when the relevant provisions were enacted.

Further guidance might also be derived from the valuable “taxonomy” of tax-avoidance transactions that Professor Edgar devised, noting that tax-avoidance transactions that lack economic substance can generally be categorized into one of three types:

1. transactions that create a tax attribute such as a deduction, loss, or tax credit that can be used to shelter income from tax (“tax-attribute creation”);
2. transactions that transfer tax attributes, such as income, deductions, losses, or tax credits, from one taxpayer to another in order to obtain a joint tax benefit that can be shared between the taxpayers (“tax-attribute trading”); and
3. transactions and arrangements whose non-tax characteristics closely replicate those of an alternative transaction or arrangement, but result in substantially less tax than the alternative (“transactional substitutions”).¹⁶⁸

As Professor Edgar observed, these kinds of transactions are familiar to most tax professionals and represent the vast majority of tax-avoidance cases that appear before the courts.¹⁶⁹ For these reasons, it makes sense to draw upon criteria that courts have considered abusive in order to devise objective factors of misuse or abuse. As with factors derived from the GAARs of other jurisdictions, these factors would also operate as interpretive guidelines or presumptions and be subject to an exception when it is reasonable to consider that the tax benefit was intended or anticipated when the relevant provisions were enacted.

167 UK GAAR, supra note 5, section 207(4).

168 Edgar, “Building a Better GAAR,” supra note 12, at 848-50.

169 For a useful categorization of Canadian GAAR according to these categories up to 2006, see Edgar, “Designing and Implementing a Target-Effective General Anti-Avoidance Rule,” supra note 12, at 257-58. An updated list of notable Canadian cases in each category include: (1) transactions like those in *Triad Gesto*, supra note 164, that create offsetting gains and losses, the former of which are deferred and/or tax-preferred or non-taxable, while the latter are used to shelter current income from tax; (2) income-shifting transactions like those in *Canada v. 594710 British Columbia Ltd.*, 2018 FCA 166, that allocate income from one taxpayer to another who is either taxable at a lower rate or has losses or other deductions that shelter this income from tax, and deduction-shifting transactions like those in *Canada Trustco*, supra note 1 and *Matthew*, supra note 14, that transfer losses or other deductions from one taxpayer to another to whom these deductions are more valuable; and (3) surplus-stripping transactions, like those in *McNichol* and *RMM*, supra note 121, that convert what would otherwise be taxable dividends into tax-preferred capital gains, and treaty-shopping arrangements, like those in *MIL*

Although Professor Edgar recommended that GAAR should be amended to include a concept of economic substance based on these three categories of tax avoidance,¹⁷⁰ he would have rejected the suggestion that objective factors based on these categories should operate as interpretive guidelines or presumptions rather than fixed rules, and would have criticized the idea that these factors should draw on criteria that courts themselves have considered abusive. On the contrary, he argued, the harmful consequences attributable to these transactions (assuming that they are primarily tax-motivated) are such that they should all be subject to GAAR without having to "engage in a generalized exercise in statutory interpretation to determine whether the particular tax avoidance transaction is acceptable."¹⁷¹ In addition, he suggested, it is "simply not clear that the judiciary has the kind of institutional competence to engage in the policy-based inquiry implicated by a statutory interpretation exercise."¹⁷² For these reasons, he concluded that the role of statutory interpretation in the application of GAAR should be "significantly diminished" or eliminated altogether by amending GAAR in two ways: (1) deeming all tax-attribute-creation and tax-attribute-trading transactions to constitute a misuse or abuse "unless there is an explicit legislative regime sanctioning the transaction,"¹⁷³ and (2) adding an economic substance concept "as tantamount to the synthetic replication of a higher-taxed transaction . . . to enable the judiciary to address a limited range of transactional substitutions."¹⁷⁴

For the purpose of this paper, it is less important to address the details of these recommendations than it is to explain why they differ from my own recommendations for amending GAAR and how they relate to alternative conceptions regarding the essential purposes of a GAAR. From Professor Edgar's consequentialist perspective, the function of a GAAR is to ensure an efficient level of tax avoidance by balancing its marginal costs and benefits—a task for which the judiciary is (with the deepest of respect) obviously unsuited. From a non-consequentialist perspective, on the other hand, the ultimate purpose of a GAAR is to protect the integrity of the tax provisions at issue by discouraging and counteracting transactions and arrangements that contradict their objects or purposes. Although this is not an easy task, and is

(*Investments*) SA and *Alta Energy*, supra note 121, that enable taxpayers to obtain benefits under a tax treaty that would otherwise be unavailable.

170 Edgar, "Building a Better GAAR," supra note 12, at 904.

171 Ibid., at 880.

172 Ibid., at 841. See also *ibid.*, at 837: "It is utterly hopeless to leave it to the judiciary to articulate a behavioral prohibition that is neither under-inclusive nor over-inclusive in its identification of prohibited transactions. Trained as lawyers, and not public policy analysts, judges (and the lawyers appearing before them) simply do not have the institutional competence to execute this important task."

173 Ibid., at 895.

174 Ibid., at 903.

best assisted by legislative guidance on the kinds of objective factors that may constitute a misuse or abuse of the relevant provisions, it is a quintessentially judicial function for which courts are clearly competent.¹⁷⁵

CONCLUSION

General anti-avoidance rules and principles have an important role to play in domestic tax legislation and tax treaties, not only to prevent adverse consequences such as revenue losses, efficiency costs, inequitable shifting of tax burdens, and the erosion of voluntary tax compliance, but also to uphold the rule of law by discouraging and counteracting transactions and arrangements that undermine the integrity of tax laws and contradict the object and purpose of these laws. These rules and principles may be consistent with the ideal of legality to which the rule of law aspires, but this is the case only if they are designed in a manner that is also consistent with the principles on which this ideal is based. To this end, I have argued in this paper that

1. the standard that is adopted to discourage and counteract unacceptable tax avoidance should be codified in the form of an explicit rule in domestic tax legislation and tax treaties;
2. this rule should include (a) a “subjective element” or purpose test and (b) an “objective element” or misuse and abuse test, the second of which determines whether the transaction or arrangement at issue is consistent with the object and purpose of the relevant provisions, and the first of which justifies the application of this interpretive approach in place of the ordinary interpretive approach on which taxpayers can otherwise rely on the basis of a principle of legal certainty;
3. the “subjective element” or purpose test (a) should be assessed objectively by reference to what a reasonable person would consider the purposes of a transaction or arrangement to be (not the subjective purposes of the person or persons involved), (b) may reasonably be satisfied where one of the principle purposes for which the transaction or arrangement was undertaken or arranged was to obtain a tax benefit, and (c) may be informed by objective indicia of artificiality;
4. the “objective element” or misuse or abuse test should be informed by objective factors that are indicative of economic substance and should be expressly incorporated into a GAAR;

175 Brian J. Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49:1 *Canadian Tax Journal* 1-39, at 31. See also Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule,” note 150, at 502, explaining that the object, spirit, and purpose of legislation are “concepts [that] should be familiar to the courts because they form part of the modern approach to statutory interpretation as mandated by the Supreme Court of Canada.”

5. these objective factors should be informed by factors included in the GAARs of other jurisdictions (for example, the UK GAAR), as well as criteria that courts have considered abusive in the various types of tax-avoidance cases that they have considered—cases that Professor Edgar very usefully categorized as tax-attribute-creation cases, tax-attribute-transfer cases, and transactional substitution cases;
6. these objective factors should operate not as fixed rules, but as guidelines or presumptions to which courts can refer to determine whether a transaction or arrangement results in a misuse or abuse of the provisions at issue;
7. courts have the institutional competence to carry out the interpretive exercise that is required under a misuse or abuse test, particularly if assisted by these objective factors; and
8. the addition of these objective factors would improve the consistency of GAAR decisions and promote legal certainty.

In this way, finally, this paper has argued that a GAAR is not only consistent with, but essential to, the ideal of legality to which the rule of law aspires.

Although I disagree in this paper with Professor Edgar's consequentialist approach to GAARs, my argument was inspired and shaped by a serious engagement with his approach—the kind of engagement that I believe most academics hope to stimulate through their scholarship. I hope that this essay honours his legacy and is a fitting tribute to the influence of his scholarship.

Ahead by a Century: Tim Edgar, Machine-Learning, and the Future of Anti-Avoidance

Benjamin Alarie*

PRÉCIS

L'apport de Tim Edgar à notre compréhension de l'évitement fiscal et de la lutte contre l'évitement fiscal demeure en avance sur son temps. Dans cet article, l'auteur fait valoir que les travaux de Tim Edgar sur l'élaboration de meilleures règles générales anti-évitement (RGAE) étaient particulièrement prescients, car ils étaient justes dans leur affirmation voulant que l'évitement fiscal puisse et doive être éliminé par des mesures anti-évitement efficaces. L'auteur soutient que la position et la vision de Tim Edgar se réaliseront éventuellement, mais que Tim Edgar lui-même ne savait pas comment cela allait se faire. L'auteur affirme tout d'abord que le droit est incomplet, ce qui rend difficile d'insister sur l'adoption immédiate de mesures anti-évitement strictes. L'auteur explique comment et pourquoi le stade actuel de développement du droit est loin de préciser entièrement le droit, y compris le droit fiscal. Il affirme ensuite que nous verrons dans les prochaines décennies des approches beaucoup plus complexes et efficaces au développement du droit. Sont décrits, en termes généraux, certains des mécanismes par lesquels nos systèmes fiscaux évoluent vers une singularité juridique (un état du droit qui est fonctionnellement complet et bien défini). L'auteur expose ensuite les implications de ses deux principales affirmations pour l'avenir des RGAE et de la lutte contre l'évitement fiscal — en particulier, comment la réalisation d'un système juridique beaucoup plus complet ne laissera effectivement plus de place à l'évitement fiscal. Le droit fiscal, dans la réalisation asymptotique des travaux et de la vision de Tim Edgar, deviendra bien ciblé et pourvu des moyens pour lutter contre l'évitement fiscal. L'évitement fiscal comme nous le connaissons cessera d'exister.

ABSTRACT

Tim Edgar's contributions to our understanding of tax avoidance and anti-avoidance remain ahead of their time. In this paper, the author argues that Edgar's work on building better general anti-avoidance rules (GAARS) was particularly prescient—correct in its claim that tax avoidance can and should be eliminated through effective anti-avoidance measures. The author maintains that although Edgar's position and vision will eventually

* Osler Chair in Business Law, University of Toronto.

be realized, Edgar himself did not anticipate the manner in which this would occur. The author's first claim is that the law is incomplete, and this incompleteness problematizes any insistence on the immediate adoption of strict anti-avoidance measures. The author explains how and why the current stage of legal development falls significantly short of completely specifying the law, including the tax law. The author's second claim is that the next decades will bring considerably more sophisticated and effective approaches to legal development. Described, in broad terms, are some of the mechanisms through which our tax systems are moving toward a legal singularity (a state of the law that is functionally complete and well specified). The author proceeds to outline the implications of his two main claims for the future of GAARS and anti-avoidance—specifically, how the realization of a much more complete system of law will leave effectively no further scope for tax avoidance. Tax law, in the asymptotic realization of Edgar's work and vision, will become well targeted and well equipped to address tax avoidance. Tax avoidance as we know it will cease to exist.

KEYWORDS: GAAR ■ ANTI-AVOIDANCE ■ TAX AVOIDANCE ■ EFFICIENCY ■ TAX POLICY ■ DIGITALIZATION

CONTENTS

Introduction	614
Claim One: Tax Law Is Incomplete	617
Claim Two: Toward a “Legal Singularity” in Tax Law	622
Implications for the Future of Anti-Avoidance and GAARS	628
Conclusion	629

INTRODUCTION

The contributions of Professor Tim Edgar (1960–2016) to our understanding of tax avoidance and anti-avoidance remain ahead of their time. In this paper, which I dedicate to his memory, I argue that in his academic work on the building of better general anti-avoidance rules (GAARS),¹ Edgar was “ahead by a century.”²

My contention in this paper is that Edgar was correct in his claim that tax avoidance can and should be eliminated through effective anti-avoidance measures.³

1 Tim Edgar, “Building a Better GAAR” (2008) 27:4 *Virginia Tax Review* 833–906.

2 “Ahead by a Century” is a reference to the 1996 song of that name on the album *Trouble at the Henhouse*, by the Canadian rock band The Tragically Hip. The band's lead singer, Gordon Downie (1964–2017), battled terminal illness contemporaneously with Tim Edgar (1960–2016); they passed away within months of each other. I believe that Tim would appreciate the reference.

3 In adopting this position, Tim Edgar was no doubt influenced by his colleague at Western University and long-time proponent of the Canadian GAAR, Brian Arnold. See, generally, Brian J. Arnold, “Reflections on the Relationship Between Statutory Interpretation and Tax Avoidance” (2001) 49:1 *Canadian Tax Journal* 1–39; and Brian J. Arnold, “The Long, Slow, Steady Demise of the General Anti-Avoidance Rule” (2004) 52:2 *Canadian Tax Journal* 488–511. Much of the argument here would also apply to the positions that Brian Arnold has taken on GAAR over the years.

In his most prominent article on the subject of tax avoidance and GAARs,⁴ Edgar asserted that “tax avoidance should be viewed as a negative externality, and externality theory suggests appropriate policy instruments that can be used to eliminate the consequential attributes of avoidance behavior.”⁵ Later in the article, he took this point further, stating that “[t]he consequential attributes of all tax-avoidance behavior require a response of some sort intended to eliminate such behavior.”⁶ I argue in this paper that Edgar’s position and vision will eventually be realized but that Edgar himself did not anticipate the manner in which his views will be vindicated. Any effort to foresee where tax law will lead with respect to GAARs and anti-avoidance will probably produce only a very abstract vision.⁷ Nonetheless, that is my aim in this paper.

My central thesis—that the future of law will vindicate Edgar’s views on tax avoidance—depends on two subordinate claims. The first is that tax law is currently woefully incomplete, thus seriously threatening the integrity of Edgar’s vision. Legal scholarship in general underappreciates how tax law’s incompleteness undermines the view that tax avoidance can and should be eliminated.⁸ This is certainly not because the view is flawed in principle. Instead, the lack of appreciation is related to the absolute nature of the view and to the fact that it is not predicated or conditional on the underlying state of the development of tax law. Owing to the law’s incompleteness, I do not believe that Edgar’s view has ever truly been borne out (at least not yet). The law’s incompleteness and the inevitable perception that governments are taking half-measures to combat tax avoidance generally account for the frustration of many academics and commentators with respect to tax avoidance.⁹

4 For a masterful synthesizing discussion of Edgar’s many publications and, in particular, his GAAR publications, see, elsewhere in this issue, Richard Krever, “A Tax Policy Legacy: Tim Edgar’s Contributions to Tax Scholarship and Tax Legislation” (2020) 68:2 *Canadian Tax Journal* 1-20.

5 Edgar, *supra* note 1, at 833.

6 *Ibid.*, at 838.

7 Currently, it seems almost certain that we cannot anticipate accurately how the law will evolve, either. It is likely to occur in fits and starts, like biological evolution. Consider the debate, in the research on evolution, between the “jerks” (who argue that punctuated equilibria often led to relatively rapid shifts in species, from a geological perspective) and the “creeps” (who argue that speciation took long periods of time during which there were relatively gradual changes). Refer to the description of “Punctuated Equilibrium,” *Wikipedia* (https://en.wikipedia.org/wiki/Punctuated_equilibrium).

8 See Benjamin Alarie, “The Challenge of Tax Avoidance for Social Justice in Taxation,” in Helmut P. Gaisbauer, Gottfried Schweiger, and Clemens Sedmak, eds., *Philosophical Explorations of Justice and Taxation: National and Global Issues* (Cham, Switzerland: Springer, 2015), 83-98 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2563133).

9 See, for example, Allison Christians, “Avoidance, Evasion, and Taxpayer Morality” (2014) 44 *Washington University Journal of Law and Policy* 39-60, at 43 (<https://ssrn.com/abstract=2417655>): “One possibility is that governments cannot prevent this behavior; the other is that they can do so but choose not to for political reasons”; and David G. Duff, “Tax Avoidance in

My criticism of the unqualified view that all “tax avoidance is necessarily undesirable” is similar to the criticisms levelled at those who insist that breaches of contract are necessarily immoral and repugnant. (It is dubious whether and to what extent a decision to breach and pay damages in contract law is morally offensive.)¹⁰ The position that I advance here also draws inspiration from Michael Trebilcock’s work on tax avoidance¹¹ and from Ian Ayres’s work on options in law and with respect to the structure of legal entitlements.¹² However, despite the persuasiveness of the case based on the incompleteness of the current law, not all is lost in the long run for Edgar’s view.

The second claim supporting the thesis of this paper is that the remainder of the 21st century will see a marked improvement in the design, specification, implementation, and administration of our tax and legal systems. Elsewhere, drawing inspiration from the late-19th-century insights of Oliver Wendell Holmes Jr.¹³ and the more recent insights of John Rawls,¹⁴ I have made the case for the emergence of a “legal singularity”¹⁵—in other words, a state of the law that is functionally complete and well specified. This condition will be achieved through more sophisticated theoretical and empirical approaches to studying the past, understanding the present, and predicting the future.¹⁶ The process will proceed in fits and starts.¹⁷ We

the 21st Century,” in Chris Evans and Richard Krever, eds., *Australian Business Tax Reform in Retrospect and Prospect* (Sydney: Thomson Reuters, 2009), 477–501 (<http://dx.doi.org/10.2139/ssrn.1457453>).

- 10 See, for example, Robert L. Birmingham, “Breach of Contract, Damage Measures, and Economic Efficiency” (1970) 24:2 *Rutgers Law Review* 273–92, at 284–86; and Steven Shavell, “Is Breach of Contract Immoral?” (2006) 56:2 *Emory Law Journal* 439–60, at 442–50.
- 11 See Michael J. Trebilcock, “Section 260: A Critical Examination” (1964) 38:7 *Australian Law Journal* 237; and Benjamin Alarie, “Trebilcock on ‘Tax Avoidance’” (2010) 60:2 *University of Toronto Law Journal* 623–42.
- 12 Ian Ayres, *Optional Law: The Structure of Legal Entitlements* (Chicago: University of Chicago Press, 2010).
- 13 See, in particular, Oliver Wendell Holmes, “The Path of the Law” (1897) 10:8 *Harvard Law Review* 457–78, at 469, where Holmes states that “[f]or the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics.”
- 14 See John Rawls, *A Theory of Justice*, rev. ed. (Cambridge, MA: Harvard University Press, 1999). A treatment of the idea of a reflective equilibrium is forthcoming in Norman Daniels, “Reflective Equilibrium,” in *Stanford Encyclopedia of Philosophy* (Stanford: Stanford University, Center for the Study of Language and Information, Metaphysics Research Lab) (online).
- 15 See Benjamin Alarie, “The Path of the Law: Towards Legal Singularity” (2016) 66:4 *University of Toronto Law Journal* 443–55 (<https://doi.org/10.3138/UTLJ.4008>).
- 16 Early signs of this are abundantly clear to those who are paying attention. Consider the increasing use of technology to predict legal outcomes, the use of new theoretical and empirical methods to test legal ideas, and, more generally, the explosion in computing power, data, and algorithms over the past several decades.
- 17 Consider the reference to punctuated equilibrium, *supra* note 7.

will harness the insights gleaned from superior theoretical and empirical methods to create and administer legal approaches that, viewed from a public policy perspective, are ever more optimal—for example, more sophisticated rules, standards, and institutions. Over the next few decades, we will grow accustomed to vastly more sophisticated methodologies for filling in the gaps in those rules and standards, and we will embrace more evidence-based, nimble, and responsive law-making and law-enforcing institutions. New kinds of policy instruments will be made possible through technology. We will become much better at identifying the optimal *objectives* for public policy and at adopting and implementing the *means* for realizing those objectives.

The remainder of this paper comprises four parts. To begin with, I present the first claim—that the law is incomplete and that this incompleteness problematizes any insistence on the immediate adoption of strict anti-avoidance measures. In the process, I explain how and why the current stage of legal development falls significantly short of completely specifying the law, including the tax law. In the next part of the paper, I present the second claim, which is that we are going to unlock considerably more sophisticated and effective approaches to legal development over the coming decades. In presenting this second claim, I describe in broad terms some of the mechanisms through which our tax systems are moving toward a legal singularity. In the third part of the paper, I describe these two claims’ implications for the future of GAARs and anti-avoidance. More specifically, I explain how the realization of a much more complete system of law will leave effectively no further scope for tax avoidance; tax law, in the asymptotic realization of Edgar’s work and vision, will become well targeted and well equipped to address tax avoidance.

CLAIM ONE: TAX LAW IS INCOMPLETE

Edgar’s claim that tax avoidance is wholly undesirable presupposes and depends on the existence of a complete and properly specified system of tax law (a perfect or near-perfect system). If such a complete system were our point of reference, we would be prepared to accept the claim that tax avoidance—viewed from the consequentialist perspective preferred by Edgar—is necessarily undesirable. (We would accept this claim cautiously, however, since such a system would require significantly more legal development in every respect than is currently the case.) With such a perfect system in place, any deviation from the pattern of tax liability established by tax law would presumably result in private benefits to the tax avoider, and there would be, by definition, insufficient countervailing public policy rationale or justification.¹⁸ To establish that not all tax avoidance today is necessarily undesirable from a consequentialist perspective, I must demonstrate that the world’s current systems

18 On the other hand, in a perfect tax system, any such “tax avoidance” would be justifiable because of what it secures in terms of non-tax policy benefits. On how loopholes result from multicriterial tradeoffs in policy settings, see Leo Katz, “A Theory of Loopholes” (2010) 39:1 *Journal of Legal Studies* 1-32.

of tax law are incomplete and, in meaningful ways, far from optimal.¹⁹ I suspect that tax academics and practitioners alike will find this claim all too easy to accept.

Curiously, it was the practical shortcomings of the way in which GAARs generally target and address tax avoidance that prompted Edgar to make his claims about the inherently disagreeable nature of tax avoidance. GAARs' deficiencies motivated Edgar to support policy makers in developing theoretical insights that could be used, in turn, to suggest methods for improvement. It is worth pointing out, however, that the same kinds of legal processes and pressures that produce GAARs—including the inevitable pressures from the political economy, which de-fang and blunt the rules—also generate the rest of our tax law (and, of course, law more generally). This fact leads Edgar's view inescapably into a challenge of sorts: the design and implementation of GAARs that he found so wanting are typically layered over incomplete and perhaps even more unsatisfactory tax and legal systems.²⁰ To make the point a different way, a perfectly targeted, "Edgar-approved" GAAR layered on top of a highly imperfect tax and legal system is like putting lipstick on a pig. A wide variety of explanations exist, of course, for how and why the current tax and legal systems remain imperfectly designed and specified. These explanations cite, *inter alia*, the difficulty of path-dependency in the law, incomplete information, limits to human cognition, the difficulties of coordinating numerous tax sovereigns with conflicting national and subnational interests, technological limitations, corruption, agency costs, the various frictions associated with non-state political economy considerations, and the fundamental issue of scarcity of time and resources.²¹ Reflecting on the origins of GAARs' infirmity could very well lead to skepticism about the nature and propriety of the tax and legal systems on which GAARs are based, and could easily lead to disillusionment about the efficacy of efforts to combat tax avoidance.²² To his credit, despite these challenges, Edgar did not lose sight of the goal of effective anti-avoidance.

Incompleteness is pervasive in law, a feature not only of the common law, such as tort and contract law (which depend critically on new judgments to drive legal development), but also of the law in general, including tax law. Referring to tax law as "incomplete" is not meant as a normative criticism or critique (though it might be taken this way); instead, my claim is—as was Edgar's, in this respect—a positive one. The incompleteness that I refer to is understandable, given the current state of our overall legal development and technology. The relatively static nature of the current statutory, regulatory, and administrative approach to tax law (and other

19 I describe below what I mean by a "complete" system of tax law.

20 More on this below.

21 For a recent treatment of many of these issues, see Thomas Piketty, *Capital and Ideology*, trans. Arthur Goldhammer (Cambridge, MA: Harvard University Press, 2020).

22 The resulting realization could be similar to the malaise described in David M. Trubek and Marc Galanter, "Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States" (1974) 4 *Wisconsin Law Review* 1062-1102.

areas of law) means that this law cannot specifically and proactively address every potential future contingency in an optimal way. These challenges were considered directly in the design of the UK GAAR, which was criticized for being both too narrow and too broad.²³ Consider also the challenges that the Organisation for Economic Co-operation and Development's (OECD's) base erosion and profit-shifting (BEPS) project have encountered since work began in 2013, despite ostensible widespread adoption across the Group of Twenty (G20).²⁴

I am not criticizing tax law alone for being incomplete and imperfect. Tax law reflects our current level of development in various dimensions (for example, legal, social, political, and technological), and incompleteness is a pervasive feature of every area of law. The mission and professional responsibilities of lawyers, judges, and legal academics include the basic obligation to help support the law's further development and refinement. We pretend that our legal development is sufficient, but in reality the law is significantly underspecified. This is not because we lack individuals and institutions willing to do the hard work to improve it (although many benefit by slowing its improvement). It is largely because (1) our techniques and methods for improving the law remain slow and crude; (2) we can have only limited confidence in our ability to craft improvements, given the limits to our knowledge and understanding; and (3) the legal system involves many aspects that work interdependently, like a Rubik's cube—any change to one aspect will affect many others. This complexity, path-dependency, and interdependence make change difficult, so we tend to prefer and undertake the gradual and incremental over the bold and potentially better and more effective.

Consider the common law.²⁵ To determine liability for negligence in the tort context, we rely on ex post notions of what would have been “reasonably foreseeable” to a “reasonable person” in a particular setting, and we do so to determine whether a defendant might be said to have met the required “standard of care” in satisfaction of a duty of care to a plaintiff. To provide practical guidance on these kinds of questions is difficult and at best uncertain, for a wide variety of reasons. In the context of contract law, legal incompleteness is also widely acknowledged and accepted. It is well known that contracts are virtually always incomplete; parties

23 Refer to the discussion in Judith Freedman, “The UK General Anti-Avoidance Rule: Transplants and Lessons” (2019) 73:6/7 *Bulletin for International Taxation* 332–38 (www.ibfd.org/sites/ibfd.org/files/content/pdf/The-UK-General-Anti-Avoidance-Rule.pdf).

24 See Organisation for Economic Co-operation and Development, “Closing Tax Gaps—OECD Launches Action Plan on Base Erosion and Profit Shifting,” July 19, 2013 (www.oecd.org/tax/beps/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm).

25 In the common law, Lord Denning is sometimes celebrated as a maverick, willing to go beyond the merely gradual and incremental in order to improve the law through bold reforms that played fast and loose with the usual methods of the common law. See, for example, the introduction (“The Obituaries of Lord Denning”) in Charles Stevens, *The Jurisprudence of Lord Denning: A Study in Legal History, Volume III, Freedom Under the Law: Lord Denning as Master of the Rolls, 1962–1982* (Newcastle: Cambridge Scholars Publishing, 2009), at 1.

simply cannot foresee and address every potential future contingency.²⁶ Indeed, contract scholars accept that contracting parties can never succeed in negotiating a set of terms appropriate for governing every potential outcome.²⁷

A tort or contract law student from a century ago would be perfectly at home in many law school classrooms in 2020; he or she would be reading many of the same cases and making similar arguments about hypotheticals that would seem natural and would be readily grasped. The private law has made progress over the past century, of course, particularly in theoretical and empirical studies of the consequences of its various aspects, but the way in which a representative law student, lawyer, legal academic, or judge interacts with the private law has changed little, save perhaps in that a greater number of statutes now, especially with respect to consumer protection, affect private-law determinations.

Law's incompleteness is not an easy problem to solve. Indeed, we resort to the incomplete notions that pervade the private law because experience with the messiness of the real world teaches us that it is too difficult to specify in complete detail what is or is not in a particular legal category *ex ante*. This issue has given rise to the literature regarding the choice of rules versus standards.²⁸ As this literature points out, we are generally more confident in judges' ability to reach defensible after-the-fact decisions as to whether a particular situation satisfied certain requirements in a particular setting than we are in our ability (or the ability of a legislature) to specify beforehand a set of complex and exhaustive rules stipulating what should be ruled in and what should be ruled out. And such incompleteness is not only an aspect of private law. Incompleteness abounds in public law as well. For example, with respect to the difficult-to-articulate legal category of obscenity, US Supreme Court Justice Potter Stewart famously remarked, in his concurring opinion in *Jacobellis v. Ohio*,²⁹ that "he knows it when he sees it."³⁰ There exist many such examples of the challenges of completely specifying the boundaries of legal categories in private law and public law. Tax law inevitably shares in this incompleteness. Indeed, many commentators have grappled with³¹ and taken issue with the Canadian GAAR because of the imperfect identification of what ought to be classified as "misuse" or "abuse"

26 See, for example, Alan Schwartz, "Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies" (1992) 21:2 *Journal of Legal Studies* 271-318.

27 Avery W. Katz, "Contractual Incompleteness: A Transactional Perspective" (2005) 56:1 *Case Western Reserve Law Review* 169-86, at 169.

28 See Louis Kaplow, "Rules Versus Standards: An Economic Analysis" (1992) 42:3 *Duke Law Review* 557-629.

29 *Jacobellis v. Ohio*, 378 US 184 (1964).

30 *Ibid.*, at 197. The complete quote is, "I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description [of obscenity], and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that."

31 See Jinyan Li, "Economic Substance: Drawing the Line Between Legitimate Tax Minimization and Abusive Tax Avoidance" (2006) 54:1 *Canadian Tax Journal* 23-56.

for the purposes of subsection 245(3) of the Income Tax Act.³² Given the incompleteness of the law, it can be quite a challenge to identify a clear policy objective associated with particular provisions or sets of provisions that may (or may not) have been drafted in a coordinated manner.

A more complete law is possible. I use the word “complete” in this context to describe a system of law (specifically, tax law) that exhibits three key characteristics: it is well designed, well specified, and administered effectively

A complete tax system demonstrates “optimized design”; that is, it is well designed and optimized to allow appropriate tradeoffs among the many competing public policy goals that the tax system implicates. It allows these tradeoffs through appropriate rules, functional standards, and reliable legal methodologies for addressing gaps. For the tax system to be well designed and optimal in this sense, a number of things are required, at a minimum: the input and sophistication of many different kinds of experts (for example, empiricists, economists, accountants, philosophers, lawyers, and social scientists of all stripes), robust public debate, a process for capturing and implementing the results that is immune to capture by special interests, and testing—lots and lots of testing. The life of the law has not been (and will not be) logic; it has been (and will be) experience.³³

The second characteristic of a complete tax system (according to my meaning of “complete”) is that it is *well specified*, in the sense that questions about whether and how particular rules and standards apply to any given situation can consistently and reliably be answered (allowing “deep specification”). Deep specification is present in a tax system when its characterization of such elements as transactions, events, and entities is consistent, aligned with that system’s optimized public policy design, and resistant to being gamed by the taxpayer.³⁴

The third aspect of a complete tax system is that it is *administered effectively*. By “effective administration” I mean that its design and specific elements are capable of being consistently and reliably applied, and that the administration of the system involves a minimum of mistakes (that is, the system is able to avoid false positives and false negatives). Arguably, of course, our current method of providing such consistency is to rely on tax administrations, judges, and our court systems.³⁵ This is a

32 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended. See, for example, Joel Nitikman, “Is GAAR Void for Vagueness?” (1989) 37:6 *Canadian Tax Journal* 1409–47.

33 Hat-tip to Oliver Wendell Holmes Jr., *The Common Law* (Boston: Little, Brown, 1881), at 1, who penned the famous line, “[t]he life of the law has not been logic: it has been experience.”

34 Resistance to being gamed is a particularly important quality in the anti-avoidance context; being gamed by taxpayers is extraordinarily difficult to guard against. Historically, this was even more the case, given the legacies of strict construction and legal substance in Anglo-Canadian income tax law. See Benjamin Alarie and David G. Duff, “The Legacy of UK Tax Concepts in Canadian Income Tax Law” [2008] no. 3 *British Tax Review* 228–52 (<https://ssrn.com/abstract=1120784>).

35 For a discussion, see Binh Tran-Nam and Michael Walpole, “Tax Disputes, Litigation Costs and Access to Tax Justice” (2016) 14:2 *eJournal of Tax Research* 319–36.

cumbersome way to achieve effective administration, and it is only partially effective. This method works in some circumstances, but, given its costs in time and financial resources (not to mention the fact that it produces too many false positives and false negatives), it is an imperfect way of realizing the aims of the tax system.

Given the ways in which tax law and policy have continued to evolve in our current state of legal development (which is itself a result of our current technological and institutional limitations), the state of our tax law systems today, in Canada and around the world, clearly falls short of meeting a standard of “completeness” that exhibits optimized design and deep specification. In the next part of this paper, I explain the mechanisms that will help to guide law—and tax law, specifically—in the direction of greater completeness.

CLAIM TWO: TOWARD A “LEGAL SINGULARITY” IN TAX LAW

The recognition that tax law has been and continues to be incomplete is the basis of my claim in this paper that not all of what is currently regarded as tax avoidance in our current system of taxation is necessarily undesirable from a social welfare perspective. This claim is in tension with Edgar’s view that the “consequential attributes of all tax-avoidance behavior require a response of some sort intended to eliminate such behavior.”³⁶ The primary aspirations for tax law and policy, in my view, should be to hasten as much as possible the advent of a more complete and effective system of tax law. A tax system that approaches completeness will not include the pitfalls and windfalls that we see littered throughout the imperfect patchwork of tax systems today, interacting with underlying legal systems that are less than ideally defined.

Tax-avoidance behaviour will naturally diminish in practical importance over the next century as tax law (and the legal system generally) becomes progressively more optimal in its design, and complete in its specification. Perhaps it is risky to argue teleologically, as I do here, that tax law will continue to improve, though I believe that history supports such a view. A review of the past few centuries or even of the 20th century alone suggests that this argument is not unreasonable. For example, the income tax systems in Canada and the United States are just over a century old and have undergone highly significant changes over that period.³⁷ Tariffs and excise taxes have become vastly less important to public finances in OECD nations. Value-added taxes, first introduced in France in 1954, have become well established throughout the OECD member states (with the exception of the United States).³⁸ Given the rapid development of new methods of taxation, it is

36 Edgar, *supra* note 1, at 838.

37 See Jinyan Li, J. Scott Wilkie, and Larry F. Chapman, *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act* (Toronto: Canadian Tax Foundation, 2017).

38 See Kathryn James, “Exploring the Origins and the Global Rise of VAT,” in *The VAT Reader: What a Federal Consumption Tax Would Mean for America* (Falls Church, VA: Tax Analysts, 2011), 15–22 ([www.taxhistory.org/www/freefiles.nsf/Files/JAMES-2.pdf/\\$file/JAMES-2.pdf](http://www.taxhistory.org/www/freefiles.nsf/Files/JAMES-2.pdf/$file/JAMES-2.pdf)).

abundantly reasonable to expect that these and other kinds of taxes will continue to develop apace.³⁹ Indeed, many areas of law have undergone rapid development over the past century.

A functionally complete legal system, as I have suggested above, is one in which we have achieved a condition of “legal singularity.”⁴⁰ A careful reading of Edgar’s work on the development of a more target-effective GAAR suggests that he would agree in principle that legal singularity would solve the tax-avoidance problem as he saw it: such a complete tax law would, by definition, capture as tax revenue what would be optimal to capture and would leave untaxed what ought not to be taxed. Indeed, a functionally complete tax system would achieve precisely the sort of effective targeting that Edgar viewed as the desirable consequence of a well-designed GAAR.⁴¹ In this respect, therefore, the views that I advance here are consistent in spirit and direction with those animating Edgar’s contributions to the discussion.

A legal singularity will not emerge entirely spontaneously. Considerable effort and investment are required for a full understanding of how individuals and firms respond to taxes and how the tax law influences decision making and behaviour. Academic work, particularly empirical work on the consequences of various tax policies, continues to accumulate. In the context of empirical tax research in public economics, the National Bureau of Economic Research’s (NBER’s) Public Economics Program produced increasing numbers of papers in the three-decade period ending in 2010: 398 papers in 1990, 665 in 2000, and 1025 in 2010. A growing proportion of these papers were empirical in nature—29.1 percent in 1990, 46.4 percent in 2000, and 52.5 percent in 2010.⁴² With respect to empirical tax research in the accounting field, Douglas Shackelford and Terry Shevlin canvassed the growth of empirical literature in the 15 years leading up to 2001, including over 200 separate papers in their survey, and they concluded, “We are encouraged by the rapid progress of the field in the last few years and look forward to further research enhancing our understanding of the role of taxes in organizations.”⁴³ And there are indications that empirical tax research in accounting has increased significantly since 2001. For example, newly available administrative data have, over the past two decades, considerably increased researchers’ ability to address certain issues.⁴⁴ In

39 For a sophisticated attempt to outline what further changes to our tax systems could look like, including a greater reliance on wealth and wealth-transfer taxes, see Piketty, *supra* note 21, part 4, “Rethinking the Dimensions of Political Conflicts.”

40 *Ibid.*

41 See Edgar, *supra* note 1, at 852.

42 See National Bureau of Economic Research, “The NBER Public Economics Program” (www.nber.org/programs/pe/pe.html).

43 Douglas A. Shackelford and Terry Shevlin, “Empirical Tax Research in Accounting” (2001) 31:1-3 *Journal of Accounting and Economics* 321-87, at 376 ([https://doi.org/10.1016/S0165-4101\(01\)00022-2](https://doi.org/10.1016/S0165-4101(01)00022-2)).

44 See Lillian F. Mills, “Pursuing Relevant (Tax) Research” (2019) 94:4 *Accounting Review* 437-46, at 442 (<https://doi.org/10.2308/accr-10660>).

addition, positive signs now suggest that empirical methods will allow academic researchers to gain considerable insight into the effects of the 2017 US tax reform.⁴⁵ All of this research increases our collective understanding and brings us incrementally closer to more effective systems of taxation.

Perhaps the idea of a legal singularity in tax law will sound fanciful to readers of this paper. What are the mechanisms through which tax law will evolve toward this more complete condition of the future? Indeed, how can I justify this claim that mechanisms will emerge to produce a tax system more optimal, robust, and resistant to being gamed than the current system? A number of such mechanisms, in addition to the theoretical and empirical work outlined above, are likely to be in play, and most of them will be clear and familiar enough (or at least reasonably imaginable now); other, less imaginable mechanisms will also emerge. A framework for identifying at least some of these different mechanisms would be helpful, though I cannot claim to have identified adequately the various influences.⁴⁶ Time will tell.

An initial distinction could be made between, on the one hand, those mechanisms that operate within and internally to the system of tax law (call them internal mechanisms), and, on the other hand, mechanisms that operate on this system in a more direct, explicit, and external way (call them external mechanisms). Internal mechanisms elaborate, stretch, and extend the tax law system to address issues that have not been explicitly addressed *ex ante*. The majority of the legal academic work in taxation and the work of the courts and tax practitioners would fall into the internal mechanism category. This is the work that strives to connect and integrate the sometimes arcane and technical aspects of tax law with the messy reality of the lives of individuals and families and the realities of firms and businesses.

External mechanisms, by contrast, modify or patch the source code of the tax law system. Much of the academic work in public economics and tax accounting could best be classified as feeding into the external mechanisms affecting the evolution of tax law; these studies give policy makers insight into the likely consequences of various policy options and directly and indirectly influence changes to substantive tax law through the legislative drafting process and the development of regulation. Ultimately, I expect that the distinction between these internal and external mechanisms will be less sharp than I portray them here.⁴⁷ The next few decades will see the emergence of much better endogenous methods enabling the tax law to improve itself in a dynamic way through the development and deployment of new technologies in our legal system.

45 Ibid., at 443.

46 Because of my imaginative limitations, this is an incomplete and highly imperfect list. I cannot purport to offer a complete inventory.

47 An example of a work that crosses over is that of Thaddeus Hwong and Jinyan Li in this issue, in which the authors conduct a transnational empirical study of GAAR judgments in order to suggest reforms to GAARs. See, elsewhere in this issue, Thaddeus Hwong and Jinyan Li, "GAAR in Action: An Empirical Study of Transaction Types and Judicial Attributes in Australia, Canada, and New Zealand."

The internal mechanisms for the improvement of tax law begin where the statutory materials end. Thus, the internal mechanisms for improving the completeness of tax law are the conventional ones involving the administrative state, courts, and the resolution of taxpayer disputes. The administrative state is tasked with supplying rules and regulations that flesh out and specify the details that elaborate on the statutory source materials. Administrative bodies provide dispute resolution and can also provide guidance on what may or may not be acceptable from a tax law and policy perspective, subject of course to the overriding discretion of the courts. In the event of a dispute between a taxpayer and the tax administration about the application of tax law to a particular situation, the courts provide a mechanism for resolving those disputes in the form of the conventional methods of fact-finding, statutory interpretation, and legal analysis. And, of course, there are avenues for appeal to higher courts, as applicable. All of this is perfectly conventional and familiar.

Technology has been and will continue to influence the speed with which these internal mechanisms contribute to the completion of tax law. Historically, the most natural way in which technology has accelerated these processes is by making legal information available more quickly. The traditional technology for this was print. Extensive physical tax libraries were a feature of many tax practices until not so long ago. Many still find physical copies of tax legislation indispensable. More recently, the emergence of online research has made even more information available far more quickly than before. This movement from analogue to digital legal information has quickened the pace at which tax law can internally be elaborated through mechanisms that propagate information. The digital availability both of tax cases from tax and appellate courts and of tax statutes and regulations has made navigating the tax system easier for taxpayers and their advisers than ever before. Even seemingly simple advances such as automated checklists of things to consider before taking a particular tax position constitute materially important advances in the internal mechanisms for improving tax law.

Predicting what the tax law requires by predicting what courts will actually do is a key component of what lawyers do. We know that in many fields, algorithmic approaches to prediction work better than human judgment alone. It is reasonable to expect that in the near future, data-driven approaches to the law and algorithmic assessments of risk will become commonplace in the legal-services industry, despite some resistance to change in this industry. The next step in the development of the internal mechanisms that will propel the tax system to greater completeness has already begun. Machine-learning systems are now able to synthesize the legal information from, among other sources, legislation, case law, regulations, and administrative rulings; and to provide insight into what current law is apt to require. These systems do this by anticipating and predicting what would happen if a particular set of facts and circumstances were to be considered in the judicial process, using past tax administration rulings and court decisions as training data. These methods, now in their infancy, will continue to increase the speed, internal consistency, and reliability of our tax law systems. Machine-learning technology, which already produces excellent results in circumstances where accurate predictions would previously have

been considered too difficult, will continue to develop. The ability to collect, store, process, and analyze data will continue to improve exponentially. If Moore's law holds, computing power can be expected to double, on average, every two years. If growth continues at this pace, computing capabilities will have increased more than 100,000-fold by the year 2050. Innovations in machine-learning and artificial intelligence will yield powerful insights about tax law from the inside—providing new tools for taxpayers and their advisers to understand the current and likely future state of tax law.

Naturally, tax-avoidance opportunities exist where there are mismatches, inconsistencies, or ambiguities in our tax law systems. Not all of the work required to reconcile these systems in a body of tax law can be carried out through internal mechanisms. These new digital and computational methods of identifying the limits of the consistencies are also leading to the accelerated development and propagation of tax-avoidance strategies. This development, in turn, encourages legislatures to address, through *external* changes to the source code of tax law itself, the deficiencies identified through the internal mechanisms discussed above. How do these external mechanisms work?

A recent study has considered the use of reinforcement learning in taxation models to better optimize tax systems for efficiency and fairness.⁴⁸ The authors claim to have identified improved tax policies by using a simulation that includes agents relying on reinforcement learning.⁴⁹ With respect to productivity and equality, these policies are a significant improvement on policies derived from an alternative tax approach based on Emmanuel Saez's work in the optimal tax literature.⁵⁰ I cite this recent tax optimization research (of which there is doubtless much more to come) mainly to suggest that our current tax and legal systems have significant room for improvement. We have not yet achieved a final optimal design that would enable us—and indeed compel us, in the interests of good public policy—to strictly enforce the system's rules; the state of our legal development is provisional, evolving, and as yet incomplete and imperfect.

External efforts at improving the tax law are influenced not only by the theoretical and empirical academic work in public economics, tax accounting, and the legal academy, but also by, for example, voters, non-profits (such as the Canadian Tax Foundation),

48 Stephan Zheng et al., "The AI Economist: Improving Equality and Productivity with AI-Driven Tax Policies," April 28, 2020 (<https://arxiv.org/abs/2004.13332>).

49 See *ibid.*, at 3: "The AI-driven tax policies make use of different kinds of tax rate schedules than those suggested by baseline policies, and our experiments demonstrate that the AI-driven tax policy can improve the trade-off between equality and productivity by 16% when compared to the prominent Saez tax framework."

50 As representative contributions from the optimal tax literature that form the basis of the Saez framework, the authors cite, *inter alia*, Emmanuel Saez, "Using Elasticities To Derive Optimal Income Tax Rates" (2001) 68:1 *Review of Economic Studies* 205-29 (<https://doi.org/10.1111/1467-937X.00166>); and Emmanuel Saez and Stefanie Stantcheva, "Generalized Social Marginal Welfare Weights for Optimal Tax Theory" (2016) 106:1 *American Economic Review* 24-45.

industry organizations, politicians, political parties, and non-governmental organizations.⁵¹ Of course, the imperatives of fiscal policy and of financing government itself probably provide the greatest impetus for further development of the law through direct changes to tax legislation.

In the long run, tax law will reach functional completeness through these internal and external mechanisms. For now, however, the tax law is incomplete. This incompleteness means that taxpayers must often proceed without knowing for certain how the gaps in the tax law will be filled by tax policy makers, tax administrators, and (if it comes to that) judges. These various groups may not agree on whether and how our incompletely specified tax law will apply to the taxpayer's situation. Indeed, because taxation at the point of interpretation and application represents a zero-sum transfer (some would argue a negative sum, given the resources that are consumed in interpreting, applying, and contesting the law), the incentives to take positions based on whether the tax would apply (if you take the position of a tax administrator) or not apply (if you take the position of a taxpayer) are obvious and natural. Nevertheless, given the stakes involved and the arms race between (on the one hand) governments seeking to preserve revenues and (on the other hand) taxpayers seeking to avoid taxation, it is inevitable that significant sums will continue to be invested both in the devising of means to avoid taxation and in continuing to articulate and implement tax law effectively.

In a frequently cited passage of the Supreme Court of Canada's judgment in *Stuart Investments*,⁵² Estey J identifies what is probably the most fundamental mechanism in the further development of tax law:

These interpretative guidelines, modest though they may be, and which fall well short of the bona fide business purpose test advanced by the respondent, are in my view appropriate to reduce the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized tax-payer reaction. Otherwise, where the substance of the Act, when the clause in question is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question.⁵³

Ultimately, it is probably this fundamental and familiar dynamic between the taxpayer and the state that will prove to be the key mechanism propelling tax law to ever greater specification, and that will bring about the legal singularity in taxation.⁵⁴

51 For an excellent treatment of the importance of democratic input into the improvement of tax law, see Kim Brooks, Åsa Gunnarsson, Lisa Philipps, and Maria Wersig, eds., *Challenging Gender Inequality in Tax Policy Making: Comparative Perspectives* (Oxford: Hart, 2011).

52 *Stuart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

53 *Ibid.*, at 580.

54 See Alarie, *supra* note 17.

IMPLICATIONS FOR THE FUTURE OF ANTI-AVOIDANCE AND GAARS

To this point, I have made two main claims. The first is that the tax law is incomplete, which leads to the imperfect realization of our public policy objectives. The second is that we can expect tax law (and law generally)—through a number of internal and external mechanisms, strongly abetted by technology and the interests of taxpayers and governments—to continue to develop in a way that is increasingly detailed and increasingly optimal in various respects. What does this mean for Edgar’s assertion that tax avoidance is undesirable and that a major objective of public policy should be the elimination of tax avoidance?

Interestingly (and encouragingly), the incompleteness of the law may catch us up in an eddy for some indeterminate amount of time, but it will not divert us from the law’s ultimate downstream destination. Edgar was right about the unsatisfactory performance of past and present GAARS and about the general desirability of improving how tax systems evolve through the use of improved anti-avoidance measures. This is what anchors the lasting contributions of his work. A key point is that the problems with current tax systems extend beyond their GAARS. The problems with GAARS, past and current, are a by-product of significant legal incompleteness, which itself is an effect of our current level of overall legal development.

This incompleteness, in turn, gives rise to the pervasive tax-avoidance possibilities of today. If and when tax law can explicitly (or implicitly) contemplate and address every potential future contingency in a satisfactory fashion, no scope for tax avoidance will remain; in such a world, there will be only compliance or non-compliance (that is, tax evasion). With a complete system of tax law, tax avoidance would be coincident with tax evasion.⁵⁵ This is the sort of world presupposed by Edgar’s view that all tax avoidance is bad and needs to be eliminated. How does this affect how we should think about anti-avoidance measures generally and GAARS specifically?

All GAARS can be seen as providing short-term workarounds, or “kluges,”⁵⁶ that serve to mitigate the worst effects of the incompleteness of tax law. According to the “GAARS as kluges” view, a principal role of GAARS is to buy legislatures time and sometimes political will (all too often, alas, not enough of either) to patch deficiencies with more specific and better-designed responses. The GAARS-as-kluges concept would also suggest that sophisticated taxpayers prefer this kind of approach to

55 Note here the connection between tax evasion and The Tragically Hip reference in the title of this essay. The name of the album on which “Ahead by a Century” appears is *Trouble at the Henhouse*, which is a reference to foxes being put in charge of guarding the henhouse, only to later raid it. I suspect that Tim would have appreciated the allusion.

56 A “kluge” (or “kludge”) is described on *Wikipedia* (<https://en.wikipedia.org/wiki/Kludge>) as “a workaround or quick-and-dirty solution that is clumsy, inelegant, inefficient, difficult to extend and hard to maintain. This term is used in diverse fields such as computer science, aerospace engineering, Internet slang, evolutionary neuroscience, and government. It is similar in meaning to the naval term *jury rig*.”

faster, more proactive, and, perhaps, clumsier legislative responses to tax avoidance. GAARs as kluges are important and indispensable, but they are vital in their current form only until a sufficiently complete tax law emerges.

The emergence of tax law that is sufficiently complete is undoubtedly conjectural and, at best, lies some distance in the future, but it is this progress toward ever better tax law that increasingly strengthens Edgar's claim that tax avoidance is undesirable and ought to be eliminated.

CONCLUSION

In this paper, I have made the case that the law is incomplete but will become more complete over the coming decades. What are the implications of this argument for Edgar's views regarding GAARs, and for anti-avoidance measures in the future? In my view, the future will reveal Edgar as having been correct about tax avoidance and anti-avoidance. GAARs will be so deeply reinvented and woven so deeply into the fabric of tax law that they will no longer exist as such (at least, not recognizably). At the same time, as we make continuous progress in the design, specification, and administration of law, including tax law, Edgar's view of tax avoidance as a negative externality that ought to be eliminated will become thoroughly unassailable. An alluring long-term consequence of such vindication is that, as the design of tax and legal systems continues to be improved, optimized, and finely specified through new approaches, the scope for tax avoidance as we know it today will diminish and, in the end, become practically negligible. Tax avoidance either will not exist at all or will coincide with tax evasion. In the long run, tax avoidance is dead.

PERSONAL TAX PLANNING

Co-Editors: Brian J. Anderson,* Sonia Gandhi,** Dino Infanti,***
and Jim MacGowan****

PACK YOUR SUITCASE! THE BAGGAGE OF CANADA'S DEPARTURE TAX

*Sonia Gandhi, Megan Dalton, and Yooham Jung******

Canadians who choose to cease their residence in Canada and relocate outside the country may not be aware that their departure can come at a high tax cost. Leaving Canada can give rise to an unexpected and hefty tax bill because Canada imposes a departure tax on individuals who give up their Canadian residence. Relocating Canadians who hold certain assets may be deemed to have sold those assets, at fair market value, at the time of departure. This can give rise to tax even though the assets may not actually have been disposed of. In this article, the authors break through the complexities of Canada's departure tax regime by providing a comprehensive overview of the rules, highlighting key administrative considerations, and identifying planning opportunities to minimize Canada's exit tax.

KEYWORDS: DEPARTURE TAXES ■ DEEMED DISPOSITION ■ EMIGRATION ■ IMMIGRATION ■ RESIDENCE
■ CANADIAN EXIT TAX

* Of Deloitte LLP, Winnipeg (e-mail: bjanderson@deloitte.ca).

** Of KPMG LLP, Toronto (e-mail: soniagandhi@kpmg.ca).

*** Of KPMG LLP, Vancouver (e-mail: dinfanti@kpmg.ca).

**** Of Deloitte LLP, Halifax (e-mail: jmacgowan@deloitte.ca).

***** Of KPMG LLP, Toronto. We would like to give special thanks to Alexandra Yep and Paul Corupe for their invaluable insights.

PLANIFICATION FISCALE PERSONNELLE

Co-rédacteurs de chronique : Brian J. Anderson*, Sonia Gandhi**,
Dino Infanti*** et Jim MacGowan****

FAITES VOTRE VALISE! LE BAGAGE DE L'IMPÔT DE DÉPART DU CANADA

*Sonia Gandhi, Megan Dalton et Yooham Jung******

Les particuliers canadiens qui choisissent de cesser de résider au Canada pour s'installer à l'étranger ne savent peut-être pas que leur départ peut avoir un coût fiscal élevé. Quitter le Canada peut donner lieu à une facture fiscale inattendue et élevée, parce que le Canada perçoit un impôt de départ auprès des particuliers qui renoncent à leur résidence canadienne. Les particuliers canadiens qui détiennent certains actifs peuvent être réputés avoir vendu ces actifs, à leur juste valeur marchande, au moment de leur départ. Ainsi, les particuliers peuvent être imposés même s'ils n'ont pas disposé réellement des actifs. Les auteurs de cet article facilitent la compréhension du régime complexe de l'impôt de départ du Canada en donnant un aperçu complet des règles, en mettant en lumière les principales considérations administratives, et en dégageant des occasions de planification pour minimiser l'impôt de départ à payer.

MOTS CLÉS : IMPÔTS DE DÉPART ■ DISPOSITION RÉPUTÉE ■ ÉMIGRATION ■ IMMIGRATION ■ RÉSIDENCE
■ IMPÔT DE DÉPART CANADIEN

* De Deloitte LLP, Winnipeg (courriel : bjanderson@deloitte.ca).

** De KPMG LLP, Toronto (courriel : soniagandhi@kpmg.ca).

*** De KPMG LLP, Vancouver (courriel : dinfanti@kpmg.ca).

**** De Deloitte LLP, Halifax (courriel : jmacgowan@deloitte.ca).

***** De KPMG LLP, Toronto. Nous souhaitons remercier Alexandra Yep et Paul Corupe pour leurs conseils précieux.

SELECTED US TAX DEVELOPMENTS

Co-Editors: Peter A. Glicklich* and Michael J. Miller**

THE UNBEARABLE ABSURDITY OF THE US TAX RULES FOR WITHHOLDING ON DISPOSITIONS OF PARTNERSHIP INTERESTS

*Michael J. Miller***

Section 1446(f) of the Internal Revenue Code requires the transferee of a partnership interest to withhold 10 percent of the amount realized by the transferor if, among other requirements, the transferor is a non-US person, a gain is recognized on the sale, and such gain is “effectively connected” with a US trade or business conducted by the partnership. The author of this article has examined the proposed regulations and other guidance implementing this provision and found them deficient in several respects. He points out that, unfortunately, they disregard the statutory requirements and generally require withholding by all transferees of partnership interests, anywhere in the world, even if the partnership has never conducted any activities within the United States. The proposed regulations and other guidance provide for limited exceptions, but as the author explains, the exceptions are unrealistic and wholly inadequate.

KEYWORDS: PARTNERSHIPS ■ WITHHOLDING ■ DISPOSITIONS ■ US ■ REGULATIONS

* Of Davies Ward Phillips & Vineberg LLP, New York (e-mail: pglicklich@dwvp.com).

** Of Roberts & Holland LLP, New York and Washington, DC (e-mail: mmiller@rhtax.com).

CURRENT TAX READING

Co-Editors: Robin Boadway, Kim Brooks, Jinyan Li, and
Alan Macnaughton*

Alexandre Laurin, *TFSAs: Time for a Tune-Up*, C.D. Howe Institute E-Brief
(Toronto: C.D. Howe Institute, December 19, 2019)

The federal government enacted the tax-free savings account (TFSA) over 10 years ago. Canadians are now very familiar with the TFSA, and it is timely to assess its role as one of the devices available for sheltering savings from income taxation. Alexandre Laurin suggests a number of reforms that could align TFSAs better with their original purpose, which, as he reminds us, was to increase the incentive for low- and middle-income Canadians to save for major expenditures and unexpected needs, and to enhance the ability of seniors to decumulate their wealth in retirement. Apparently (and surprisingly) the original purpose of TFSAs was not to serve as a long-term retirement vehicle, according to the federal budget of 2008, when the TFSA was proposed.

By some indicators, TFSAs have been very successful. The number of contributors and total contributions for TFSAs outstrip those for RRSPs, as do contributions per contributor. Both TFSA and RRSP contribution amounts increase with the age of the contributor, which suggests that both TFSAs and RRSPs are used for retirement saving. Evidence suggests that savings in TFSAs have to a significant extent displaced savings in RRSPs, rather than stimulated higher savings. Perhaps not surprisingly, given their flexibility, TFSA withdrawals have been higher than RRSP withdrawals for younger persons, presumably for large purchases.

Laurin argues that TFSAs have been the preferred vehicle for capital decumulation in retirement. Not only are contributions to TFSAs high among the elderly, but retirees' withdrawals from TFSAs are lower than their withdrawals from RRSPs. TFSAs are also preferred by the young, whose contributions to TFSAs are much higher than their contributions to RRSPs. This is consistent with the fact that tax rates are lower early in life than they are later in life, which implies that, for the young, the tax benefits from TFSA contributions outweigh the tax benefits from RRSP contributions.

* Robin Boadway is of the Department of Economics, Queen's University, Kingston, Ontario (e-mail: boadwayr@econ.queensu.ca). Kim Brooks is of the Schulich School of Law, Dalhousie University, Halifax (e-mail: kim.brooks@dal.ca). Jinyan Li is of Osgoode Hall Law School, York University, Toronto (e-mail: jinyanli@osgoode.yorku.ca). Alan Macnaughton is of the School of Accounting and Finance, University of Waterloo (e-mail: amacnaughton@uwaterloo.ca).

The popularity of TFSAs among both the retired and the young leads Laurin to propose some reform options. These reforms aim to enhance the attractiveness of TFSAs for both groups. For the retired, he suggests two reforms to facilitate capital decumulation in retirement, both of which introduce features that already exist for RRSPs. One reform would be to allow TFSA assets to be held as annuities, to insure against longevity. The other would be to include a spousal provision that allows, at death, an individual's surviving spouse to take advantage of the individual's unused TFSA contribution room.

The purpose of the reforms, with respect to the young, would be to enhance the usefulness of TFSAs as vehicles for retirement savings. Laurin proposes the creation of a tax-free pension account (TFPA) to supplement TFSAs. Like TFSAs, these accounts would provide tax-free returns and withdrawals. They could be offered by employers as employer pension plans, with the same creditor protection as existing plans, and they could involve penalties for early withdrawal, such as a loss of contribution room. Their contribution limits could be integrated into a single limit with those of RRSPs and RPPs. Unused TFSA room could be used for TFPA contributions. Notably, TFPAs would result in an expansion of options for retirement saving vehicles, but with no increase in tax-preferred savings limits.

One final difference between TFSAs and RRSPs applies to Canadian residents filing US tax returns. For these residents, TFSA income must be included, but not RRSP income until it is withdrawn. Moreover, withholding taxes apply on dividends received in TFSAs, but not on dividends earned in RRSPs. As a consequence, TFSAs are of limited benefit to these taxpayers, and Laurin suggests that this limitation could be remedied by a revision of tax treaties.

These are all timely suggestions for reforming the structure of TFSAs after a decade of experience with these savings vehicles. There may well be other useful suggestions in this regard.

R.B.

Tracy Snoddon and Trevor Tombe, "Analysis of Carbon Tax Treatment in Canada's Equalization Program" (2019) 45:3 *Canadian Public Policy* 377-92 (<https://doi.org/10.3138/cpp.2019-036>)

Carbon pricing is an increasingly important source of provincial government revenues, and it will become the fifth-largest revenue source if the federal carbon price rises to \$50 per tonne as promised. Moreover, the relatively unequal allocation of these revenues among provinces is second only to the unequal allocation of natural resource revenues. This clearly has implications for the equalization system, whose design aims to equalize revenue-raising capacity among provinces. Snoddon and Tombe carefully review the current treatment of carbon revenues in the equalization system, point out the shortcomings of this treatment, and consider the consequences of alternative treatments.

They point out several anomalies in the way provincial carbon-pricing revenues enter the equalization system. First, carbon revenues are included as consumption

tax revenues along with provincial sales taxes, excise taxes, and other taxes on consumption. As the authors show, this implies that equalization entitlements resulting from carbon revenues are allocated on the basis of provincial shares of aggregate consumption compared with provinces' shares of population. Equalization entitlements based on provincial shares of carbon-pricing tax bases would differ considerably, because carbon emissions are distributed much differently among provinces, and much more unequally, than is per capita consumption. The current treatment penalizes provinces with relatively low carbon emissions per capita, such as Quebec, while favouring the other provinces that receive equalization.

Second, carbon-pricing revenues come both from provincial regimes and from backstop revenues collected by the federal government in provinces whose own pricing regimes do not satisfy the federal carbon-pricing benchmark. The benchmark includes a carbon price of \$20 per tonne in 2019-20, rising to \$50 in 2022-23, plus an output-based pricing system for large emitters. The federal carbon tax applies in Alberta and Saskatchewan, and federal output-based pricing applies in Prince Edward Island. Both federal elements apply in Ontario, New Brunswick, and Manitoba. Only provincial carbon-pricing revenues enter equalization calculations, even though federal backstop revenues are returned to residents in the provinces in which they have been collected. This exclusion of federal backstop revenues favours Quebec while penalizing the other equalization recipients.

Third, the equalization calculation does not include the value of "free emissions" permits that some provinces allocate to large emitters. Under the "representative tax system" approach used in the equalization system, these emissions represent a tax base that could yield provincial revenues if provinces chose to tax the emissions.

Snoddon and Tombe note some further implications of carbon tax revenues for equalization. Using a separate carbon tax base would give equalization-receiving provinces an incentive to reduce their carbon emissions, and therefore their fiscal capacity, in order to increase their equalization entitlement. Rather than being an adverse incentive, this would be beneficial, since it would reduce the damage that carbon emissions cause. The authors also observe that equalizing carbon tax revenues would significantly increase the cost of removing the GDP cap on aggregate equalization payments that currently applies.

To assist in estimating the effects of changing the treatment of carbon-pricing revenues in equalization, Snoddon and Tombe note that the equalization entitlements of province i from, say, consumption taxation can be stated as $E_i = (p_i - f_i)R$, where p_i is province i 's share of population, f_i is province i 's share of the consumption tax base, and R is national consumption tax revenue. Since carbon-pricing revenues are included as consumption tax revenues, the current system equalizes them according to the distribution of consumption across provinces. Separating carbon-pricing revenues from the consumption tax base would result in equalization entitlements from consumption and carbon-pricing revenues of $E_i = (p_i - f_i)\tilde{R} + (p_i - g_i)C$, where C is aggregate carbon-pricing revenues, $\tilde{R}$ is aggregate consumption tax revenues not including C , and g_i is province i 's share of national emissions. Since the share of national emissions is smaller than the share of consumption for

most equalization-receiving provinces, their equalization entitlements would rise if carbon-pricing revenues were treated as a separate category.

Snoddon and Tombe estimate the effect that planned increases in the carbon price would have on equalization according to four different scenarios. They make comparisons with the existing system, using 2017-18 estimates for five equalization-receiving provinces: Manitoba, Quebec, New Brunswick, Nova Scotia, and Prince Edward Island.

The first scenario involves treating federal backstop revenues as provincial carbon-pricing revenues. Quebec would benefit from such a policy, while the other four provinces would lose, though the effects would be rather small. The authors recognize that some might question whether federal backstop revenues should be included as provincial revenues, given that they are transferred directly to provincial residents rather than to provincial governments.

The second policy experiment treats carbon-pricing revenues as a distinct equalization category separate from consumption taxation. Doing so also increases by a sizable amount entitlements to Quebec, whose emissions are relatively low, and slightly reduces entitlements to the other four provinces. Moreover, an increase in the carbon tax to \$50 per tonne has a large effect on equalization. As noted above, equalizing provincial carbon-pricing revenues encourages recipient provinces to reduce carbon emissions, and the authors estimate this incentive to be large.

Third, Snoddon and Tombe estimate the effects of including as implicit carbon-pricing revenues the value of provincial abatement subsidies and free permits allocated to large emitters. Under the existing system, where carbon-pricing revenues are included in the consumption taxation category, equalization entitlements in Quebec and Prince Edward Island would increase if subsidies and free permits were included. If carbon-pricing revenues were separated, Manitoba, Nova Scotia, and Prince Edward Island would gain. Whether subsidies and free permits should be included in equalization is debatable. Snoddon and Tombe argue that it is consistent with the principle that equalization should not penalize provinces for the tax policy choices they make.

Finally, Snoddon and Tombe estimate the effects of removing the GDP cap on equalization. Their calculations show that this increases equalization entitlements significantly, especially as carbon-pricing revenues increase.

This article offers much food for thought as we approach the next five-year renewal of the equalization system.

R.B.

Ariel Jurow Kleiman, Amy K. Matsui, and Estelle Mitchell, *The Faulty Foundations of the Tax Code: Gender and Racial Bias in Our Tax Laws*
(Washington, DC: National Women's Law Centre, November 2019),
38 pages

The scholarship and policy analysis detailing the ways that tax laws around the world differentially affect women and racialized people have proliferated over the last

50 years. Several Canadian scholars have been foundational in building that work. Nevertheless, tax laws themselves have been remarkably impervious to that analysis.

In this report, the authors detail some of the provisions from the US Code that have differential (and discriminatory) effects on women and racialized people. With respect to returns to labour, the authors point to the largely anachronistic US system of joint filing; the non-recognition of informal labour; the differential treatment of work-related loss compensation (that is, the taxable nature of discrimination awards, often received by women and racialized workers, relative to the tax-exempt nature of workers' compensation awards, often received by men); and the divergent treatment of business expenses (comparing, for example, the deductibility of luxury goods and the limited recognition of child-care expenses). They also review some of the different effects of the tax treatment of savings (generally earned by high-income men, and preferentially treated) and housing preferences (generally given to higher-income white people). These discriminatory tax preferences have been reviewed in detail in many other reports. What this report offers is a useful clarity of analysis.

Perhaps less typically, the authors also point out ways in which tax administration practices can have discriminatory consequences. For example, they note the high rates of audit for the earned-income tax credit (a credit largely received by low-income people, particularly women and people of colour), and they contrast those audit practices with the relatively low rates of audit for high-net-worth individuals.

The report does not offer policy prescriptions to rectify the biases it identifies. Instead, the authors focus on pressing for better disaggregated data and for greater transparency in tax expenditure reporting.

K.B.

Palma Joy Strand and Nicholas A. Mirkay, "Racialized Tax Inequity: Wealth, Racism, and the US System of Taxation," *Northwestern Journal of Law and Social Policy* (forthcoming) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3442674)

The modest scholarship based on critical tax theory attempts to make sense of how tax laws discriminate against racialized people; most of that work originates in the United States. This article thoughtfully advances that body of work.

The authors advance two arguments: first, that racism explains the ways in which the tax system is designed (both at the federal and state level) to discriminate against blacks and other people of colour; and, second, that there are concrete examples of provisions in the tax codes that result in differential (discriminatory) treatment of blacks and people of colour. The authors refer to these two strands of argument as, respectively, the "why" and the "how" views.

In part I of the article, Palma Joy Strand offers a beautifully written, succinct narrative about the rise of income inequality, leaving race out of her account. She then connects that narrative to the ways in which income and wealth inequality are profoundly related to race. Tracing the origins of this inequality to slavery, and offering, from there, a broad view of the history of inequality, Strand concludes that

the tax system is the new racism. Her concluding paragraph in this first part brings her argument to a fine point:

Our thesis here is that the tax system as a whole—federal, state, local; income, payroll, sales, property, individual, corporate—has since the 1970's gradually but distinctly shifted in ways that serve to protect and consolidate existing White wealth and wealth perpetuation. The tax system as a whole accomplishes this in two distinct ways. First, the system as a whole has shifted away from taxes on wealth to taxes on consumption. Taxes on wealth are progressive; they fall more heavily on those with greater assets and higher incomes, often unearned incomes. Taxes on consumption, in contrast, are regressive; they fall more heavily on those with fewer assets and lower incomes, often earned incomes. Second, tax expenditures for individuals have skewed to largely benefiting wealthier, higher-income taxpayers, disguising government benefits for these citizens and leaving poorer, lower-income taxpayers to scramble for other, non-tax-supported resources. Concurrently, support for direct expenditures for public infrastructure that supports everyone has declined.¹

Part II of the article looks for evidence of racial bias in the tax system as a whole, and finds it. This part, written by Nicholas Mirkay, looks at a broader array of provisions and policy decisions than any that I have seen considered to date. Mirkay examines

(i) income versus payroll; (ii) estate tax roll-back; (iii) capital gains preference; (iv) roll-back of top marginal income tax rates; (v) reduction of corporate tax rates and other business-focused tax benefits; (vi) shift of CEO compensation from salary to entity ownership incentives; and (vii) “mandarin/aristocratic” tax expenditures—home mortgage interest deduction, pre-tax contributions to retirement plans, tax benefits for education.²

Mirkay makes the case for three broadening factors in the analysis of tax laws, such that greater attention would be paid to these laws' implications for race equality. First, he argues that the analysis has to consider not only income, but also wealth. Second, he makes the familiar argument that tax expenditures are simply disguised spending. Finally, he presses for a review of state tax policies alongside federal ones.

The article concludes with two recommendations: it urges policy makers (and the general public) to acknowledge racial wealth inequality, and it asks governments to review tax laws to remove their racial (and wealth) preferences.

K.B.

1 At 18-19.

2 At 19.

Emmanuel Saez and Gabriel Zucman, *The Triumph of Injustice: How the Rich Dodge Taxes and How To Make Them Pay*
(New York: W.W. Norton, 2019)

This is a radical and somewhat polemical proposal for basic reform to the US income tax system, written by two highly influential public economics scholars. Saez won the John Bates Clark Medal in 2009, awarded to the American economist under age 40 who is judged to have made the most significant contribution to economics; he won it largely for his work on optimal tax theory and policy. Zucman is well known for his detailed quantitative work on tax evasion, tax avoidance, and tax havens. This short book considers the evolution of the progressivity of US tax policy and tax administration over the past century in connection with the growth of income and wealth inequality. Saez and Zucman argue for a return to the progressive, pre-1980 tax policies through a combination of (1) the broadening of the income base, (2) the restoring of a progressive rate structure and high corporate tax rates, (3) the instituting of a progressive annual wealth tax, and (4) the tightening up of tax administration in order to fight profit shifting and tax evasion. In the process, the additional revenues raised would be used to expand significantly the spending on social programs.

The book contains little explicit analysis. Its core proposals are based on two premises. One is that tax policy should be much more progressive, particularly in taxing the wealthy. In chapter 5, the authors explicitly adopt a Rawlsian perspective that holds that only the poor matter, and they suggest that this view is widely accepted among economists. This implies that the tax revenue obtained from the rich should be maximized. The second premise is that a high level of wealth inequality is detrimental in its own right because it undermines democracy and meritocracy, and stifles competition. These arguments fit the US case better than cases elsewhere, given the more pronounced inequality and less progressive tax structure in the United States. Many of these proposals have found their way into current US political discourse. Nonetheless, they will be of more than passing interest in Canada.

The first chapter documents average tax rates in the United States, by income class, for all forms of taxes, including personal and corporate income, payroll, and sales. The average tax rate is roughly constant, but it declines at the top income levels. It is much less progressive than it was before 1980. Chapter 2 explains in more detail the evolution of US taxes, beginning with wealth taxes, followed by the introduction of the income tax in the 19th century, and arriving at the present day. Until recently, top income tax rates were as high as 80 percent, corporate tax rates were about 50 percent, and a progressive inheritance tax applied on large estates, with top rates close to 80 percent. During this period, wealth and income inequality were much less than they are now, which Saez and Zucman attribute in part to low incentives for top earners to bargain for higher salaries and to hold wealth in a taxable form.

In chapter 3, the authors highlight the key tax innovations of the mid-20th century: the progressive inheritance tax, the high top personal tax rates, and the high corporate income rates. Together, these taxes caused income inequality to abruptly decline from the 1930s to the 1970s. The Reagan administration's tax reforms of

1986, which reduced the top personal tax rate to 28 percent, undid these innovations. Saez and Zucman argue that this development precipitated (1) an increase in executive compensation, abetted by tax avoidance and evasion; (2) a deterioration in tax morality; (3) increasingly lax tax enforcement; and (4) the flourishing of a tax-sheltering industry that favoured high-income taxpayers. The authors note, especially, the weak enforcement of the “economic substance doctrine,” according to which a transaction, in order to be valid, must have both a substantive purpose and an economic effect aside from a reduction in tax liability.

Chapter 4 recounts the extent to which profit shifting has flourished in the 21st century. About 60 percent of profits of US multinationals are now booked in low-tax countries, and 20 percent in stateless entities. Forty percent of all profits of all multinationals covering most industries are booked in tax havens. This is profit shifting on a massive scale. Saez and Zucman label it tax evasion rather than tax avoidance, since it contravenes the economic substance doctrine, which national tax authorities are failing to enforce. Moreover, the Organisation for Economic Co-operation and Development (OECD) base erosion and profit shifting (BEPS) initiative has been largely unsuccessful because, while tax bases have been coordinated, tax rates have not been. Average corporate tax rates worldwide have fallen from almost 50 percent to 24 percent, largely because countries are competing for the profits of multinationals.

At the same time, as chapter 5 notes, labour’s share in national income has fallen from 45 percent to 40 percent. This reflects, in part, the dramatic decline in taxes on capital income relative to taxes on labour income. Saez and Zucman disparage—oddly, perhaps, and with limited rationale—the view in the public economics literature that capital income taxes should be very low, possibly zero. They also cast doubt on empirical evidence that the corporate tax has shifted to labour, pointing out that there is no inverse relation between corporate income tax rates and investment over the long run. To them, the corporate tax is a form of safeguard that discourages the shifting of labour income to capital income. The biggest response to higher corporate tax rates, as they see it, is profit shifting, which tax authorities have allowed to occur.

Chapter 6 takes on the issue of low corporate tax rates. Saez and Zucman argue that a key reason for low rates is corporate lobbying, and that low rates come at the serious cost of encouraging tax avoidance. The authors propose a four-point plan to reduce corporate tax competition. First, according to this plan, each country would impose remedial corporate taxes on profits booked by its multinationals in tax havens. Second, the Group of Twenty (G20) nations would agree on a minimum corporate tax rate and on rules to prevent corporate inversions (changes in residence to avoid taxes). Third, countries would tax multinational profits booked in countries that refuse to apply the minimum rate on the basis of the location of sales. Finally, countries would impose sanctions on tax-haven countries. Furthermore, international tax treaties should be expanded to include tax rate coordination.

The next chapter addresses the taxation of the rich. As mentioned above, the authors adopt a Rawlsian perspective, such that only the least well-off “count,”

which implies that the government should maximize tax revenue from the rich. The top tax rate should then be inversely related to the elasticity of taxable income (ETI), and the tax on the rich should increase with the concentration of wealth. The ETI can be reduced through the reduction of tax avoidance, made possible by treating all forms of income the same and eliminating tax-planning opportunities. The authors would create a public protection bureau to regulate tax avoidance by enforcing the economic substance doctrine and applying sanctions to tax havens. The top marginal tax rate could be set at about 75 percent, resulting in an average tax rate of 60 percent. The authors would institute a progressive wealth tax, with valuation concerns alleviated by the government's agreement to buy shares at valuation for wealth tax purposes.

Saez and Zucman seek to allay critics' fears that the high tax rates they propose would be above the revenue-maximizing rate (beyond the peak of the Laffer curve). They note that the very high marginal tax rates of the Roosevelt era were intended to reduce the income and wealth of the super-rich, and were successful in doing so. From 1946 to 1980, the respective incomes of all groups grew at a similar rate, except for the income of the very wealthy, which grew at a lower rate. Since 1980, the incomes of the bottom 90 percent have grown little, while the incomes of those at the top have grown a lot.

Chapter 9 goes beyond tax reform to consider the options that open up to government through the pursuit of fairer taxation. Saez and Zucman argue that simply taxing the rich more would add 4 percentage points of national income to tax revenues. They recommend going beyond that in order to finance a substantial expansion of US social programs. They shun, on fairness grounds, the introduction of a national value-added tax, and they propose instead a supplementary national income tax. Such a tax would include all sources of income, with no deductions and a single rate. They argue that a flat tax rate of 6 percent could finance universal health care, child care, and better access to higher education. The book concludes by inviting readers to use the tax simulator model developed by the authors to quantify the effects of tax reforms on income and wealth inequality.

This is a very readable if exhausting book, offering no-holds-barred opinions. It relies on the sweeping use of historical evidence for far-reaching prescriptive policy proposals. Despite the fact that it addresses uniquely US issues, it is well worth a close look. As far as the prospects for policy implementation are concerned, one can only say good luck!

R.B.

Meredith R. Conway, "And You May Ask Yourself, What Is That Beautiful House: How Tax Laws Distort Behavior Through the Lens of Architecture" (2019) 10:2 *Columbia Journal of Tax Law* 165-97
(<https://doi.org/10.7916/cjtl.v10i2.3468>)

Conway's article is a fun, quick tour through some of the tax policies that have influenced architectural design, primarily of homes, and primarily in the pre-1900

period. The author builds on the familiar refrain that the imposition of taxes changes behaviour.

In this article, Conway divides these architectural changes into seven major types. The categories are based primarily on the type of tax. So, for example, she has a section on hearth and chimney taxes. In it, she documents taxing practices from the Byzantine Empire, France, the Netherlands, England, Ireland, and New Orleans. In each case, she explains how a tax on hearths or chimneys resulted in changes to architectural design (for example, several homeowners would band together to share one chimney), and she identifies some of the consequences (usually negative) of such change—for example, the increase in fires that resulted from chimney sharing.

Conway spends relatively little time describing each tax. It would take extensive historical research to fully document the rationale behind, and consequences of, each tax. As a result, the article is more teaser than detailed review. One of the advantages of the article's approach is its scope: Conway addresses taxes imposed by multiple jurisdictions over a relatively extended period of history. Nascent in the article is the idea of tax transfer: how ideas about what constitutes an appropriate subject of tax were transferred between jurisdictions and over time, along with the tax laws' architectural consequences. The article concludes with some preliminary reflections on the use of tax policy to advance eco-friendly building. On the evidence of Conway's historical research in this article, more work on the lessons learned for future tax policy design would be welcome.

K.B.

Rachel Davies and Miranda Stewart, *The Gatekeeper Court: For the Revenue or for the Taxpayer?* Melbourne Legal Studies Research Paper series no. 828 (Melbourne: University of Melbourne, Law School, 2019) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3414811)

Davies and Stewart prepared this paper to commemorate the 40th anniversary of the Federal Court of Australia. In Australia, the High Court is the final arbiter of tax disputes (when it grants leave to hear a case); however, few cases make it to that level of court. Thus, the Federal Court is tantamount to the highest level of court in tax decision making.

Davies and Stewart's analysis is based on a database (which they created) of reported tax cases heard by the Federal Court and the Federal Court of Appeal between 1977 (when the former court was established) and June 2, 2019. Their research offers some interesting statistics. For example, tax cases represent less than 3 percent of all reported judgments (there are 30 to 50 reported tax judgments each year). Tax disputes seem to be more frequently finalized and settled earlier in the process than other kinds of disputes, such that, over time, fewer tax cases are being decided by the courts. Only 19 of 135 Federal Court judges who have decided tax cases since 1977 were women. Approximately 25 percent of current judges have never delivered a tax judgment. The article offers many other fun facts of this kind.

The article also tracks details on court outcomes (taxpayers win on at least one issue in just over 43 percent of the cases) and on substantive issues in dispute. For example, approximately 30 percent of the income tax cases concerned the determination of assessable income; 29 percent concerned deductions; and 13 percent concerned the taxation of trusts.

The final two parts of the paper dig more substantively into a few topics. The authors offer some commentary on the court's role in statutory interpretation, in the interpretation of anti-avoidance decisions, and in the emerging international tax challenges. The penultimate section offers a unique look at the relationship between the commissioner and the courts.

K.B.

Lily L. Batchelder and David Kamin, "Taxing the Rich: Issues and Options"

(2019) (<https://ssrn.com/abstract=3452274>)

Lily Batchelder is among the United States' most prolific and interesting mid-career tax law scholars. Her work ranges across all areas of income tax law—from business taxation to personal taxation, to the taxation of savings and the digital economy. In this article, she dives, with colleague David Kamin, into the high-profile issue of taxing the rich. In the light of the Democratic primaries and the candidates' various proposals for reducing income inequality, the issue of taxing the wealthy is squarely on the policy radar.

In this report, Batchelder and Kamin review four possible structural reforms: (1) increasing the top marginal rate, (2) taxing accrued gains at ordinary rates, (3) wealth taxes, and (4) financial transactions taxes. The authors' aim is not to rule out any of these options but, instead, to offer some reflections on preferable approaches with respect to each of the four.

Roughly the first half of the paper is spent arguing that the level of income inequality is unacceptable and that something more fundamental in the tax system needs to change. The second half looks at the four proposed structural changes, noting the advantages and challenges of each. This paper is unlikely to drive any particular policy reform; its aim is to canvass the four alternatives and try to register how they interact with each other (for example, an increase in top rates works best in combination with accrual taxation at higher rates), with a view to advancing the position that at least some of these reforms are necessary to curb the economic and social risks of increased inequality. As a final note, I would add that some readers may find the appendices, which detail the authors' methodology, useful.

K.B.

Marko Koethenbuerger, Federica Liberini, and Michael Stimmelmayer,
(Un)Intended Effects of Preferential Tax Regimes: The Case of European
***Patent Boxes*, EconPol Working Paper no. 29** (Munich: ifo Institute,
July 2019)

Two considerations heavily influence corporate tax policy. One is the desire for efficient business tax regimes that encourage the growth of productivity. The second is the need to respond to changes in the corporate tax base through profit shifting and tax competition from lower-tax jurisdictions. These influences apply particularly strongly to the taxation of profits from intellectual property. They have led many European countries to implement patent boxes, which offer preferential tax rates on income generated from patents. The hope underlying such measures is that they will both encourage patent activity that leads to productivity gains and reduce the incentive to undertake profit shifting through the relocating of patents to low-tax countries and tax havens. The European experience with patent boxes is relevant for Canada, given that similar concerns about productivity and profit shifting arise in both Canada and Europe.

Patent boxes can increase productivity by encouraging innovation, but they can also intensify tax competition by encouraging profit shifting to patent box countries without improving real outcomes. The question addressed by Koethenbuerger et al. is: What is the importance of productivity relative to profit-shifting effects? The authors estimate the effect of patent boxes on pre-tax profits for European firms, and they separate the effect caused by productivity improvements from the effect caused by profit shifting. The analysis focuses on affiliates of both multinational and domestic conglomerates, since conglomerates own a disproportionate share of patents. Data for 2007 to 2012 are used for affiliates in six European countries that introduced patent boxes during that period. Data include profits, corporate tax rates, ownership structure, patents, physical assets, labour costs, and financial structure.

The distinction between affiliates in domestic conglomerates and those in multinational conglomerates is important. Since only the latter can benefit from international profit shifting, changes in the profits of domestic conglomerates' affiliates that are owing to patent boxes reflect productivity effects alone, whereas changes in the profits of multinational corporations' affiliates reflect both productivity and profit-shifting effects. Thus, Koethenbuerger et al. can estimate the relative importance of the two effects. As well, a comparison of the effect of patent boxes on pre-tax profits with their effect on earnings before interest and taxes (EBIT) can indicate the extent to which profit shifting occurs through internal debt arrangements rather than through other mechanisms such as transfer pricing.

More precisely, Koethenbuerger et al. regress pre-tax profits for European affiliates by sector and year against (1) dummy variables for years since the introduction of a patent box; (2) the affiliate's fixed assets, labour costs, and financial leverage; (3) dummy variables for domestic and multinational conglomerates, and for whether the affiliate already owned a patent before a patent box was introduced; and (4) a tax

indicator showing differences between the tax treatment of the affiliate and the tax treatment of the rest of the multinational enterprise (MNE) measured by statutory corporate tax rates.

Several results are obtained. Not surprisingly, pre-tax profits are significantly increasing in fixed assets and labour costs, and decreasing in leverage. Affiliates facing lower tax rates than their parent corporations obtain higher pre-tax profits: an increase in the differential by 10 percentage points increases affiliates' pre-tax profits by 4 percentage points. Those affiliates with the lowest tax rates in the conglomerate obtain pre-tax profits that are 5.8 percent higher than those of all other affiliates. Affiliates with patent ownership before the introduction of the patent box have pre-tax profits that are 4.7 percent higher than those of affiliates without a patent before the patent-box introduction. These results confirm that patent boxes can lead to sizable pre-tax profit increases.

Comparing the affiliates of domestic conglomerates with those of multinational ones indicates the extent to which the higher pre-tax profits owing to patent boxes result from productivity increases as opposed to profit shifting. The affiliates of multinational conglomerates experience a 13 percent increase in pre-tax profits compared with a 3.5 percent increase in the profits of affiliates in domestic conglomerates. The difference can be attributed to profit shifting. Patent boxes result in 11 percent higher pre-tax profits for affiliates in MNEs that have no link to a tax haven. Koethenburger et al. also find that the exclusion of acquired or pre-existing patents from eligibility for patent boxes reduces the tax sensitivity of the pre-tax profits of affiliates of multinational corporations. Finally, measuring profits by EBIT instead of by pre-tax profits significantly increases the responsiveness of changes induced by patent boxes. Thus, some profit shifting occurs via internal debt arrangements.

The authors conclude that, overall, about two-thirds of the effect of patent boxes on pre-tax profits is due to profit shifting and only one-third is due to productivity improvement. Moreover, profit shifting by multinational corporations can be either inward (to patent box affiliates) or outward, in the case of ordinary taxed income. While inward shifting leads to a rise in pre-tax profits of about 15 percent, two-thirds of this is offset by outward profit shifting to lower-tax countries. Much of this profit shifting can be mitigated by excluding acquired patents from patent boxes. The authors do not study the other key design issue, which is whether a condition for patent box eligibility is that the patent lead to further innovative development.

R.B.

Kerrie Sadiq and Richard Krever, “Actions To Counter Base Erosion and Profit Shifting: A General Report,” in Kerrie Sadiq, Adrian Sawyer, and Bronwyn McCredie, eds., *Tax Design and Administration in a Post-BEPS Era: A Study of Key Reform Measures in 18 Jurisdictions* (Birmingham, UK: Fiscal Publications, 2019), 1-24

The material on BEPS has proliferated; it is impossible to keep up. This chapter by Kerrie Sadiq and Richard Krever offers a handy source of comparative grounding. The authors summarize what 18 countries around the world are doing in response to the 15 BEPS action items.

The chapter is clearly written, an easy and enjoyable read. The 18 comparator jurisdictions (each assigned its own chapter in the book) include Australia, Canada, China, India, the Netherlands, South Africa, and the United States, among others.

The chapter has several unique features. First, the authors review the national responses within the context of what motivated the OECD BEPS initiative, and they consider the initiative in connection with both historical and current political events. (The connection to “unprecedented global terrorist attacks,” while not surprising, is not a narrative that one expects from tax scholars.) Second, the authors nicely identify countries that have deviated from the model template. Given that both of the authors are academics in Australia, it is perhaps to be expected that the story of Australia—with its willingness to implement unilateral measures, including extensions to its GAAR and a diverted profits tax—is especially well told. Third, the collection brings together chapter reviews from high-, medium-, and lower-income countries. This canvassing of jurisdictions offers a picture of the effects of the OECD’s initiatives that goes beyond the OECD’s own member states.

K.B.

Michael P. Devereux, Alan J. Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön, and John Vella, *Residual Profit Allocation by Income*, Oxford University Centre for Business Taxation Working Paper no. 19/01 (Oxford: University of Oxford, Saïd Business School, Centre for Business Taxation, March 2019)

These authors constitute the majority of an international group of tax economists and tax lawyers who took it on themselves to propose reforms to the system of international business taxation. Their impetus for reform is the need to address two apparent problems of the existing system: profit shifting to low-tax countries and economic inefficiencies arising from the design of the tax base. The authors’ proposals, which will appear in a forthcoming book of which this paper will be a chapter, consist of two alternatives. One is the destination-based cash flow tax (DBCFT). Basing corporate taxation on cash flows avoids the disincentive to invest and the over-encouragement of debt financing in the current corporate income tax system. The use of the destination principle mitigates profit shifting more than an origin-based tax system does, since the final destination of sales on which the principle is based is more difficult to manipulate than the source of profits. The recent

US tax reform moved the tax base in the direction of a cash flow tax, but it also largely adopted the origin principle, despite the DBCFT's being promoted by several congressional Republicans. Apparently, the DBCFT was a move too far.

The second proposal by Devereux et al. goes partway toward a DBCFT, while retaining some features that are more familiar to practitioners and policy makers. It is also closer to recent OECD proposals for dealing with profit shifting. The authors propose a system for taxing multinational enterprises (MNEs) that is called residual profit allocation by income (RPA-I). The system consists of two main components. First, routine (that is, normal competitive) profits are taxed at the source of business activity through the use of existing transfer-pricing techniques and permanent establishment rules. Second, residual (above-normal) profits are allocated to countries in proportion to residual gross income (RGI), which is defined as sales to third parties less attributed cost. Roughly speaking, this is the destination basis. Countries can apply their own tax rates, with possibly different rates on routine and residual profits.

Devereux et al. argue that the RPA-I system has several advantages over the current system. It makes tax avoidance more difficult because of the immobility of third-country purchasers, and it involves fewer distortions of real economic activity. Since the system is based on observed sales, transparency is enhanced. The distinction between routine and residual profits is similar to profit splits that use existing transfer-pricing rules. Routine profits are familiar and can be calculated with reference to the profits that would be earned by outsourcing the task to a third party. Unlike the DBCFT, which allocates all profits on the basis of the destination of final sales, routine profits are allocated to countries where wealth or profits are generated. Some would argue that this enhances fairness.

Note that an important difference between the DBCFT and the RPA-I systems is that while the former would tax only above-normal profits or rents, the RPA-I, like the current system, would tax all shareholder income. This implies that the RPA-I system would not avoid the distortions that the existing corporate tax imposes on investment and financing decisions.

The authors point out that distinguishing routine from residual profits is similar to the transfer-pricing method for profit splits approved by the OECD, and the paper gives a good summary of the OECD 2018 proposals for taxing MNEs. In other ways, however, the RPA-I method departs significantly from the OECD approach. In particular, the RPA-I applies more broadly than the OECD profit-split, since the latter is restricted to MNEs with certain characteristics (that is, highly integrated, with hard-to-value intangibles), while the former applies to all. As well, the RPA-I method allocates residual profits by destination, while the OECD approach is based on the location of business activity, which is more difficult to assign.

The paper is long, detailed, and argued with care and persuasion, as one expects from authors of this quality. After an introductory overview, Devereux et al. present a worked example of an MNE with three affiliates in three different counties, in order to illustrate the details of the RPA-I system. This includes a calculation of routine profits that uses a cost-plus (markup) approach based on comparable local

supply markets. Residual profits can then be calculated by using either a bottom-up approach, based on residual profits in each market country, or a top-down approach that calculates the total MNE residual profits to be allocated to affiliates. A number of other issues are discussed, including (1) the extent to which tax base harmonization among countries is useful, (2) the splitting of income into routine and residual for remote sales, (3) the treatment of interest expenses (including the inability to deduct within-MNE interest), and (4) the treatment of taxable losses.

The authors compare RPA-I with other proposals. Other RPA approaches exist that use different ways of determining routine profits, and that allocate the residual in different ways. A useful comparison is with formulary apportionment, which allocates all profits and not just the residual. Sales-based formulary apportionment is similar to the RPA-I for residual profits, but it presumably requires much more international tax harmonization. Alternative ways of allocating residual profits are also discussed, including allocation by sales revenue, allocation by costs (similar to the source principle), and allocation by other factors.

Devereux et al. then evaluate RPA-I, using five criteria: economic efficiency, robustness to avoidance, ease of administration, fairness, and incentive compatibility. Separate evaluations apply for the cases where the RPA-I method is universally adopted and where it is unilaterally adopted by one country. Focusing on the former, the authors note that while the RPA-I method's distorting effects on real investment and debt finance are similar to those of the current corporate tax, it has less effect than the corporate tax on decisions about corporate location, because residual profits are taxed on a destination basis. As well, tax avoidance is more difficult under the RPA-I approach, since the benefit of lending from low- to high-tax countries is much reduced, as is the incentive for locating intellectual property in low-tax countries. Transfer-pricing manipulation is relevant only for routine profit allocation, given that residual profits are allocated on a destination basis. Ease of administration is also improved, since many difficult transfer-pricing issues are mitigated by the taxation of residual profits at destination. The RPA-I system, unlike the current system, involves the need to allocate profits from remote sales. RPA-I is arguably fairer than the DBCFT, since source countries are compensated for routine profits. But in the RPA-I, unlike in the existing system, residual profits or rents are allocated to destination countries rather than to the countries responsible for their generation. Finally, the RPA-I reduces the incentive for countries to reduce tax rates, since residual profits go to destination countries. The remaining tax competition effects apply only to competition for routine profits.

In the case where the RPA-I system is unilaterally imposed, BEPS from non-implementing countries may be aggravated, but otherwise the evaluation is similar to the case where RPA-I is unilaterally adopted.

Devereux et al. conclude by discussing some practical implementation questions. One issue is whether RPA-I should apply to unincorporated businesses—a minor problem, the authors suggest. Another issue concerns the allocation of non-allocable expenses among affiliates, which can be done through the use of standard accounting principles. The need for base harmonization, which is required under

the proposals of the European Commission, is considered, and the authors suggest that one can achieve a reasonable outcome without full harmonization. Finally, some issues arise when it comes to collecting tax on residual profits at destination for (1) sales to unrelated business customers, (2) remote sales, and (3) sales of intermediate goods.

Like the DBCFT, the RPA-I is largely driven by the quest to reduce profit shifting, and it does so by applying the destination principle to residual profits or rents, which are the source of the most problematic profit shifting. Unlike the DBCFT system, the RPA-I system would continue to tax normal corporate income, and to do so at source. Devereux et al. do not address the rationale for taxing all shareholder income rather than rents alone. Nor do they discuss what becomes of the case for the integration of the personal and corporate income taxes under RPA-I. As well, both their DBCFT and RPA-I proposals would allocate all rents to destination countries, largely in order to solve the profit-shifting problem. To some, forgoing the taxation of rents generated in their own economy may seem an unfair price to pay for solving that problem.

R.B.

Daisy Ogembo, “Are Presumptive Taxes a Good Option for Taxing Self-Employed Professionals in Low & Middle-Income Countries?” (2019) 5:2 *Journal of Tax Administration* 26-57 (<http://jota.website/index.php/JoTA/article/view/233/171>)

Presumptive taxes present a fascinating but under-theorized area of study. Many countries around the world, mostly low- and middle-income countries, use them as a proxy for determining the income of taxpayers who might not be able to keep books and records adequately or for whom the compliance costs of the full income tax calculation may be too great, relative to the income they earn. Generally, presumptive taxes are applied to small and sometimes medium-sized businesses, including farming. Often, self-employed professionals are excluded from their application, presumably on the assumption that such professionals are highly educated and thus better able to tolerate the record-keeping and compliance burdens, and also that they earn substantial income.

Ogembo’s article is a wonderful exploration of whether the standard exemption of professionals from presumptive taxes makes sense: Does this exemption align with the purposes of presumptive taxation?

Her article begins with a review of how presumptive taxes work. This review includes a description of the presumptive taxes imposed on professionals in India, Greece, Costa Rica, and Guatemala. The presumptive tax design in each country is interesting in its own right. In India, for example, self-employed professionals who do not have total gross receipts above a fixed threshold can avail themselves of the presumptive tax. That tax assumes that their income is 50 percent of their total gross receipts for the year. Taxpayers can choose to calculate their income under the regular regime if they prefer that option. In Costa Rica, if a professional fails to file

a return when due, the presumptive tax applies, and it is assumed that a professional's income is either 250 or 335 times (the percentage varies by profession) the basic salary. The presumptive tax effectively acts as an incentive for professionals to file.

Designing tax systems that ensure the effective taxation of professionals matters because these individuals often have high incomes, receive cash payment (for which their customers do not require receipts), and are highly likely to evade. It is perhaps surprising that so few scholars and policy makers have seriously studied the effect of presumptive taxes on professionals (regardless of whether they are included or excluded from these taxes).

A major portion of Ogembo's article is her review of a study that she conducted in Kenya, based on semi-structured interviews with taxpayers, tax experts, and senior government officials. With respect to taxpayers, she interviewed 10 dentists and 12 lawyers in Nairobi. She also interviewed six members of the public sector, three members of the private sector, and one academic.

Ogembo's article offers a broad discussion of her findings, but it is worth noting some of the highlights provided by the interviews with taxpayers: for example, (1) taxpayers generally believed that many other professionals were evading taxes; (2) both lawyers and dentists reported being involved in tax evasion through a variety of strategies, such as by keeping two sets of files and destroying evidence; (3) many believed that there was little or no chance that their evasion would be detected; (4) many professionals (including the lawyers) confessed that they had little knowledge of the tax law; and (5) most had a low regard for the tax authority.

After reviewing her findings, Ogembo turns to the question that motivated her research in this area: Are presumptive taxes a viable solution to these problems? Ultimately, she concludes that they are, at least for newly qualified, self-employed professionals, provided that the presumptive tax is well designed and rigorously monitored. She offers some additional information necessary for the proposal of an effective presumptive tax for newly qualified, self-employed professionals. The necessary data include a good register of professionals, a study of the range of incomes within the professions, and additional study of the design of threshold and lump-sum options.

K.B.

Reuven S. Avi-Yonah, *Advanced Introduction to International Tax Law*, 2d ed.

(Cheltenham, UK: Edward Elgar, 2019), 192 pages

When a primer is well done, it becomes one of the "go to" books on its owner's shelf. This is one of those books. Avi-Yonah is a prolific writer and voracious reader. He has a Peter Hogg-like skill for taking a high volume of material and extrapolating the crucial bones of it, simplifying without any loss of rigour or complexity.

This advanced introduction to international tax law is divided into two parts. In the first part, Avi-Yonah lays out the fundamentals of international taxation—jurisdiction, source, inbound taxation, transfer pricing, outbound taxation, and the treaty network. In each chapter, he reveals the principles of why that element

of international tax law has evolved in the way it has. Although the examples are primarily American, the text is written in such a way that Canadian students (or students of any other jurisdiction) will find it useful. And the chapter is more than a brilliant description; it advances Avi-Yonah's argument, developed in his other scholarly work, that international tax is a form of international law and that the single-tax principle has deep roots in international tax.

The second part of the book includes five chapters that are revisions of work that Avi-Yonah has published elsewhere. In my view, these new versions of those earlier works, streamlined to fit into this text, are better than the originals. Avi-Yonah has clarified and condensed the earlier discussions, to their advantage. A few of these chapters are quite US-focused, and therefore of less interest to (some) Canadians and perhaps less useful as teaching material for Canadian students. A highlight for me is the first of these five chapters, in which the author revisits his argument for a destination-based corporate tax. The chapter includes a useful and succinct review of the various design proposals for destination-based corporate taxes, and it outlines some of the advantages and disadvantages of the alternatives.

K.B.

Mark Brabazon, *International Taxation of Trust Income: Principles, Planning and Design* (Cambridge: Cambridge University Press, 2019)

The taxation of trusts varies substantially among countries, and so dramatically that many civil-law jurisdictions lack the concept altogether. There are myriad justifications for a comparative and international book on the taxation of trusts.

Brabazon's book has three main goals: (1) to compare the laws of Australia, New Zealand, the United Kingdom, and the United States, with the aim of discerning overarching principles in the domestic taxation of trusts; (2) to identify ways in which those design features result in non- or double taxation (as a result of international mismatches and treaties); and (3) to offer some policy prescriptions for those deviations from the single-tax principle.

The book is divided into two major parts. In the first part, Brabazon, in the functionalist tradition, reviews the laws in the four comparator jurisdictions, focusing on how they differ from one another in their tax treatment of the grantor, beneficiary, trust, and distributions. Although the core focus is the law of the four comparator countries, Canadian rules are occasionally highlighted. For example, Brabazon briefly discusses (1) attributed trust income (subsection 108(5)), (2) the language in section 212 that imposes tax on income "of or from" a resident trust received by a non-resident, and (3) Canada's willingness to recharacterize both the source and the income of some amounts. The review's main revelation is that despite perceptions that tax laws are being harmonized around the world, the tax treatment of trusts remains quite different among the jurisdictions that recognize them.

Part two of the book turns to a broad consideration of global tax trends and initiatives, and their ramifications for the taxation of trusts. Brabazon explores the interaction of domestic rules and the BEPS project, along with the implications of

the overlying tax treaty for trust taxation. The book concludes by reviewing how the challenges of non- and double taxation might be resolved.

Ultimately, this is a detailed and thoughtful review of a topic that generates a great many underexplored issues in international taxation. Even though it has limited Canadian illustrations, it merits attention.

K.B.

Carlo Garbarino, *Taxation of Bilateral Investments: Tax Treaties After BEPS*

(Cheltenham, UK: Edward Elgar, 2019), 205 pages

The BEPS initiatives, including the MLI, will have substantial implications for the interpretation of bilateral treaties. In this book, Garbarino explores how BEPS initiatives' changes to the OECD model and commentary will affect the taxation of bilateral investments, and he focuses on the destination country. The book's four chapters address four topics: (1) doing business through a permanent establishment, (2) access to tax treaties, (3) operating through corporate vehicles, and (4) dispute settlement and enforcement.

As with all of Garbarino's work, one of the remarkable features of this book is the author's comprehensive knowledge of tax treaties and tax treaty cases from countries around the world. Almost 40 Canadian cases are discussed, alongside decisions from over 35 other countries.

K.B.