Interpreting the Income Tax Act—
Part 1: Interpretive Doctrines

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PRÉCIS

Depuis que la Cour suprême du Canada a rejeté l'interprétation stricte utilisée dans l'affaire *Stubart Investments Ltd. c. Sa Majesté la Reine*, les tribunaux ont eu recours à diverses doctrines pour interpréter la Loi de l'impôt sur le revenu, sans adopter une méthode d'interprétation préférée. Dans certaines causes, une interprétation fondée sur l'objet visé ou téléologique a été privilégiée, selon laquelle le tribunal devrait d'abord établir l'esprit de la législation et appliquer les dispositions d'une manière conforme à cet esprit. Dans le cadre d'autres causes, une règle d'interprétation littérale est préconisée, selon laquelle le tribunal devrait d'abord considérer le libellé de la disposition en cause, pour tenir compte de l'esprit uniquement lorsque ce libellé est ambigu. Ou encore, l'approche du libellé en contexte global est préférée, comme dans l'affaire *Stubart*, selon laquelle le libellé de la loi [traduction] « doit être lu dans son contexte global et selon le sens grammatical et usuel, en harmonie avec l'esprit et l'objet de la loi et l'intention du Parlement ». En outre, des éléments de l'interprétation stricte persistent encore dans l'affirmation d'une supposition résiduelle en faveur du contribuable.

Malgré les doctrines d'interprétation auxquelles renvoient les tribunaux, plusieurs facteurs sont pris en considération dans la plupart de ces affaires afin de déterminer le sens de la disposition pertinente en cause : le texte lui-même, le système législatif, le but du texte, l'intention du législateur et les effets pratiques d'autres interprétations. À cet égard, la pratique d'interprétation réglementaire des tribunaux est implicitement pragmatique. Cependant, dans la mesure où la doctrine d'interprétation à laquelle se reporte les tribunaux touche la manière dont les facteurs pouvant être pertinents sont pris en considération dans le cadre d'une affaire donnée, le choix entre les différentes doctrines peut avoir des

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effets sur la manière dont la décision est prise et sur la substance de la décision elle-même.

Cet article en deux parties porte sur les différentes doctrines que les tribunaux canadiens ont utilisées pour interpréter la Loi de l'impôt sur le revenu. Ces doctrines y sont évaluées et une approche « pragmatique » comportant un moyen plus ouvert, raisonné et équilibré d'interprétation réglementaire que les autres méthodes y est présentée.

Quatre principales doctrines dont se servent les tribunaux canadiens pour interpréter la Loi de l'impôt sur le revenu sont examinées dans la première partie de l'article : l'interprétation stricte, l'interprétation fondée sur l'objet visé, la règle de l'interprétation littérale, et l'approche du libellé en contexte global. Après l'explication des caractéristiques de chacune de ces quatre doctrines, les causes ayant fait jurisprudence en matière de fiscalité dans lesquelles ces doctrines ont été définies et appliquées sont examinées. La manière dont les doctrines en cause ont influé sur les décisions des tribunaux y est illustrée et ces décisions y sont évaluées à la lumière de l'approche pragmatique préconisée dans la deuxième partie.

Alors que l'interprétation stricte et la règle de l'interprétation littérale minimisent l'esprit et l'objet de la loi et les intentions du Parlement, donnant lieu à des décisions en désaccord avec l'intention du législateur et l'objet de la loi (par exemple, la décision majoritaire dans l'affaire *Friesen*), l'interprétation fondée sur l'objet visé minimise le libellé de la loi, donnant lieu à une confusion quant à la doctrine (par exemple, les affaires *Bronfman Trust* et *McClurg*) et à des décisions en désaccord avec le libellé de la loi (par exemple, l'affaire *Neuman*). Même si l'approche du libellé en contexte global constitue une perspective plus pragmatique, selon laquelle le libellé de la loi doit être pris en contexte et « en harmonie avec l'esprit et l'objet de la loi et l'intention du Parlement », la Cour suprême du Canada n'a pas encore admis que cette approche est une doctrine d'interprétation indépendante, distincte de l'interprétation fondée sur l'objet visé et de la règle de l'interprétation littérale. En outre, dans la mesure où la méthode du libellé en contexte global limite la portée de l'interprétation contextuelle et ne tient pas compte des effets pratiques d'autres interprétations, elle n'est que partiellement pragmatique et omet de décrire entièrement le processus d'interprétation auquel les tribunaux ont systématiquement recours.

Chacune des doctrines d'interprétation examinées dans la première partie est évaluée dans la deuxième partie de l'article. Les caractéristiques essentielles d'une méthode d'interprétation réglementaire explicitement pragmatique y sont expliquées et un argument en faveur de cette méthode à titre d'approche de rechange à chacune des doctrines d'interprétation actuellement utilisées y est formulé.

ABSTRACT

In the years since the Supreme Court of Canada rejected strict construction in *Stubart Investments Limited v. The Queen*, the court has employed various doctrines to interpret the Income Tax Act without

settling on a preferred interpretive approach. While some cases have favoured a purposive or "teleological" approach, according to which the court should first determine the purpose of the legislation and apply the provision in a manner consistent with that purpose, others affirm a plain meaning rule whereby the court should begin with the words of the applicable provision, considering its purpose only where these words are ambiguous. Yet other cases employ the words-in-total-context approach proposed in *Stubart*, requiring the words of the statute "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." In addition, elements of strict construction arguably persist in the literalism of the plain meaning rule and the continued affirmation of a residual presumption in the taxpayer's favour.

Notwithstanding the interpretive doctrines to which the court actually refers, most of these cases consider several factors in determining the meaning of the relevant provision at issue: the text itself, the statutory scheme, the purpose of the text, the intentions of the legislature, and the practical consequences of alternative interpretations. In this respect, the court's actual practice of statutory interpretation is implicitly pragmatic. However, to the extent that the interpretive doctrine to which the court refers affects the manner in which potentially relevant factors are taken into account in the context of a particular case, the choice among the different doctrines can affect both the manner in which the decision is reached and the substance of the decision itself.

This two-part article discusses the various doctrines to which Canadian courts have referred in interpreting the Income Tax Act, evaluates these doctrines, and proposes an alternative "pragmatic" approach that offers a more open, reasoned, and balanced method of statutory interpretation than each of the alternatives otherwise available.

Part 1 of the article reviews the four main doctrines applied by Canadian courts in interpreting the Income Tax Act: strict construction, purposive interpretation, the plain meaning rule, and the words-in-total-context approach. After the characteristics of each of these four doctrines have been explained, the article examines leading tax cases in which these doctrines have been defined and applied, illustrating the manner in which the applicable doctrine has influenced the courts' decisions and critically evaluating these decisions in light of the pragmatic approach developed in part 2.

While strict construction and the plain meaning rule downplay the scheme of the Act, the object of the Act, and the intentions of Parliament, leading to decisions at odds with legislative intentions and statutory purposes (for example, the majority judgment in *Friesen*), purposive interpretation downplays the words of the Act, resulting in doctrinal confusion (for example, *Bronfman Trust* and *McClurg*) and decisions at odds with the text of the Act (for example, *Neuman*). Although the words-in-total-context approach affirms a more pragmatic outlook, according to which the words of the Act are to be read

contextually and "harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament," the Supreme Court of Canada has yet to acknowledge this approach as an independent interpretive doctrine different from purposive interpretation and the plain meaning rule. Moreover, to the extent that the words-in-total-context approach limits the scope of contextual analysis and disregards the practical consequences of alternative interpretations, it is only partly pragmatic and fails to fully describe the interpretive process that the court implicitly employs.

Part 2 of the article evaluates each of the interpretive doctrines examined in part 1, explains the essential features of an explicitly pragmatic approach to statutory interpretation, and advances an argument for this approach as an alternative to each of the interpretive doctrines currently employed.

All Laws, written, and unwritten, have need of Interpretation.

Thomas Hobbes, *Leviathan*[1]

INTRODUCTION

During the last 15 years, the Supreme Court of Canada has reconsidered—but as yet not resolved—the manner in which the courts ought to interpret the Income Tax Act.[2] Until *Stubart Investments Limited v. The Queen*,[3] the prevailing rule in Canada was that tax statutes should be strictly construed. In *Stubart*, the Supreme Court of Canada rejected this traditional rule, favouring instead the "modern rule" affirmed in Driedger's *Construction of Statutes*, according to which "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."[4]

In the years since *Stubart*, the court has struggled both with the doctrinal implications of this decision and with the interpretive principles by which the Act ought to be understood. In some cases, the court has emphasized "the scheme of the Act, the object of the Act, and the intention of Parliament," adopting an explicitly "purposive" or "teleological" approach to its interpretation.[5] In other decisions, the court has favoured a "plain

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[1] Thomas Hobbes, *Leviathan* (1651) (Harmondsworth, UK: Penguin, 1985), part II, chapter 26, 322.

[2] RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act.

[3] 84 DTC 6305; [1984] CTC 294 (SCC).

[4] E.A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983), at 87, cited in *Stubart*, supra footnote 3, at 6323; 316.

[5] The leading case, which involved the interpretation of Quebec's Act Respecting Municipal Taxation, RSQ, c. F-2.1, is *Corporation Notre-Dame de Bon-Secours v. Communaute*

(The footnote is continued on the next page.)

meaning rule" according to which "unambiguous" statutory provisions should be construed without regard to other indications of statutory meaning.[6] Most recently, the court has returned to the so-called words-in-total-context approach[7] suggested by the passage quoted above, concluding that "in order to determine the clear and plain meaning of the statute it is always appropriate to consider the 'scheme of the Act, the object of the Act, and the intention of Parliament.' "[8]

Notwithstanding these interpretive doctrines, most of these decisions consider several factors in determining the meaning of the relevant provisions at issue: the text of these provisions, their purpose within the statutory scheme, the intentions of the legislature, and the practical consequences of alternative interpretations. In this respect, the court's actual practice of statutory interpretation is implicitly pragmatic, and on its face, it might suggest that the interpretive doctrines to which the court refers have little or no practical effect on the outcome of the case. However, to the extent that these doctrines govern the way in which potentially relevant factors are taken into account in the context of a particular case, the choice among different doctrines can influence both the manner in which a decision is reached and the substance of the decision itself. For this reason, approaches to statutory interpretation matter, both for the litigants themselves and for the legal system as a whole.

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[5] Continued . . .
Urbaine de Quebec et al., 95 DTC 5017; [1995] 1 CTC 241 (SCC). For purposive approaches to the interpretation of the Income Tax Act, see *The Queen v. Bronfman Trust*, 87 DTC 5059; [1987] 1 CTC 117 (SCC); the majority decision in *The Queen v. McClurg*, 91 DTC 5001; [1991] 1 CTC 169 (SCC); and *Neuman v. The Queen*, 98 DTC 6297; [1998] 3 CTC 177 (SCC). These cases are examined in detail later in this article.

[6] See, for example, *Antosko et al. v. The Queen*, 94 DTC 6314; [1994] 2 CTC 25 (SCC); and the majority decision in *Friesen v. The Queen*, 95 DTC 5551; [1995] 2 CTC 369 (SCC). These cases also are discussed in a later section of the article.

[7] The label "words-in-total-context approach" was first used in *Harris Steel Group Inc. v. MNR*, 85 DTC 5140; [1985] 1 CTC 181 (FCA), per MacGuigan JA. For other tax cases in which the Federal Court of Appeal has referred to this interpretive approach in these terms, see *Lor-Wes Contracting Ltd. v. The Queen*, 85 DTC 5310; [1985] 2 CTC 79 (FCA); *Vaillancourt v. The Queen*, 91 DTC 5352; [1991] 2 CTC 42 (FCA); *British Columbia Telephone Company v. The Queen*, 92 DTC 6129; [1992] 1 CTC 26 (FCA); *The Queen v. Old HW-GW Limited*, 93 DTC 5199; [1993] 1 CTC 363 (FCA); *Kayelle Management (Yukon) Inc. v. MNR*, 94 DTC 6116; [1994] 1 CTC 271 (FCA); *The Queen v. Coopers & Lybrand Limited*, 94 DTC 6541; [1994] 2 CTC 336 (FCA); *Tonn et al. v. The Queen*, 96 DTC 6001; [1996] 1 CTC 205 (FCA); *Shaklee Canada Inc. v. MNR*, [1996] 1 CTC 180 (FCA); *Shell Canada Limited v. MNR*, 98 DTC 6177; [1998] 2 CTC 207 (FCA); *Seaspan Intl. Ltd. v. MNR* (1998), 229 NR 132 (FCA); and *The Queen v. Brelco Drilling Ltd.*, May 11, 1999 (FCA) [not yet reported].

[8] *The Queen v. Province of Alberta Treasury Branches et al.*, 96 DTC 6245, at 6248; [1996] 1 CTC 395, at 403-4 (SCC). For other cases in which the Supreme Court of Canada has employed a words-in-total-context approach, see *The Queen v. Golden et al.*, 86 DTC 6138; [1986] 1 CTC 274 (SCC); and *Symes v. The Queen et al.*, 94 DTC 6001; [1994] 1 CTC 40 (SCC). The latter two cases are examined in a later section of the article.

This two-part article examines the various interpretive doctrines applied by Canadian courts in interpreting the Act, evaluates these doctrines, and advances an alternative "pragmatic" approach that would make explicit the court's implicit recognition that various factors, including the practical consequences of different interpretations, are relevant to statutory interpretation.

Part 1 of the article introduces the four main doctrines to which Canadian courts have referred to interpret the Act: strict construction, purposive interpretation, the plain meaning rule, and the words-in-total-context approach. To the extent that courts and commentators are often unclear about the characteristics of the various doctrines to which they refer, the first task is to define these doctrines and illustrate the ways in which they have been applied in leading tax cases. Accordingly, part 1 begins by reviewing the origins of these doctrines and then examines a number of leading cases, explaining the manner in which the applicable interpretive doctrine shaped each decision and evaluating these decisions in light of the pragmatic approach proposed in part 2.

Part 2 evaluates each of the interpretive doctrines examined in part 1 and outlines the essential features of an alternative pragmatic approach to statutory interpretation. Building upon the doctrinal analysis of part 1, part 2 examines arguments for and against each interpretive doctrine, referring to each of the cases examined in part 1 to illustrate the relevant argument. To the extent that interpretive doctrines influence both the manner in which cases are decided and the outcomes of the decisions themselves, this analysis suggests that a pragmatic approach promises a more open, reasoned, and balanced method of statutory interpretation than each of the alternatives otherwise available.

STRICT CONSTRUCTION

For many years, the dominant approach to the interpretation of tax legislation in Canada involved strict construction, according to which statutory language was construed literally, ambiguities in taxing provisions were resolved in favour of the taxpayer, and ambiguities in provisions setting out deductions or exemptions were resolved against the taxpayer.[9] This section examines this doctrine and its application in Canadian income tax

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[9] For useful reviews of the doctrine of strict construction, see Gerald D. Sanagan, "The Construction of Taxing Statutes" (January 1940), 18 *The Canadian Bar Review* 43-51; Gwyneth McGregor, "Literal or Liberal? Trends in the Interpretation of Income Tax Law" (March 1954), 32 *The Canadian Bar Review* 281-303; J.T. Thorson, "Canada," in International Fiscal Association, *Cahiers de droit fiscal international*, vol. 50a, *The Interpretation of Tax Laws with Special Reference to Form and Substance* (London: International Fiscal Association, 1965), 75-82; Gwyneth McGregor, "Interpretation of Taxing Statutes: Whither Canada?" (1968), vol. 16, no. 2 *Canadian Tax Journal* 122-36; Douglas J. Sherbaniuk, "Tax Avoidance—Recent Developments," in *Report of Proceedings of the Twenty-First Tax Conference*, 1968 Conference Report (Toronto: Canadian Tax Foundation, 1969), 430-42; and Stephen W. Bowman, "Interpretation of Tax Legislation: The Evolution of Purposive Analysis" (1995), vol. 43, no. 5 *Canadian Tax Journal* 1167-89, at 1169-74.

cases, reviews alternative interpretive doctrines to which courts occasionally referred notwithstanding the dominance of strict construction, and considers the decline of strict construction in the years since *Stubart*.

Doctrine

Among judicial expressions of the doctrine that taxing statutes should be strictly construed, the leading statement is undoubtedly that of Lord Cairns in *Partington v. The Attorney-General*, who expressed "the principle of all fiscal legislation" as follows:

> If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called equitable construction, certainly such a construction is not admissible in a taxing statute where you simply adhere to the words of the statute.[10]

A similar view appears in *Cape Brandy Syndicate v. Inland Revenue Commissioners*, where Rowlatt J stated that

> in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.[11]

Each of these statements was adopted by Canadian courts and, until *Stubart*, affirmed as the primary rule for interpreting tax legislation in Canada.[12] As an initial matter, therefore, strict construction required the courts to adhere to "the letter of the law" reflected in "the words of the statute," notwithstanding "the spirit of the law" (expressed in the scheme of the Act, the object of the Act, or the intention of Parliament) or the consequences of the court's interpretation, which, according to Lord Cairns, must be disregarded "however great the hardship may appear to the judicial mind to be."

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[10] (1869), LR 4 HL 100, at 122. See also *Cox v. Rabbits* (1878), 3 AC 473 (HL), and in particular the statement of Lord Cairns quoted in the text below at footnote 13.

[11] [1921] 1 KB 64, at 71 (KB). This passage was affirmed in *Canadian Eagle Oil Co., Ld. v. The King*, [1946] AC 119, at 140 (HL), per Viscount Simon LC; and *Mangin v. IRC*, [1971] AC 739, at 746 (PC).

[12] For references to the rule in *Partington*, supra footnote 10, see *The King v. H.J. Crabbs* (1934), 1 DTC 272; [1928-34] CTC 288 (SCC); *Worthington and Forbes v. A-G Man.* (1936), [1935-37] CTC 193 (SCC); *Rex v. Montreal Telegraph Co.* (1945), 2 DTC 699; [1945] CTC 287 (SCC); *MNR v. Sheldon's Engineering Ltd.*, 55 DTC 1110; [1955] CTC 174 (SCC); and *The Queen v. Malloney's Studio Limited*, 79 DTC 5124; [1979] CTC 206 (SCC). For references to the passage from the *Cape Brandy Syndicate* case, supra footnote 11, see *MNR v. Panther Oil & Grease Manufacturing Co. of Canada Ltd.*, 61 DTC 1222; [1961] CTC 363 (Ex. Ct.); *MNR v. Bégin*, 62 DTC 1099; [1962] CTC 148 (Ex. Ct.); *The Queen v. Harman*, 79 DTC 5037; [1979] CTC 12 (FCTD), aff'd. 80 DTC 6052; [1980] CTC 83 (FCA); and *A-G (Quebec) v. Dame M.J. Stonehouse*, [1979] CTC 233 (SCC).

The first presumption, favouring the taxpayer in cases of ambiguous taxing provisions, follows directly from the literal approach outlined in *Partington*. As Lord Cairns stated in *Cox v. Rabbits*, "a Taxing Act must be construed strictly; you must find words to impose the tax, and if words are not found which impose the tax, it is not to be imposed."[13] Consequently, as Fitzgibbon LJ explained in *In Re Finance Act, 1894, and Studdert*, tax statutes are "subject to the rule that no tax can be imposed except by words which are clear, and the benefit of the doubt is the right of the subject."[14] Like the passages from *Partington* and *Cape Brandy Syndicate*, each of these statements was affirmed by Canadian courts.[15]

The second presumption, favouring the taxing authorities in cases of ambiguous benefit provisions, stems from the rule against equitable construction expressed by Lord Cairns in *Partington*, and the further assumption, expressed most clearly in Lord Halsbury's decision in *Tennant v. Smith*, that taxing statutes have no purpose other than the collection of tax:

> [I]n a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes. In various cases the principle of construction of a taxing Act has been referred to in various forms, but I believe they may be all reduced to this, that inasmuch as you have no right to assume that there is any governing object which a taxing Act is intended to attain other than that which it has expressed by making such and such objects the intended subject of taxation, you must see whether a tax is expressly imposed.[16]

Since the latter assumption implied that "taxation is the rule and exemption the exception," it followed, as Ritchie CJ concluded in *Wylie v. City of Montreal*, that "the intention to exempt must be expressed in clear unambiguous language . . . and therefore . . . be strictly construed."[17]

Application

Among the many applications of strict construction to the interpretation of the Income Tax Act, some of the most illustrative involve the attribution rules, designed to prevent the avoidance of tax through income splitting by deeming any income or loss from property transferred or loaned to a spouse or minor child or property substituted therefor to be

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[13] Supra footnote 10, at 478.

[14] [1900] 2 IR 400, at 410 (CA).

[15] For references to Lord Cairns's statement in *Cox v. Rabbits*, supra footnote 10, see *Omer H. Patrick v. MNR* (1935), 1 DTC 303; [1935-37] CTC 58 (Ex. Ct.); *The King v. Imperial Tobacco Co. of Canada Ltd.* (1938), 1 DTC 437; [1938-39] CTC 283 (Ex. Ct.); *O'Connor v. MNR* (1943), 2 DTC 637; [1943] CTC 255 (Ex. Ct.); *The King v. BC Elec. Ry. Co. Ltd.* (1945), 2 DTC 692; [1945] CTC 162 (Ex. Ct.); and *Rolland Paper Co. v. MNR*, 60 DTC 1095; [1960] CTC 158 (Ex. Ct.). For references to Fitzgibbon LJ's statement in *In Re Finance Act, 1894, and Studdert*, supra footnote 14, see *The King v. H.J. Crabbs*, supra footnote 12, and *Precision Small Parts Limited v. MNR*, 82 DTC 1811; [1982] CTC 2799 (TRB).

[16] [1892] AC 150, at 154 (HL).

[17] *Wylie v. City of Montreal* (1886), 12 SCR 384, at 386.

that of the transferor or lender and not that of the recipient.[18] These rules, which (like so many others in the current version of the Act) originated in a single provision of the 1917 Income War Tax Act[19] but are now contained in several sections of the Act,[20] are the product of repeated legislative responses to judicial decisions in which the courts' traditional adherence to strict construction ignored and frustrated the rules' manifest purpose to prevent tax avoidance through income splitting.

In *MNR v. MacInnes*,[21] for example, the minister sought to apply the attribution rule in subsection 32(2) of the Income War Tax Act[22] to dividend income from shares acquired by the taxpayer's wife with the proceeds from the sale of other securities that she had acquired with money and bonds given to her by the taxpayer. The court held that the rule, which applied to "income derived from [transferred] property or from property substituted therefor," did not apply to income from property substituted for property substituted for transferred property. Although the words "substituted property" might reasonably have been interpreted to include subsequent substitutions ad infinitum,[23] Thorson P referred to the rule in *Partington*, emphasized that "a tax liability cannot be fastened upon a

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[18] See subsections 74.1(1) and (2) and paragraph 248(5)(a), which deems property substituted for substituted property to be substituted property. See also the attribution rules for capital gains and losses in section 74.2, which applies only where property is transferred or loaned to a spouse, and section 75.1, which applies to certain transfers of farm property to a minor child.

[19] SC 1917, c. 28, subsection 4(4): "A person who, after the first day of August 1917, has reduced his income by the transfer or assignment of any real or personal, movable or immovable property, to such person's wife or husband, as the case may be, or to any member of the family of such person, shall, nevertheless, be liable to be taxed as if such transfer or assignment had not been made, unless the Minister is satisfied that such transfer or assignment was not made for the purpose of evading the taxes imposed under this Act or any part thereof."

[20] In addition to sections 74.1, 74.2, and 75.1, which set out the basic attribution rules, see also sections 74.3 and 74.4, which apply to transfers and loans to trusts and corporations, and section 74.5, which contains a number of special rules, some of which forestall methods of avoiding the attribution rules, while others exempt certain categories of transfers and loans from the application of the rules.

[21] 54 DTC 1031; [1954] CTC 50 (Ex. Ct.).

[22] The rule then read, "Where a husband transfers property to his wife, or *vice versa*, the husband or wife, as the case may be, shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor as if such transfer had not been made." This provision is the predecessor to the current rule in subsection 74.1(1).

[23] See, for example, McGregor, "Literal or Liberal?" supra footnote 9, at 296: "it would seem to be perfectly clear that the wording, 'or property substituted therefor,' is sufficiently wide to cover any number of substitutions, and that to require the act to state explicitly that more than one substitution is included is not only unnecessary but amounts to a refusal to give the existing language its plain meaning." See also Sherbaniuk, supra footnote 9, at 435, arguing that the court should have let the words of the provision "draw nourishment from their purpose" by giving the statutory words "a less restrictive and more reasonable interpretation."

person unless his case comes within the express terms of the enactment by which it is imposed," and concluded that

> if Parliament has intended that a husband should be liable to tax in respect of income derived not only from property transferred by him to his wife and property substituted therefor but also from property substituted for such substituted property it should have expressed its intention in clear terms.[24]

Indeed, the fact that the Act was amended after the years at issue but before the hearing of the case to deem property substituted for substituted property to be substituted property,[25] merely confirmed the court in its conclusion that the taxpayer was not liable "under the law as it stood in 1948."[26]

Employing a similar strict and literal approach, the Exchequer Court held that the attribution rules, which originally applied only where property was "transferred," did not apply to loans,[27] even non-interest-bearing demand loans whose primary purpose could reasonably be regarded as avoidance of the attribution rules.[28] In yet another case,[29] the Exchequer

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[24] *MacInnes*, supra footnote 21, at 1033; 53.

[25] See subsection 22(3) of the 1948 Income Tax Act, as amended by SC 1952, section 6. According to this provision, "where a person who did own or hold property has disposed of it and acquired other property in substitution therefor and subsequently, by one or more further transactions, has effected one or more further substitutions, the property acquired by any such transaction shall be deemed to have been substituted for the property originally owned or held." A similar rule is now found in paragraph 248(5)(a).

[26] *MacInnes*, supra footnote 21, at 1033; 53.

[27] See *Dunkelman v. MNR*, 59 DTC 1242, at 1244; [1959] CTC 375, at 379 (Ex. Ct.), per Thurlow J, emphasizing that the attribution rule in subsection 22(1) of the Income Tax Act, RSC 1952, c. 148, must be "strictly construed and not extended to anything beyond the scope of the natural meaning of the language used, regardless . . . of how much a particular case may seem to fall within its supposed spirit or intendment." Notwithstanding the ratio in *Dunkelman*, the decision may have been consistent with the purpose of the attribution rules to the extent that the loan at issue in the case was secured by a mortgage, the terms of which required repayment over a five-year period at what appears to have been a market rate of interest. Moreover, as the court noted, ibid., at 1243; 377, "[b]oth the interest and principal were subsequently paid."

[28] See *Oelbaum v. MNR*, 68 DTC 5176, at 5178; [1968] CTC 244, at 246-47 (Ex. Ct.), per Jackett P (as he then was), applying the court's prior decision in *Dunkelman*, supra footnote 27, notwithstanding the minister's argument that the rule in that case should apply only to a "more businesslike transaction than . . . in the case at bar," in which the taxpayer had loaned $150,000 to his wife in consideration for which she had executed three $50,000 non-interest-bearing promissory notes payable on demand, each of which remained outstanding at the time of the court's decision five years later. See also former *Interpretation Bulletin* IT-258R2, "Transfer of Property to a Spouse," May 11, 1982, paragraph 8, which stated, "A transfer does not include a genuine loan made by a person to his spouse." For a case examining the "genuineness" of a loan for these purposes, see *Harvey v. The Queen*, 94 DTC 1911; [1995] 1 CTC 2507 (TCC), concluding that the taxpayer had not effected a genuine loan to a trust whose intended beneficiaries were his minor children and whose intended trustee was his spouse.

[29] *Robins v. MNR*, 63 DTC 1012; [1963] CTC 27 (Ex. Ct.).

Court held that the attribution rule in subsection 21(1) of the 1952 Income Tax Act,[30] which applied to "income for a taxation year from the property or from property substituted therefor," did not apply to business income from the sale of real estate acquired by the taxpayer's spouse with capital supplied by the taxpayer.[31] While the exclusion of non-interest-bearing loans was reversed by statutory amendment effective May 22, 1985,[32] non-application to business income remains,[33] subject to a statutory exception for partnership income,[34] notwithstanding that this interpretation

[30] The rule then read, "Where a person has, on or after August 1, 1917, transferred property, either directly or indirectly, by means of a trust or by any other means whatsoever, to his spouse, or to a person who has since become his spouse, the income for a taxation year from the property or from property substituted therefor shall, during the lifetime of the transferor while he is resident in Canada and the transferee is his spouse, be deemed to be income of the transferor and not of the transferee." This provision is the predecessor to the current rule in subsection 74.1(1).

[31] See *Robins*, supra footnote 29, at 1014; 30, concluding that "what is deemed to be the income of the transferor, and it is clearly stated, is income from property only. Indeed there is no mention of income from a business such as we have here and, therefore, this section can be of no assistance in determining whether the business profit resulting from the real estate transactions is taxable as income of the appellant or of his wife." For a brief commentary on the case, see McGregor, "Interpretation of Taxing Statutes," supra footnote 9, at 132, commenting that "[t]he intention of Parliament in enacting this provision is crystal clear; but that did not prevent the Exchequer Court . . . from . . . interpreting the section literally and strictly, . . . with the result of frustrating that intention."

[32] See SC 1986, c. 6, which amended the attribution rules to apply to "loans" as well as "transfers" as the latter had been defined by the courts. See also subsection 74.5(2), which exempts income, gains, and losses from property loaned by the taxpayer, or property substituted therefor, to the extent that interest is charged at a stipulated rate, payable no later than 30 days after the end of the year in respect of which the interest is payable, and actually paid no later than 30 days after the end of the year in respect of which the interest is payable.

[33] See *Interpretation Bulletin* IT-511R, "Interspousal and Certain Other Transfers and Loans of Property," February 21, 1994, paragraph 5, in which Revenue Canada expresses its administrative position that the attribution rule in subsection 74.1(1) does not apply "to attribute business income or losses even if the business operates with some or all of the property obtained originally from the transferor." See also *Interpretation Bulletin* IT-510, "Transfers and Loans of Property Made After May 22, 1985 to a Related Minor," December 30, 1987, paragraph 3, which applies the same approach to the attribution rule in subsection 74.1(2); and *Interpretation Bulletin* IT-434R, "Rental of Real Property by an Individual," April 30, 1982 (as amended by special release, dated July 7, 1989), paragraph 11, which states, "Subsections 74.1(1) and (2) apply only where the transferred property produces income from property. Neither of these subsections apply where the loaned or transferred property produces business income."

[34] See subsection 96(1.8), which stipulates, for the purposes of the attribution rules, that "where an individual has transferred or lent property, either directly or indirectly, by means of a trust or by any other means whatever, to a person and the property or property substituted therefor is an interest in a partnership, the person's share of the amount of any income or loss of the partnership for a fiscal period in which the person was a specified member of the partnership shall be deemed to be income or loss, as the case may be, from the property or substituted property." This provision, which was enacted by SC 1988, c. 55, section 66(3), applies only to 1989 and subsequent taxation years, and reverses the decision in *Hollinger v. MNR*, 73 DTC 5003; [1972] CTC 592 (FCTD), aff'd. 74 DTC 6604; [1974] CTC 693 (FCA).

disregards the purpose of the attribution rules to prevent income splitting and arguably is not mandated by the words of the provision.[35]

Although strict construction generally favoured taxpayers by granting them the benefit of the doubt when they were not caught by the literal words of taxing provisions, the assumption that tax statutes have no purpose other than tax collection and the conclusion that consequences must be disregarded "however great the hardship may appear to the judicial mind to be" could also work to their disadvantage. In several cases, for example, the courts concluded that the attribution rules applied to transfers of property notwithstanding that the transferee may have paid fair consideration for the property transferred.[36] These cases, which were reversed by statutory amendment effective May 22, 1985,[37] not only ignored the purpose of the attribution rules to prevent income splitting (since income splitting is not achieved where the transferee pays market value for the property transferred), but made possible so-called reverse attribution arrangements whereby income could be attributed to a lower-income spouse who borrowed money to purchase income-producing property, sold this property to the higher-income spouse for proceeds equal to the fair market value of the property, and used these proceeds to repay the loan. Although reverse attribution is still technically possible under the current attribution rules,[38] these arrangements are now subject to a specific anti-avoidance rule in subsection 74.4(11), which excludes the application of the attribution rules to any transfer or loan of property where

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[35] Given the context of the words in the attribution rules, it is arguable that the words "income from *the* property [emphasis added]" need not be given the same meaning as the words "income from property," which appear elsewhere in the Act (for example, in the definition of a "specified investment business" in subsection 125(7)). For an approach consistent with the purpose of the attribution rules, see *Trinca v. MNR* (1951), 3 Tax ABC 354, where the board attributed to the taxpayer a portion of the income from a retail business carried on by his wife, based on the proportion of "the total cost of purchasing and commencing the business and making the alterations in the store premises" accounted for by capital contributed by the taxpayer. Although this case was decided under subsection 32(2) of the Income War Tax Act, which applied to "income *derived* from such property or property substituted therefor [emphasis added]," it is not obvious that the words "income from the property" are substantially different from the earlier words "income derived from such property." Nor is there any evidence that Parliament intended to restrict the scope of the attribution rules when the statutory provision was amended in 1948.

[36] See, for example, *McLaughlin v. MNR*, 52 DTC 1074; [1952] CTC 104 (Ex. Ct.); *German v. MNR*, 57 DTC 1216; [1957] CTC 291 (Ex. Ct.); *Campbell v. MNR*, 63 DTC 493; (1963), 32 Tax ABC 203; and *Lackie v. The Queen*, 79 DTC 5309; [1979] CTC 389 (FCA).

[37] See subsection 74.5(1), enacted by SC 1986, c. 6, section 38, which excludes transfers for fair market value from the attribution rules in subsections 74.1(1) and (2) and section 74.2, provided in the case of a transfer of property to or for the benefit of the taxpayer's spouse that the taxpayer elected not to transfer the property on a tax-deferred basis under subsection 73(1).

[38] Since the exclusion for spousal transfers in subsection 74.5(1) applies only where the transferor elects not to transfer the property on a tax-deferred basis under subsection 73(1), the attribution rules continue to apply to transfers at fair market value to or for the benefit of the transferor's spouse provided that the transferor does not make this election.

> it may reasonably be concluded that one of the main reasons for the transfer or loan was to reduce the amount of tax that would, but for this subsection, be payable under this Part on the income and gains derived from the property or from property substituted therefor.[39]

In other cases, strict construction operated to the taxpayer's detriment by disallowing deductions for which the taxpayer might have qualified on a broad and purposive construction of the statutory language but was unable to qualify on a narrow and literal reading. In *Witthuhn v. MNR*,[40] for example, the board disallowed a medical expense deduction in respect of the cost of a full-time attendant for the taxpayer's bedridden wife, who could sit for a few hours a day in a special rocking chair, on the basis that she was not "necessarily confined by reason of illness, injury or affliction to a bed or *wheelchair* [emphasis added]" as required by subparagraph 27(1)(c)(iv) of the 1952 Act.[41] According to W.S. Fisher,

> I am of the opinion that, on a strict interpretation of the statute as enacted, the appellant is not legally entitled to the deduction claimed, however much one may feel that, in equity, he should get the benefit thereof. As has been so often stated, however, there is, unfortunately, no equity in a taxation statute.[42]

Similarly, in *Patry v. MNR*,[43] where the taxpayer sought to deduct as a moving expense under section 62 the difference between rent paid to the landlord of her former apartment and rent received from another tenant to whom she sublet the apartment after she was unable to cancel the lease, the board invoked strict construction to disallow the deduction. Notwithstanding that the statutory definition of "moving expenses" in subsection 62(3) is open-ended (using the word "includes" rather than "means"), Guy Tremblay referred to paragraph 62(3)(d), which specifically includes as an allowable moving expense "the cost to the taxpayer of cancelling the lease by virtue of which the taxpayer was the lessee of the old residence," and concluded:

> In applying principles of interpretation, the Board has no authority to extend the meaning of "cost of cancelling the lease" to include expenses which an employee, who is obliged to sublet her apartment for less than the rental actually paid to the landlord, must incur. The Board does recognize that it would be in keeping with equity for the legislator to allow such an expense in moving costs; but the legislator would have to expressly provide for such an expense in the Act.[44]

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[39] This rule was also enacted effective May 22, 1985. See SC 1986, c. 6, section 48.

[40] 57 DTC 174; (1957), 17 Tax ABC 33.

[41] This provision was the predecessor to paragraph 118.2(2)(c), which includes in the definition of medical expenses for which a credit may be claimed "remuneration for one full-time attendant upon the patient in a self-contained domestic establishment in which the patient lives" under certain circumstances.

[42] *Witthuhn*, supra footnote 40, at 177; 37.

[43] 82 DTC 1349; [1982] CTC 2368 (TRB).

[44] Ibid., at 1351-52; 2371-72.

Whether this decision is consistent with other cases allowing a deduction for the carrying costs of a former residence whose sale is not completed until sometime after the taxpayer has moved to a new residence is highly doubtful.[45]

Alternatives

Notwithstanding its dominance until *Stubart*, strict construction was never the only method used by English and Canadian courts to interpret tax statutes.[46] On the contrary, as the following review demonstrates, on several occasions courts referred to the purpose of the statute, the intentions of the legislature, the context in which the relevant statutory language was employed, and the consequences of alternative interpretations.

Objects and Intentions

For some courts, tax statutes should, like other statutes, be interpreted according to the object or purpose of the statute and the intention of the legislature. In *Cartwright v. City of Toronto*, for example, Duff J (as he then was) concluded that tax statutes "must be construed according to the usual rule, that is to say, with reasonable regard to the manifest object of them as disclosed by the enactment as a whole."[47] Similarly, in *Attorney-General v. Carlton Bank*, Lord Russell insisted that the duty of a court in the case of any statute, including a tax statute, is

> to give effect to the intention of the Legislature as that intention is to be gathered from the language employed having regard to the context in connection with which it is employed.[48]

This statement was cited with approval by the Supreme Court of Canada in *The King v. Algoma Central Rway Co*.[49]

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[45] See, for example, *McLay v. MNR*, 92 DTC 2260; [1992] 2 CTC 2649 (TCC); *Penner v. The Queen*, [1997] 1 CTC 2564 (TCC); *Seguin v. The Queen*, 97 DTC 3255; [1998] 1 CTC 2453 (TCC); and *Graham v. The Queen*, 97 DTC 1074 (TCC). These cases are now subject to a proposed amendment, announced in the 1998 federal budget, according to which the definition of "moving expenses" in subsection 62(3) will specifically include "mortgage interest, property taxes, insurance premiums and costs associated with maintaining heat and power, to a maximum of $5,000 payable in respect of a vacant 'old residence' of the taxpayer for a period that begins after 1997 and does not exceed three months, during which reasonable efforts are being made to sell the 'old residence.' " (Canada, Department of Finance, 1998 Budget, Notice of Ways and Means Motion To Amend the Income Tax Act, resolution 25, February 24, 1998.) In *Patry*, supra footnote 43, the net cost to the taxpayer of carrying the lease on her former apartment (after subtracting rent received from the sublease) was $50 per month for 12 months or $600.

[46] For an early analysis of these alternative approaches to statutory interpretation, see W. Friedmann, "Statute Law and Its Interpretation in the Modern State" (November 1948), 26 *The Canadian Bar Review* 1277-1300. For a brief summary of these alternatives as applied to the interpretation of taxing statutes, see Bowman, supra footnote 9, at 1171-73.

[47] (1914), 50 SCR 215, at 219.

[48] [1899] 2 QB 158, at 164 (CA).

[49] (1902), 32 SCR 277, at 283, aff'd. [1903] AC 478 (PC).

In *Smith v. The Attorney General of Canada*,[50] the Exchequer Court adopted such a purposive approach to hold that profits from an illegal liquor trade were "income" within the meaning of subsection 3(1) of the Income War Tax Act, concluding that non-taxation would contradict "the proper incidence of taxation under the law" by "shift[ing] the burden that should have been borne by [the individual taxpayer] on the shoulders of his fellow citizens." According to Audette J,

> [t]he old rule, formulated as far back as 1584 in Heydon's case, is still in force and in harmony with the duty of the court in our days, where it says that
>
> > the office of all judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono publico*.[51]

Although reversed by the Supreme Court of Canada,[52] the Exchequer Court decision was upheld by the Privy Council.[53]

Contextual Analysis

In addition to these purposive approaches, other cases rejected the narrow literalism of strict construction by affirming a contextual approach to the interpretation of statutory language.[54] In *Lumsden v. Inland Revenue Commissioners*, for example, Viscount Haldane stated that "the duty of judges in construing statutes," including those that impose taxation, "is to adhere to the literal construction *unless the context renders it plain that such a construction cannot be put on the words* [emphasis added]."[55] Similarly, in *Versailles Sweets, Limited v. The Attorney-General of Canada*, Duff J (as he then was) explained, after quoting Lord Cairns's statement in *Partington*, that

> Lord Cairns, of course, does not mean to say that in ascertaining "the letter of the law," you can ignore the context in which the words to be construed stand. What is meant is, that you are to give effect to the meaning of the language.[56]

[50] (1924), 1 DTC 45; [1917-27] CTC 240 (Ex. Ct.).

[51] Ibid., at 45; 241.

[52] (1925), 1 DTC 78; [1917-27] CTC 244 (SCC).

[53] (1927), 1 DTC 92; [1917-27] CTC 251 (PC).

[54] For early appreciation of this contextual approach to the interpretation of taxing statutes, see Sanagan, supra footnote 9, at 46, explaining that "the 'clear and unambiguous' rule, correctly understood, includes taking into account the context of the language."

[55] [1914] AC 877, at 896-97 (HL). See also *Attorney-General v. Milne*, [1914] AC 765, at 771 (HL), in which Viscount Haldane stated that the courts "cannot depart" from the "natural meaning" of statutory language "unless, reading the statute as a whole, the context directs us to do so."

[56] [1924] SCR 466, at 468.

In *W.A. Sheaffer Pen Co. Ltd. of Canada v. MNR*,[57] the Exchequer Court employed this contextual approach to interpret the loss carryover provision in paragraph 5(p) of the Income War Tax Act,[58] according to which taxpayers could deduct "losses sustained in . . . the year immediately following the taxation year."[59] Referring to the scheme and purpose of the provision and its application to "losses sustained in the nineteen hundred and forty-four taxation year and all subsequent years,"[60] the court rejected the taxpayer's argument that the provision should be interpreted to permit the deduction of losses sustained in the *calendar* year immediately following the taxation year at issue as opposed to the *taxation* year immediately following the taxation year at issue. According to Thorson P,

> the context sets the meaning of the word "year" in the expression under consideration as "taxation year," for the whole scheme of deductibility of losses applies only in the case of losses sustained in taxation years.[61]

While the court also referred to the traditional presumption that ambiguities in relieving provisions should be resolved strictly against the taxpayer,[62] the decision turns on the contextual meaning of the statutory language, not the application of this presumption. Interestingly, the court arrived at this conclusion without considering an amendment enacted after the years at issue but before the decision which specified that the loss carryback applied to "losses sustained in . . . the *taxation year* immediately following the taxation year [emphasis added]."[63]

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[57] 53 DTC 1223; [1953] CTC 345 (Ex. Ct.).

[58] This provision, which was the predecessor to the current rule in paragraph 111(1)(a), was enacted by SC 1944-45, c. 43, section 4(5).

[59] The taxpayer had changed its year-end from December 31 to February 28 (resulting in a short taxation year from January 1, 1946 to February 28, 1946) and then, in computing its taxable income for the taxation year ending December 31, 1945, sought to deduct losses from its taxation year ending February 28, 1947 which had been sustained during the period March 1, 1946 to December 31, 1946. If the deduction was limited to losses sustained in the *taxation* year immediately following the taxation year at issue, losses sustained during the period March 1, 1946 to December 31, 1946 could be carried back only to the short taxation year from January 1, 1946 to February 28, 1946, not to the previous taxation year ending December 31, 1945.

[60] SC 1944-45, c. 43, section 4(6).

[61] *Sheaffer Pen*, supra footnote 57, at 1226-27; 351.

[62] Ibid., at 1225; 348-49, citing the decision in *Lumbers v. MNR* (1943), 2 DTC 631; [1943] CTC 281 (Ex. Ct.) (aff'd. (1944), 2 DTC 652; [1944] CTC 67 (SCC)), in which Thorson P stated, at 635; 290-91, "Just as receipts of money in the hands of a taxpayer are not taxable income unless the Income War Tax Act has clearly made them such, so also, in respect of what would otherwise be taxable income in his hands a taxpayer cannot succeed in claiming an exemption from income tax unless his claim comes clearly within the provisions of some exempting section of the Income War Tax Act; he must show that every constituent element necessary to the exemption is present in his case and that every condition required by the exempting section has been complied with."

[63] Income Tax Act, 1948, SC 1948, c. 52, paragraph 26(1)(d).

Golden Rule

Yet another alternative to strict construction involved the "golden rule," according to which courts could depart from the literal words of a statute to avoid "absurd" or "anomalous" results.[64] As stated by Lord Wensleydale in *Grey v. Pearson*,

> the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnance or inconsistency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified, so as to avoid that absurdity and inconsistency, but no farther.[65]

Indeed, this interpretive approach can be traced back to Thomas Hobbes, who favoured equitable construction on the grounds that "the Intention of the Legislator is alwayes supposed to be Equity."[66] Likewise, Blackstone concluded that a statute yielding "absurd consequences, manifestly contradictory to common reason," is void, emphasizing that "where some collateral matter arises out of the general words [of a statute], and happens to be unreasonable, there the judges are in decency to conclude that the consequence was not foreseen by the parliament, and therefore, they are at liberty to expound the statute by equity."[67]

Although courts have differed on the standard by which the consequences of a particular interpretation may be considered to be absurd or anomalous,[68] they have long affirmed the jurisdiction to avoid such consequences where this can be accomplished by an interpretation that the words of the statute are reasonably capable of bearing.[69] Likewise, in at least one English tax case, the House of Lords concluded that

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64 See, for example, Bowman, supra footnote 9, at 1171-73. For more extensive examinations of this "golden rule," see E. Russell Hopkins, "The Literal Canon and the Golden Rule" (November 1937), 15 *The Canadian Bar Review* 689-96; and Ruth Sullivan, *Driedger on the Construction of Statutes*, 3d ed. (Markham, Ont.: Butterworths, 1994), 79-99.

65 (1857), 10 ER 1216, at 1234 (HL).

66 Hobbes, supra footnote 1, at 326. For a thorough analysis of equitable construction in early English and American law, see Frederick J. deSloovère, "The Equity and Reason of a Statute" (June 1936), 21 *Cornell Law Quarterly* 591-613.

67 William Blackstone, *Commentaries on the Laws of England*, 8th ed., vol. 1 (Oxford: Clarendon Press, 1778), 91.

68 See, for example, Sullivan, supra footnote 64, at 81-85. Sullivan discusses "objective" and "subjective" views of absurdity, the former of which implies "a repugnance or inconsistency among the provisions of the statute or between provisions of the statute and its avowed object or purpose" (ibid., at 81), while the latter "allows a judge to look to the practical consequences of adopting a given interpretation and to assess those consequences against his or her own standards of justice, reasonableness or morality" (ibid., at 82). She concludes, "Modern courts may consider the consequences of every proposed interpretation and this consideration necessarily involves appeal to a wide range of standards: not only internal coherence and logical consistency but also justice, reasonableness, morality and common sense" (ibid., at 83).

69 See, for example, *Berardinelli v. Ontario Housing Corp.* (1978), 90 DLR (3d) 481, at 495 (SCC), per Estey J: "Where one interpretation can be placed upon a statutory provision which would bring about a more workable and practical result, such interpretation should be preferred if the words invoked by the Legislature can reasonably bear it."

> in order to avoid imputing to Parliament an intention to produce an unreasonable result, we are entitled and indeed bound to discard the ordinary meaning of any provision and adopt some other possible meaning which will avoid that result.[70]

One of the best examples of the application of this "golden rule" in Canadian income tax law is *Moldowan v. The Queen*,[71] where the Supreme Court of Canada was called upon to interpret former subsection 13(1) of the Act, now subsection 31(1), which limits the loss that a taxpayer may claim from farming businesses where the taxpayer's "chief source of income" for the taxation year is "neither farming nor a combination of farming and some other source of income." Recognizing that a literal reading of these words could mean that the limitation would either always apply since farming could never be a chief source of income in a taxation year in which it resulted in a loss,[72] or never apply since the arithmetic combination of farm losses and income from another source could constitute a chief source,[73] Dickson J (as he then was) fashioned a more purposive interpretation of the words "chief source of income" and the manner in which a taxpayer may "combine" two or more sources of income as "the only way in which the section can have meaning."[74] According to the court,

> [w]hether a source of income is a taxpayer's "chief source" of income is both a relative and objective test. It is decidedly not a pure quantum measurement. A man who has farmed all of his life does not cease to have his chief source of income from farming because he unexpectedly wins a lottery. The distinguishing features of "chief source" are the taxpayer's reasonable expectation of income from his various revenue sources and his ordinary mode and habit of work. These may be tested by considering, *inter alia* in relation to a source of income, the time spent, the capital committed, the profitability both actual and potential. A change in the taxpayer's mode and habit of work or reasonable expectations may signify a change in the chief source, but that is a question of fact in the circumstances.[75]

Furthermore, the court concluded:

> The reference in subsection 13(1) to a taxpayer whose source of income is a combination of farming and some other source of income . . . contemplates a man whose major preoccupation is farming, but it recognizes that such a man may have other pecuniary interests as well, such as income from investments, or income from a sideline employment or business. . . . While a quantum measurement of farming income is relevant, it is not alone decisive. The test is again both relative and objective, and one may employ the criteria indicative of "chief source" to distinguish whether or not the interest is auxiliary. A man who has farmed all of his life does not

[70] *Commissioners of Inland Revenue v. Luke* (1963), 40 TC 630, at 648 (HL).

[71] 77 DTC 5213; [1977] CTC 310 (SCC).

[72] Ibid., at 5215; 313.

[73] Ibid., at 5216; 314.

[74] Ibid., at 5215; 313.

[75] Ibid., at 5215-16; 314.

> become [subject to the restriction] simply because he comes into an inheritance. On the other hand, a man who changes occupational direction and commits his energies and capital to farming as a main expectation of income is not disentitled to deduct the full impact of start-up costs.[76]

While these tests necessitate detailed factual inquiries, they are consistent with both the words of the provision broadly understood and the purpose of the provision to limit the extent to which some, but not all, taxpayers may deduct farming losses in computing their net income from all sources.

Yet another example of the "golden rule," in which the court actually disregarded the words of the Act, is *Triple "F" Holdings Ltd. v. MNR*.[77] In this case, the minister had disallowed the taxpayer's claim for capital cost allowance (CCA) on the basis that the building in respect of which the deduction was claimed was constructed of a steel frame and corrugated steel, not "galvanized iron" or "corrugated iron" as set out in class 6 of schedule B of the Income Tax Regulations as they read at the time. Accepting the evidence of a metallurgical engineer that "no such thing as corrugated iron exists," the board allowed the taxpayer's appeal on the basis that

> [i]t would be an absurdity on my part to follow the argument of the respondent that because the *Income Tax Act* uses these words "galvanized iron" and "corrugated iron," an appellant who uses steel frame and corrugated steel is precluded from the capital cost allowance allowed him under Class 6.[78]

The Regulations were subsequently amended to refer to buildings made of "galvanized iron" or "corrugated metal."[79]

Decline

Although strict construction of taxing statutes was affirmed by the Supreme Court of Canada as late as 1983,[80] the authority of this doctrine was called into question the very next year by the court's decision in *Stubart*. Acknowledging "the demise of the strict interpretation rule for the construction of taxing statutes," and concluding that "[c]ourts today apply to [these] statute[s] the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable," Estey J adopted Driedger's "modern rule," according to which "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."[81] Two years later, in *The Queen v. Golden et al.*, a majority of the court held:

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[76] Ibid., at 5216; 315.

[77] 81 DTC 135; [1981] CTC 2084 (TRB).

[78] Ibid., at 138; 2087.

[79] See subparagraphs (a)(iv) and (v) of class 6 in schedule II of the Income Tax Regulations.

[80] *Morguard Properties Ltd. v. City of Winnipeg* (1983), 3 DLR (4th) 1, at 13 (SCC), per Estey J, citing *Nicholls v. Cumming* (1877), 1 SCR 395, at 422: "acts which impose a charge or a duty upon the subject must be construed strictly."

[81] *Stubart*, supra footnote 3, at 6323; 316, citing Driedger, supra footnote 4, at 87.

> In *Stubart Investments Limited* v. *The Queen*, [1984] 1 S.C.R. 536, at 573-79, the Court recognized that in the construction of taxation statutes the law is not confined to a literal and virtually meaningless interpretation of the Act where the words will support on a broader construction a conclusion which is workable and in harmony with the evident purposes of the Act in question. Strict construction in the historic sense no longer finds a place in the canons of interpretation applicable to taxation statutes.[82]

Since *Golden*, the Supreme Court of Canada has reaffirmed this conclusion on several occasions.[83]

In light of these passages, it seems reasonable to conclude that *Stubart* rejected the literalism of strict construction.[84] On the other hand, to the extent that the "plain meaning rule," which Estey J affirmed in *Stubart*, adopts a literal approach to the interpretation of statutory language,[85] this more recent doctrine may constitute a modified form of strict construction[86]—the essential difference being that the plain meaning rule allows the courts to consider "the scheme of the Act, the object of the Act, and the intention of Parliament" where the words of the statute are not "clear and plain," while strict construction resolved such ambiguities by applying rigid presumptions favouring the taxpayer in the case of taxing provisions and the Crown in the case of relieving provisions.[87] Indeed,

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[82] Supra footnote 8, at 6140; 277.

[83] See, for example, *Bronfman Trust*, supra footnote 5, at 5067; 128; *McClurg*, supra footnote 5, at 5010-11; 182-83; *Corporation Notre-Dame de Bon-Secours*, supra footnote 5, at 5021; 249; and *Schwartz v. The Queen*, 96 DTC 6103, at 6117-18; [1996] 1 CTC 303, at 331 (SCC).

[84] See, for example, Vern Krishna, *The Fundamentals of Canadian Income Tax*, 5th ed. (Scarborough, Ont.: Carswell, 1995), 58, concluding that in *Stubart*, "the Supreme Court of Canada rejected six decades of literal interpretation"; Peter W. Hogg and Joanne E. Magee, *Principles of Canadian Income Tax Law*, 2d ed. (Scarborough, Ont.: Carswell, 1997), 472, emphasizing that in *Stubart*, "Estey J. was at pains to reject the rule of strict interpretation of taxing statutes"; and Brian J. Arnold, "Statutory Interpretation: Some Thoughts on Plain Meaning," in *Report of Proceedings of the Fiftieth Tax Conference*, 1998 Conference Report (Toronto: Canadian Tax Foundation, 1999), 6:1-36, at 6:14-15, stating that "the *Stubart* case sent a clear signal to the courts and to the tax community that strict interpretation was inappropriate and that statutory language must be construed contextually with a view to its object and spirit or purpose."

[85] The plain meaning rule is examined in detail in a later section.

[86] See, for example, Arnold, supra footnote 84, at 6:14, suggesting that "[t]he plain meaning rule by itself is simply another way of describing strict construction." See also Arthur W. Murphy, "Old Maxims Never Die: The 'Plain-Meaning Rule' and Statutory Interpretation in the 'Modern' Federal Courts" (November 1975), 75 *Columbia Law Review* 1299-1377, at 1313, observing that "[t]he invocation of the plain meaning rule results in an insistence upon specification and attention to detail reminiscent of the insistence by the courts of an earlier era that statutes in derogation of the common law be strictly construed."

[87] See, for example, T.E. McDonnell and R.B. Thomas, "The Supreme Court and Business Purpose: Is There Life After Stubart?" (1984), vol. 32, no. 5 *Canadian Tax Journal* 853-69, at 861, arguing that the decision confirmed the doctrine of strict interpretation, "albeit . . . somewhat modified to recognize the plain meaning rule." See also Vivien Morgan, "Stubart: What the Courts Did Next," International Tax Planning feature (1987),

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although acknowledging the "demise" of strict construction, the second of Estey J's "interpretive guidelines" at the end of the decision in *Stubart* also affirmed its continued application "as modified by the courts in recent years."[88] Similarly, in *The Queen v. Province of Alberta Treasury Branches et al.*, Major J (dissenting) emphasized the continuity between strict construction and plain meaning, arguing that "the words of a taxing statute are to be read *strictly* for their plain and ordinary meaning [emphasis added]."[89] Significantly, however, Iacobucci J, who concurred in Major J's disposition of the case, rejected his approach to statutory interpretation, favouring the "words-in-total-context" approach adopted by the majority.[90]

With respect to the traditional presumptions, according to which ambiguities in taxing provisions were resolved in favour of the taxpayer while ambiguities in relieving provisions were resolved against the taxpayer, the decision in *Stubart* was less than clear. On the one hand, Estey J's general comments on strict construction suggest an aversion to any such presumptions, particularly the presumption that relieving provisions should be strictly construed against the taxpayer. Referring to cases in which exempting provisions were strictly construed against the taxpayer, for example, Estey J commented that "the introduction of exemptions and allowances was the beginning of the end of the reign of the strict rule."[91] On the other hand, by suggesting in the third of his "interpretive guidelines" at the end of the decision that the "formal validity" of a transaction may be "insufficient" where " 'the object and spirit' of [an] *allowance or benefit provision* is defeated by . . . procedures blatantly adopted by [a] taxpayer to synthesize a loss, delay or other tax saving device [emphasis added],"[92] Estey J appeared to reaffirm strict construction's asymmetrical interpretive approach to taxing provisions and relieving provisions.

In subsequent decisions, the Supreme Court of Canada has reaffirmed the presumption that ambiguities in taxing provisions should be resolved in the taxpayer's favour,[93] but rejected the presumption that ambiguities

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87 Continued . . .
vol. 35, no. 1 *Canadian Tax Journal* 155-81, at 169-70, commenting that the most significant change after *Stubart* involved the resolution of ambiguities: "In the past, resort was often made to the maxims that an ambiguity in a taxing provision is resolved in the taxpayer's favour and that an ambiguity in an exempting provision is resolved in the Crown's favour. Now an ambiguity is usually resolved openly by reference to legislative intent."

88 *Stubart*, supra footnote 3, at 6324; 316.

89 Supra footnote 8, at 6260; 425.

90 Ibid., at 6261; 427.

91 *Stubart*, supra footnote 3, at 6323; 316.

92 Ibid., at 6324; 317.

93 See *Fries v. The Queen*, 90 DTC 6662, at 6662; [1990] 2 CTC 439, at 439 (SCC), where the court allowed the taxpayer's appeal from a decision of the Federal Court of Appeal, 89 DTC 5240; [1989] 1 CTC 471, holding that strike pay was income from an unspecified source within the general language of paragraph 3(a) of the Act, on the grounds

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in relieving provisions should be resolved against the taxpayer.[94] Moreover, in *Johns-Manville Canada Inc. v. The Queen*, the court implicitly reversed the second of these presumptions, concluding that ambiguities in provisions granting *deductions* should also be resolved in the taxpayer's favour, at least where "one reasonable interpretation leads to a deduction to the credit of a taxpayer and the other leaves the taxpayer with no relief from clearly *bona fide* expenditures in the course of his business activities."[95] Consequently, as Estey J explained, "where the taxing statute is not explicit, reasonable uncertainty or factual ambiguity resulting from lack of explicitness in the statute should be resolved in favour of the taxpayer" irrespective of whether the ambiguity involves a taxing provision or a relieving provision.[96] Although the residual nature of this presumption was subsequently emphasized in *Corporation Notre-Dame de Bon-Secours*,[97] the continued existence of this residual presumption suggests another legacy of strict construction.[98]

PURPOSIVE INTERPRETATION

While strict construction of taxing statutes arguably persists in the modified form of the plain meaning rule and the residual presumption in favour of the taxpayer, *Stubart* signalled a growing judicial willingness to consider the "object and spirit" of the Act as well as "the letter of the law."[99]

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[93] Continued . . .
that "[w]e are not satisfied that the payments by way of strike pay in this case come within the definition of 'income . . . from a source' within the meaning of section 3 of the *Income Tax Act*. In these circumstances the benefit of the doubt must go to the taxpayers."

[94] See *Corporation Notre-Dame de Bon-Secours*, supra footnote 5, at 5022; 250, in which the court affirmed that "it is no longer possible to apply automatically the rule that any tax exemption should be strictly construed."

[95] 85 DTC 5373, at 5382; [1985] 2 CTC 111, at 123 (SCC).

[96] Ibid., at 5384; 126.

[97] Supra footnote 5, at 5023; 251, per Gonthier J, commenting that "recourse to the presumption in the taxpayer's favour is indicated when a court is compelled to choose between two valid interpretations," and "this presumption is clearly *residual* and should play an exceptional part in the interpretation of tax legislation," and adopting the following passage from Pierre-André Côté, *The Interpretation of Legislation in Canada*, 2d ed. (Cowansville, Que.: Yvon Blais, 1990), 412: "If the taxpayer receives the benefit of the doubt, such a 'doubt' must nevertheless be 'reasonable.' A taxation statute should be 'reasonably clear.' This criterion is not satisfied if the usual rules of interpretation have not already been applied in an attempt to clarify the problem. The meaning of the enactment must first be ascertained, and only where this proves impossible can that which is more favourable to the taxpayer be chosen."

[98] See, for example, Sullivan, supra footnote 64, at 408. See also David A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988), vol. 36, no. 1 *Canadian Tax Journal* 1-22, at 17, suggesting on the basis of the decision in *Johns-Manville Canada Inc.*, supra footnote 95, that "the rule of strict interpretation has not completely disappeared."

[99] See, for example, Krishna, supra footnote 84, at 58, commenting that in *Stubart*, the Supreme Court of Canada "moved to the purposive approach"; Hogg and Magee, supra footnote 84, at 476, referring to Estey J's "replacement of strict interpretation with purposive
(The footnote is continued on the next page.)

Subsequent decisions have confirmed purposive interpretation as a leading approach to the interpretation of tax statutes generally and the Income Tax Act in particular.[100]

Doctrine

In contrast to strict construction, which stressed the literal meaning of the statutory text and resolved ambiguities according to rigid presumptions, purposive interpretation emphasizes the reasons for which the statutory text was enacted and the objectives at which it aims, and interprets the text in light of these reasons and objectives.[101] As John Willis argued in his influential article on statutory interpretation,

> [b]efore you ever look at the words of the Act you have to discover why the Act was passed; then, with that knowledge in your mind, you must give the words under interpretation the meaning which best accomplishes the social purposes of the Act.[102]

Although purposive interpretation was common in 16th century England in the form of the so-called mischief rule[103] and was codified in the

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99 Continued . . .
interpretation" in *Stubart*; and Bowman, supra footnote 9, at 1175, noting that "[i]n Canada, the trend toward purposive interpretation of tax legislation culminated in the Supreme Court of Canada's decision in *Stubart Investments Limited v. The Queen*."

100 The leading case is *Corporation Notre-Dame de Bon-Secours*, supra footnote 5. Among income tax cases in which the Supreme Court of Canada has relied on purposive interpretation, the leading decisions are *Bronfman Trust*, supra footnote 5, and *McClurg*, supra footnote 5, which was followed in *Neuman*, supra footnote 5. See also Bowman, supra footnote 9, at 1183, concluding that purposive analysis "is consistent with the courts' approach to statutory interpretation generally and now seems to be well established in Canada"; and Hogg and Magee, supra footnote 84, at 473, describing purposive interpretation as "the dominant approach to taxing statutes as well as to other statutes."

101 For an excellent explanation of purposive interpretation, see Sullivan, supra footnote 64, at 35-77.

102 John Willis, "Statute Interpretation in a Nutshell" (January 1938), 16 *The Canadian Bar Review* 1-27, at 14. For Canadian income tax law, the article's influence was secured by its citation in *Stubart*. See also Max Radin, "A Short Way with Statutes" (November 1942), 56 *Harvard Law Review* 388-424, at 399, emphasizing that in dealing with statutes, "the task of the court is first to determine the purpose of the statute."

103 *Heydon's Case* (1584), 76 ER 637, at 638 (KB). According to this rule, "for the sure and true interpretation of all statutes in general . . . four things are to be discerned and considered:—1st. What was the common law before the making of the Act. 2nd. What was the mischief and defect for which the common law did not provide. 3rd. What remedy the Parliament hath resolved and appointed to cure the disease of the commonwealth. And. 4th. The true reason of the remedy"; in which case "the office of all the Judges is always to make such construction as shall suppress the mischief, and advance the remedy, and to suppress subtle inventions and evasions for continuance of the mischief, and *pro privato commodo*, and to add force and life to the cure and remedy, according to the true intent of the makers of the Act, *pro bono publico*." See also *Stowel v. Lord Zouch* (1569), 75 ER 536, at 556 (KB): "every thing which is within the intent of the makers of the Act, although it be not within the letter, is as strongly within the Act as that which is within the letter." For a detailed history of the origins of this approach and its subsequent displacement by strict construction, see J.A. Corry, "Administrative Law and the Interpretation of Statutes" (1936), 1 *University of Toronto Law Journal* 286-312, at 293-301.

federal Interpretation Act in the mid-19th century,[104] modern purposive interpretation originates in the writings of legal realists like Willis and the legislative reforms of the modern administrative state.[105] Legal realists emphasized the creative and purposive character of judicial decision making, criticizing formalist approaches to legal reasoning according to which judicial decisions were assumed to proceed mechanically from the authoritative cases and statutory texts to which the courts referred.[106] At the same time, legislative reforms encouraged purposive interpretation by establishing broadly worded statutory schemes designed to redress specific social and economic problems (for example, child abuse, poverty, and unemployment) and regulate various spheres of social and economic activity (such as family relationships, employment relationships, commercial transactions, financial markets, and the environment).[107]

In Canada, the development of purposive interpretation has also been influenced by the functional and purposive approach of Quebec's civil law system,[108] and the introduction of the Charter of Rights and Freedoms,[109] which the Supreme Court of Canada has interpreted in a

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104 RSC 1985, c. I-21, as amended, section 12, which states, "Every enactment is deemed remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects." This provision first appeared as section 5(28) of the pre-Confederation Interpretation Act of 1849, 12 Vict., c. 10, and was re-enacted after Confederation as section 7(39) of the Interpretation Act, 1867 (31 Vict.), c. 1. Notwithstanding that this provision applied to all federal statutes, it was largely ignored by the courts and rarely mentioned in income tax cases. For a comprehensive historical analysis of the origins and application of this provision, see Eric Tucker, "The Gospel of Statutory Rules Requiring Liberal Interpretation According to St. Peter's" (1985), 35 *University of Toronto Law Journal* 113-53.

105 On the evolution of modern purposive interpretation and the reasons for its adoption, see Sullivan, supra footnote 64, at 36-44.

106 See, for example, Corry, supra footnote 103; Willis, supra footnote 102; Harry Willmer Jones, "Statutory Doubts and Legislative Intention" (June 1940), 40 *Columbia Law Review* 957-74; Radin, supra footnote 102; Felix Frankfurter, "Some Reflections on the Reading of Statutes" (May 1947), 47 *Columbia Law Review* 527-46; Jerome Frank, "Words and Music: Some Remarks on Statutory Interpretation" (December 1947), 47 *Columbia Law Review* 1259-78; and Karl N. Llewellyn, "Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are To Be Construed" (April 1950), 3 *Vanderbilt Law Review* 395-406.

107 See the discussion of "program legislation" in Sullivan, supra footnote 64, at 42-43. For more general reflections on the impact of the modern administrative state on statutory interpretation, see Cass R. Sunstein, "Interpreting Statutes in the Regulatory State" (December 1989), 103 *Harvard Law Review* 405-505.

108 See, for example, Côté, supra footnote 97, at 318. See also Sullivan, supra footnote 64, at 41, observing that "[g]enerally speaking, the civilian judges on the Supreme Court of Canada have played an important role in developing the court's current [purposive] approach to interpretation."

109 Part I of the Constitution Act, 1982, enacted as schedule B to the Canada Act 1982 (UK), 1982, c. 11.

broad and purposive manner.[110] Not surprisingly, therefore, the authors of the leading cases on the purposive interpretation of tax statutes include Gonthier J, a civilian judge, and Dickson CJ, who wrote the court's earliest decisions on purposive interpretation of the Charter.

With respect to taxing statutes generally, the leading Canadian decision on purposive interpretation is *Corporation Notre-Dame de Bon-Secours*,[111] a case in which the taxpayer argued that it was exempt from municipal taxation under a provincial statute[112] on the grounds that it was a "reception centre" within the meaning of another provincial statute,[113] and was used for the stated purposes of this second statute to

> (a) improve the state of the health of the population, the state of the social environment in which they live and the social conditions of individuals, families and groups; [and]
>
> (c) encourage the population and the groups which compose it to participate in the founding, administration and development of establishments so as to ensure their vital growth and renewal.

Allowing the taxpayer's appeal from a decision of the Quebec Court of Appeal,[114] which employed a strict approach to conclude that the taxpayer was neither a "reception centre" within the meaning of the second statute nor used for the stated purposes of this statute,[115] the court adopted a "teleological approach" according to which courts should "first . . . determine the purpose of the legislation, whether as a whole or as expressed in a particular provision"[116] and apply a strict or liberal approach to the provision at issue "depending on the purpose underlying it."[117] As Gonthier J explained,

> [i]n other words, it is the teleological interpretation that will be the means of identifying the purpose underlying a specific legislative provision and

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[110] See, for example, *Hunter v. Southam Inc.*, [1984] 2 SCR 145; and *R v. Big M Drug Mart Ltd.*, [1985] 1 SCR 295.

[111] Supra footnote 5.

[112] Section 204(14) of the Act Respecting Municipal Taxation, RSQ, c. F-2.1, exempting "an immovable belonging to a public establishment within the meaning of the *Act respecting health services and social services* (R.S.Q., chapter S-5), including a reception centre contemplated in section 12 of that Act, used for the purposes provided by that Act."

[113] Section 1(k) of the Act Respecting Health Services and Social Services, RSQ, c. S-5, according to which a "reception centre" was defined as "facilities where in-patient, out-patient or home-care services are offered for the lodging, maintenance, keeping under observation, treatment or social rehabilitation, as the case may be, of persons whose condition, by reason of their age or their physical, personality, psychosocial or family deficiencies, is such that they must be treated, kept in protected residence or, if need be, for close treatment, or treated at home."

[114] (1992), 47 QAC 47, [1993] RL 68.

[115] See the summary of this decision in *Corporation Notre-Dame de Bon-Secours*, supra footnote 5, at 5019-20; 245-46.

[116] Ibid., at 5022; 250.

[117] Ibid., at 5023; 252.

> the Act as a whole; and it is the purpose in question which will dictate in each case whether a strict or a liberal interpretation is appropriate or whether it is the tax department or the taxpayer which will be favoured.[118]

Since the purpose of the statutory scheme was to exempt socially beneficial undertakings from municipal property taxation, the court applied a liberal approach to conclude that the taxpayer was both a reception centre and used for the stipulated statutory purposes.

Application

With respect to the Income Tax Act, the leading examples of purposive interpretation are *The Queen v. Bronfman Trust*[119] and *The Queen v. McClurg*,[120] the latter of which was followed in *Neuman v. The Queen*.[121] In *Bronfman Trust*, the court was called upon to interpret the interest deductibility provision in subparagraph 20(1)(c)(i), according to which taxpayers, in computing their income for a taxation year from a business or property, may deduct

> an amount paid in the year or payable in respect of the year . . . pursuant to a legal obligation to pay interest on . . . borrowed money used for the purpose of earning income from a business or property (other than borrowed money used to acquire property the income from which would be exempt or to acquire a life insurance policy).

In *McClurg* and *Neuman*, the court considered the anti-avoidance rule in subsection 56(2), which stipulates that

> [a] payment or transfer of property made pursuant to the direction of, or with the concurrence of, a taxpayer to some other person for the benefit of the taxpayer or as a benefit that the taxpayer desired to have conferred on the other person . . . shall be included in computing the taxpayer's income to the extent that it would be if the payment or transfer had been made to the taxpayer.

Each of these three cases is examined in turn.

Bronfman Trust

In *Bronfman Trust*, the taxpayer, a personal trust established by Samuel Bronfman for the benefit of his daughter, Phyllis, and her children, borrowed a considerable sum of money to finance capital allocations to Phyllis Bronfman, incurring substantial interest expenses, which it sought to deduct in computing its income for each of the 1970, 1971, and 1972 taxation

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118 Ibid., at 5022; 250. Thus, he emphasized, at 5023; 252, "The teleological approach will favour the taxpayer or the tax department depending solely on the legislative provision in question, and not on the existence of predetermined presumptions." In this respect, see Krishna, supra footnote 84, at 61, concluding on the basis of this statement that "incentive provisions should be interpreted to enhance their underlying purpose and anti-avoidance provisions should be read to restrict and circumscribe abusive tax avoidance."

119 Supra footnote 5.

120 Supra footnote 5.

121 Supra footnote 5.

years. On the basis that the borrowed money was used to pay capital allocations to the beneficiary, not "for the purpose of earning income from a business or property" as required by subparagraph 20(1)(c)(i), the minister disallowed the deductions. On appeal, the trust argued that the borrowed money was used *indirectly* for the purpose of earning income by permitting the trust to "retain income-producing investments until the time was ripe to dispose of them" and that the "end result of the transactions . . . was the same as if the trustees had sold assets to pay the allocations and then borrowed money to replace them, in which case . . . the interest would have been deductible."[122]

At the Supreme Court of Canada, the key interpretive issue was whether the deduction in subparagraph 20(1)(c)(i) required borrowed money to be used *directly* for the purpose of earning income or permitted qualifying *indirect* uses such as the income-preserving purpose claimed by the taxpayer. This issue was complicated by the Exchequer Court's prior decision in *Trans-Prairie Pipelines Ltd. v. MNR*, in which money borrowed by a corporate taxpayer to redeem preferred shares was held to have been used for the purpose of earning income from the taxpayer's business on the grounds that the funds became part of "the mass of capital dedicated to that business,"[123] and "fill[ed] the hole left by [the] redemption."[124] A related issue concerned the taxpayer's second argument that the interest would have been deductible had the trust "sold assets to pay the allocations and then borrowed money to replace them."[125]

Writing for a unanimous court, Dickson CJ employed a purposive approach to uphold the minister's assessment. As an initial matter, therefore, he considered the purpose of the statutory provision, agreeing with the opinion of the trial judge that "the interest deduction was designed to encourage accretions to the total amount of tax-producing capital."[126] According to Dickson CJ,

> Parliament created s. 20(1)(c)(i) . . . in order to encourage the accumulation of capital which would produce taxable income. Not all borrowing expenses are deductible. Interest on borrowed money used to produce tax exempt income is not deductible. Interest on borrowed money used to buy life insurance policies is not deductible. Interest on borrowings used for non-income earning purposes, such as personal consumption or the making of capital gains is similarly not deductible. The statutory deduction thus requires a characterization of the use of borrowed money as between the eligible use of earning non-exempt income from a business or property and a variety of possible ineligible uses. The onus is on the taxpayer to trace the borrowed funds to an identifiable use which triggers the deduction.[127]

[122] *Bronfman Trust*, supra footnote 5, at 5061; 120.

[123] 70 DTC 6351, at 6353; [1970] CTC 537, at 540 (Ex. Ct.).

[124] Ibid., at 6354; 541.

[125] *Bronfman Trust*, supra footnote 5, at 5061; 120.

[126] Ibid., at 5063; 123.

[127] Ibid., at 5064; 124.

On this basis, he determined, "the focus of the inquiry must be centered on the use to which the taxpayer put the borrowed funds."[128]

Relying on this purposive analysis, Dickson CJ adopted a strict approach to the interpretation of subparagraph 20(1)(c)(i), emphasizing the "limited circumstances" in which the interest deduction is "made available to the taxpayer"[129] and the requirement that the borrowed funds be traced to "a specific eligible use."[130] As a result, he concluded, although there might be "exceptional circumstances in which, on a real appreciation of the taxpayer's transactions, it might be appropriate to allow the taxpayer to deduct interest on funds borrowed for an ineligible use because of an indirect effect on the taxpayer's income-earning capacity,"[131] taxpayers cannot deduct "interest paid on borrowed funds which indirectly preserve income-earning property but which are not directly 'used for the purpose of earning income from . . . property.' "[132] Moreover, on the facts of the case, where the assets preserved by the trust "yielded a return which grossly fell short of the interest costs on the borrowed money," the taxpayer had not established that its bona fide purpose in using the borrowed funds was to earn income.[133]

Although the court's decision to disallow the interest deduction appears to have been justified on the facts, the process by which it arrived at this decision is troubling. While Dickson CJ's understanding of the purpose of subparagraph 20(1)(c)(i) may be valid, the absence of any obvious reference to the accumulation of income-producing capital either in the text of the provision or in the legislative record raises doubts about the court's initial "teleological" interpretation. To the extent that its conclusions on the application of the interest deduction rest on this prior interpretation, therefore, these conclusions may also be called into question.

More important, by emphasizing the *use* to which the taxpayer put the borrowed funds, the court appears to have disregarded the text of subparagraph 20(1)(c)(i), which refers to the *purpose* for which the borrowed

[128] Ibid., at 5064; 125.

[129] Ibid., at 5067; 128.

[130] Ibid., at 5067; 129. According to Dickson CJ, "[i]n my view, the text of the Act requires tracing the use of borrowed funds to a specific eligible use, its obviously restricted purpose being the encouragement of taxpayers to augment their income-producing potential." Ibid.

[131] Ibid. In these circumstances, however, Dickson CJ added, "It seems to me that, at the very least, the taxpayer must satisfy the court that his or her *bona fide* purpose in using the funds was to earn income." Ibid.

[132] Ibid.

[133] Ibid. According to the court, "[t]he taxpayer cannot point to any reasonable expectation that the income yield from the trust's investment portfolio as a whole, or indeed from any single asset, would exceed the interest payable on a like amount of debt. The fact that the loan may have prevented capital losses cannot assist the taxpayer in obtaining a deduction from income which is limited to use of borrowed money for the purpose of earning *income* [emphasis in original]." Ibid.

funds are used.[134] As a result, although the court concluded that the taxpayer did not establish that its bona fide purpose in using the borrowed funds was to earn income, it is unclear whether the decision to disallow the interest deduction turned on this finding or on the ineligible character of the direct use to which the borrowed funds were put (the payment of capital allocations to the beneficiary).

The court's decision was also unclear with respect to the Exchequer Court's prior decision in *Trans-Prairie*. On the one hand, by emphasizing the direct use of the borrowed funds rather than the purpose of the use, the decision appeared to call into question the result in *Trans-Prairie*, where the direct use of the borrowed funds had been to redeem preferred shares.[135] Indeed, Revenue Canada interpreted the decision as having overruled *Trans-Prairie* and cancelled a key interpretation bulletin based on its reading of that case.[136] On the other hand, the court did not expressly overrule *Trans-Prairie* and explicitly acknowledged that indirect eligible uses might qualify for the interest deduction where the taxpayer's "*bona fide* purpose in using the funds was to earn income."[137] In this light, the court's decision in *Bronfman Trust* is best understood as having distinguished *Trans-Prairie* on the basis that the share redemption in that case, unlike the capital allocation in *Bronfman Trust*, was itself undertaken for the purpose of earning income within the meaning of subparagraph 20(1)(c)(i).[138] Indeed, this view is consistent with Jackett P's conclusion

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[134] For recent cases emphasizing the purpose requirement in subparagraph 20(1)(c)(i), see *Mark Resources Inc. v. The Queen*, 93 DTC 1004; [1993] 2 CTC 2259 (TCC); *Canwest Broadcasting Ltd. v. The Queen*, 96 DTC 1375; [1995] 2 CTC 2780 (TCC); *Robitaille c. The Queen*, 97 DTC 1286; [1997] 3 CTC 3031 (TCC); *Shell Canada Limited*, supra footnote 7; and *Les Entreprises Ludco Ltée et al. v. The Queen*, 99 DTC 5153 (FCA). The Supreme Court of Canada will have an opportunity to revisit this subject in its reasons for granting the taxpayer's appeal in *Shell Canada Limited*. These reasons had not yet been released when this article went to press.

[135] As Dickson CJ noted, "[w]ith the exception of *Trans-Prairie* . . . the jurisprudence has generally been hostile to claims based on indirect, eligible uses when faced with direct but ineligible uses of borrowed money." *Bronfman Trust*, supra footnote 5, at 5066; 128.

[136] See *Interpretation Bulletin* IT-80, "Interest on Money Borrowed To Redeem Shares, or To Pay Dividends," November 21, 1972 (cancelled on February 12, 1987 but reinstated on June 2, 1987). The fallout from the *Bronfman Trust* decision and the subsequent introduction of draft legislation to codify Revenue Canada's prior administrative practices are reviewed in Brian J. Arnold and Tim Edgar, "Deductibility of Interest Expense" (1995), vol. 43, no. 5 *Canadian Tax Journal* 1216-44. For a prominent example of the consternation experienced in the professional tax community following the decision, see T.E. McDonnell, "Interest Deductibility—The Tax Policy Process," Current Cases feature (1987), vol. 35, no. 3 *Canadian Tax Journal* 694-97.

[137] *Bronfman Trust*, supra footnote 5, at 5067; 129.

[138] In fact, since the share redemption in *Trans-Prairie* was specifically undertaken in order to enable the taxpayer to raise further capital for expansion by way of bond issues, it would be odd to suggest that the purpose of the redemption was *not* to earn income. Likewise, it seems reasonable to regard the use of borrowed money to pay dividends as reflecting an income-earning purpose within the meaning of subparagraph 20(1)(c)(i) to

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in *Trans-Prairie* that the borrowed funds became part of "the mass of capital dedicated to [the taxpayer's] business."[139]

Lack of clarity also characterizes the court's response to the taxpayer's second argument that the interest would have been deductible had the taxpayer "sold assets to pay the allocations and then borrowed money to replace them."[140] Although observing that "[i]t would be a sufficient answer to this submission to point to the principle that the courts must deal with what the taxpayer actually did, and not what he might have done,"[141] the court also questioned the very premise on which the taxpayer's argument was based: that the interest deduction *would* have been available had the taxpayer sold assets to finance the capital allocation and borrowed funds to reacquire the assets. Emphasizing "the true commercial and practical nature of the taxpayer's transactions,"[142] the court concluded:

> If . . . the trust had sold a particular income-producing asset, made the capital allocation to the beneficiary and repurchased the same asset, all within a brief interval of time, the courts might well consider the sale and repurchase to constitute a formality or sham designed to conceal the essence of the transaction, namely that money was borrowed and used to fund a capital allocation to the beneficiary.[143]

While the court's reference to the sham doctrine is at odds with its traditional definition for the purposes of Canadian income tax law,[144] disallowance of the interest deduction in this situation could be justified

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138 Continued . . .
the extent that the payment of dividends is a necessary quid pro quo to obtain capital for the payer's business. In contrast, where a personal trust borrows funds to make a capital allocation to a beneficiary, it is difficult, if not impossible, to conceive of any income-earning purpose for the allocation.

139 *Trans-Prairie*, supra footnote 123, at 6353; 540.

140 *Bronfman Trust*, supra footnote 5, at 5061; 120.

141 Ibid., at 5067-68; 129.

142 Ibid., at 5067; 128. According to Dickson CJ, "[a]ssessment of taxpayers' transactions with an eye to commercial and economic realities, rather than juristic classification of form, may help to avoid the inequity of tax liability being dependent upon the taxpayer's sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction." Ibid.

143 Ibid., at 5068; 129-30.

144 In *MNR v. Cameron*, 72 DTC 6325, at 6328; [1972] CTC 380, at 384 (SCC), the court adopted the following definition of the word "sham" set out in *Snook v. London & West Riding Investments, Ltd.*, [1967] 1 All ER 518, at 528 (CA), per Lord Diplock: "acts done or documents executed by parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create." This definition was also cited in *Stubart*, supra footnote 3, at 6320-21; 313, where Estey J characterized a sham as a situation in which "[t]he transaction and the form in which it was cast by the parties and their legal and accounting advisers [can] be said to have been so constructed as to create a false impression in the eyes of a third party, specifically the taxing authority." This definition was subsequently reaffirmed in *McClurg*, supra footnote 5, and *Antosko*, supra footnote 6.

under the language of subparagraph 20(1)(c)(i). Since the deduction is available only where borrowed money is "used for the purpose of earning income," it seems reasonable for a court to conclude in the context of a series of transactions in which income-producing assets are sold, money is borrowed, and comparable assets repurchased, that the *purpose* for which borrowed money is used is not to earn income, even if its direct *use* is to acquire income-producing assets.[145] Indeed, this approach to the application of subparagraph 20(1)(c)(i) is consistent with the emphasis on the purpose of the use to justify the deduction in a case like *Trans-Prairie*.

McClurg

In *McClurg*, the taxpayer and his partner, Veryle Ellis, carried on a dealership in International Harvester Trucks through a Saskatchewan company called Northland Trucks. The company's articles of incorporation authorized three categories of shares (class A common, voting, and participating; class B common, non-voting, and participating where authorized by the directors; and class C preferred and non-voting), each of which carried "the distinction and right to receive dividends exclusive of all other classes of shares"[146] and were issued at a price of $1 per share. In the taxation years at issue, the taxpayer and Ellis each held 400 class A shares and 37,500 class C shares, while their wives, Wilma McClurg and Suzanne Ellis, each held 100 class B shares. In addition to her equity investment, Mrs. McClurg "played a vital role in the financing of the formation of the company" by co-signing loans and guaranteeing debts.[147]

During the 1978, 1979, and 1980 taxation years, the taxpayer and his partner received salaries and bonuses (which in the case of the taxpayer amounted to $33,968 in 1978, $65,282 in 1979, and $57,900 in 1980), but

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[145] See, for example, *Dunn v. MNR*, 74 DTC 1121; [1974] CTC 2172 (TRB), to which the court referred in *Bronfman Trust*, supra footnote 5, at 5068; 130. This interpretation is obviously at odds with the majority decision in *Singleton v. MNR*, [1999] FTR 33201 (FCA), which was released after this passage was written. Given the confusion in this area, it would be desirable for the issue to be decided by the Supreme Court.

[146] As Dickson CJ observed, this clause gave the directors "unfettered discretion as to the allocation of dividends among classes of shares." *McClurg*, supra footnote 5, at 5003; 173.

[147] Ibid., at 5012; 185. According to the court, "[f]or the respondent's investment of 37,500 preferred shares, he borrowed $37,500 from the Toronto Dominion Bank on a note co-signed by his wife and his father-in-law. The latter provided further security in the form of a term deposit certificate totalling $40,000. The purchase of the business was partly financed by a loan from the vendor, security for which was provided, in part, by the respondent and his wife through the placing of a second mortgage on their jointly-owned home in the amount of $25,000. Furthermore, Wilma McClurg co-signed with the respondent a personal guarantee to the International Harvester Company, the supplier of the company, with respect to a $500,000 debenture in connection with the business affairs of Northland Trucks. Finally, the company opened a line of credit with the Toronto Dominion Bank, initially for $50,000, and later increased to $200,000, which was guaranteed by all of the shareholders. It is worth noting that the trial judge found that Wilma McClurg had personal assets of between $15,000 and $20,000 during this time, which indicates that her personal guarantee was not without significance." Ibid., at 5004; 174.

no dividends on either class of shares. Mrs. McClurg, who "assisted in the operation of the business, performing a variety of tasks as the need arose—including stenography, bookkeeping, stock taking, and driving a truck,"[148] received a salary of $528 in 1978, $5,000 in 1979, and $5,000 in 1980. In addition, in each of these years, the taxpayer and Ellis, as directors of the company, declared dividends of $20,000 on the 200 class B shares held by their wives.

In computing the taxpayer's income for each of these taxation years, the minister included in his income $8,000 of the $10,000 dividends paid to Mrs. McClurg on the grounds that "the dividends declared in each of the years in question should be attributed equally to all of the common shares, no matter of what class and notwithstanding the express condition attaching to the class B shares that they shall carry the right to receive dividends exclusive of the other classes of shares in the company."[149] While this assessment was based partly on the conclusion that the directors' discretionary authority to declare dividends on any class of shares violated both the common law and the Saskatchewan Business Corporations Act,[150] it also depended on the application of subsection 56(2). At the Supreme Court of Canada, a majority of the panel regarded the discretionary dividend clause as a valid derogation from the common law presumption of equality among shares.[151] The case then turned on the interpretation of subsection 56(2).

For the minority, LaForest J (Wilson and L'Heureux-Dubé JJ concurring) began with a textual analysis of subsection 56(2), "break[ing] the provision down into its constituent parts."[152] For this purpose, he referred to the "analytical framework" adopted by Cattanach J in *Murphy v. The Queen*, according to which

> [t]o fall within subsection 56(2) each essential ingredient to taxability in the hands of the taxpayer therein specified must be present.
>
> Those four ingredients are:
>
> (1) that there must be a payment or transfer of property to a person other than the taxpayer;
>
> (2) that the payment or transfer is pursuant to the direction of or with the concurrence of the taxpayer;
>
> (3) that the payment or transfer be for the taxpayer's own benefit or for the benefit of some other person on whom the taxpayer wished to have the benefit conferred, and

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[148] Ibid.

[149] Ibid., at 5005; 174.

[150] RSS 1978, c. B-10.

[151] *McClurg*, supra footnote 5, at 5006-10; 177-82 (CTC), per Dickson CJ (Sopinka, Gonthier, and Cory JJ concurring). Dissenting, LaForest J (Wilson and L'Heureux-Dubé JJ concurring) held that the discretionary dividend clause violated both the common law and the Saskatchewan Business Corporations Act. Ibid., at 5013-19; 186-94.

[152] Ibid., at 5021; 195.

(4) that the payment, or transfer would have been included in computing the taxpayer's income if it had been received by him instead of the other person.[153]

Regarding the first of these elements, LaForest J concluded that the statutory requirement was easily satisfied by the payment of the dividends.[154] With respect to the second condition, he held that the taxpayer had directed the payment "as an individual in control of [the] corporation"[155] and concurred in the payment "in his personal capacity as a shareholder of the company."[156] As for the third "ingredient," LaForest J held that the payment benefited both the taxpayer by reducing his income tax[157] and Mrs. McClurg by increasing the amount to which she would otherwise have been entitled in each of the taxation years at issue by $8,000.[158] Finally, he added, "it is obvious that the $8,000 dividend would

[153] 80 DTC 6314, at 6317-18; [1980] CTC 386, at 389-90 (FCTD).

[154] *McClurg*, supra footnote 5, at 5021; 196: "With regard to the first element, the term 'payment' has acquired no technical meaning in the *Income Tax Act* and is to be interpreted in its popular sense; see *Murphy*, *supra*, at [6320; 392]. Furthermore, 'property' is defined in very broad terms in s. 248(1) of the *Income Tax Act*, and specifically includes money. It is also noteworthy that s. 16(1), the predecessor to s. 56(2), originally referred to a transfer of 'money, rights or things.' Therefore, it appears that the payment in question satisfies the first prerequisite to the operation of s. 56(2). This is confirmed by *Champ v. The Queen* [83 DTC 5029; [1983] CTC 1 (FCTD)], where it was held that the taxpayer effected a 'transfer of property' by directing the payment of dividends."

[155] Ibid., at 5021; 196. Although LaForest J preferred to base this conclusion on the taxpayer's "control" of the company (presumably de facto, since the taxpayer held only 50 percent of the voting shares), his "direction" might also have been established by virtue of his position as a director who actually authorized the payment of the dividends. On this point, however, LaForest J appears to have accepted the taxpayer's argument that "to the extent that the taxpayer directed . . . the payment of the dividend, this was done in his capacity as a director of the corporation, and not in any personal capacity." Ibid.

[156] Ibid.: "The facts indicate that the respondent, in his capacity as a shareholder, did not object to the distribution of dividends. . . . [S]ince Mr. McClurg did not demand his share of the dividends, he implicitly accepted that the company make an $8,000 payment to his wife. To this end, the appellant relied on *Bronfman, A. v. MNR*, [65 DTC 5235, at 5239; [1965] CTC 378, at 385 (Ex. Ct.)], in which Dumoulin, J. held that the 'abstention or indifference' of shareholders who had the power to object to the actions of directors was 'tantamount to an approval' and sufficient to invoke s. 16(1), the predecessor to s. 56(2)."

[157] Ibid. Although LaForest J did not expand on this point in detail, the benefit to the taxpayer presumably depended not only on the reduction in his income tax, but also on the continued use or enjoyment of the dividends as a member of the spousal unit from which a benefit was derived by the payment of dividends to his spouse. In this respect, any *net* benefit to the taxpayer depended not only on the reduction in *his* personal income tax, but also on a reduction in the *combined* tax liability of the taxpayer and his spouse resulting from the fact that the dividends were included in computing the income of the spouse, not the taxpayer, and subject to tax at a lower marginal rate. To the extent that the taxpayer derived a benefit from the payment of dividends to his spouse, therefore, it is more accurate to say that it resulted from *income splitting*, not simply a reduction in his personal income tax.

[158] Ibid.: "Since Mrs. McClurg was entitled to only $2,000 in dividends, the $8,000 portion of the payment representing Mr. McClurg's dividend entitlement amounts to a benefit to her under s. 56(2)."

have been included in Mr. McClurg's income had the allocation been properly made."[159] As a result, he concluded:

> [T]he four prerequisites to the application of s. 56(2) have been met. Since $8,000 of the $10,000 in dividends attributed to Wilma McClurg on her class B shares was properly attributable to Mr. McClurg, this amount should be included in the computation of his income.[160]

For the minority, therefore, the taxpayer was caught by the words of the statutory text.

In contrast to the minority's textual approach, the majority decision, written by Dickson CJ (Sopinka, Gonthier, and Cory JJ concurring), is thoroughly and explicitly purposive. Citing the court's prior decisions in *Stubart*, *Golden*, and *Bronfman Trust*, Dickson CJ began by considering not the text of subsection 56(2), but "the purpose of the legislative provision and the economic and commercial reality of the taxpayer's transactions."[161] Moreover, for this exercise, he referred not to the statutory provision itself, but to the Exchequer Court decision in *Miller v. MNR*, in which Thurlow J (as he then was) stated of its predecessor, subsection 16(1) of the 1952 Income Tax Act:

> In my opinion, s. 16(1) is intended to cover cases where a taxpayer seeks to avoid receipt of what in his hands would be income by arranging to have the amount received by some other person whom he wishes to benefit or by some other person for his own benefit. The scope of the subsection is not obscure for one does not speak of benefitting a person in the sense of the subsection by making a business contract with him for adequate consideration.[162]

[159] Ibid., at 5021; 197.

[160] Ibid., at 5021-22; 197.

[161] Ibid., at 5011; 183.

[162] 62 DTC 1139, at 1147; [1962] CTC 199, at 212 (Ex. Ct.). For a similar interpretation of the purpose of subsection 56(2), see B.J. Arnold, *Timing and Income Taxation: The Principles of Income Measurement for Tax Purposes*, Canadian Tax Paper no. 71 (Toronto: Canadian Tax Foundation, 1983), 87-90. Arnold emphasizes the origins of the provision in the doctrine of "indirect receipt," according to which an amount that would be included in a taxpayer's income if directly received by the taxpayer is taxable to the taxpayer if it is applied by the taxpayer for the taxpayer's benefit or at the taxpayer's direction. For a somewhat broader view of subsection 56(2), see William I. Innes, "The Taxation of Indirect Benefits: An Examination of Subsections 56(2), 56(3), 56(4), 245(2), and 245(3) of the Income Tax Act," in *Report of Proceedings of the Thirty-Eighth Tax Conference*, 1986 Conference Report (Toronto: Canadian Tax Foundation, 1987), 42:1-36, at 42:12. Innes observes that "subsection 56(2) adds a novel dimension to the concept of agency or constructive receipt" by applying "where the taxpayer desired to confer a benefit upon a third party" and concludes that "Parliament seems to have concluded, probably correctly, that the satisfaction of such moral obligations does not fall within the common law principles of agency or constructive receipt. Accordingly, Parliament perceived the need for a statutory extension of such principles and embodied it in the predecessor to subsection 56(2), first enacted in 1948." See also infra footnote 171 and accompanying text.

On this basis, Dickson CJ concluded, "The subsection obviously is designed to prevent avoidance by the taxpayer, through the direction to a third party, of receipts which he or she otherwise would have obtained."[163] In addition, he declared, "[T]he subsection reasonably cannot have been intended to cover benefits conferred for adequate consideration in the context of a legitimate business relationship."[164]

Having thus defined the purpose and scope of subsection 56(2), only then did Dickson CJ consider its application to the facts of the case. In this light, he continued, there were two reasons why the provision ought not to apply to the dividends received by Mrs. McClurg.

First, he concluded, because a dividend, if not declared and paid, "would not otherwise have been received by the taxpayer" but "would simply have been retained as earnings by the company," it follows "as a general rule" that "a dividend payment cannot reasonably be considered a benefit diverted from a taxpayer to a third party within the contemplation of s. 56(2)."[165] Since the purpose of subsection 56(2) is "to ensure that payments which otherwise would have been received by the taxpayer are not diverted to a third party as an anti-avoidance technique," he explained, and "[t]his purpose is not frustrated" by the payment of a dividend "because, in the corporate law context, until a dividend is declared, the profits belong to a corporation as a juridical person," the payment of a dividend "cannot legitimately be considered as within the parameters of the legislative intent of s. 56(2)."[166]

Second, he added, if the court were to apply subsection 56(2) to the dividend payments received by Mrs. McClurg, this "would be contrary to the commercial reality of this particular transaction," which was "not simply an attempt to avoid the payment of taxes" but a "legitimate business relationship."[167] Because Mrs. McClurg had made "very real contributions, financial and operational" to the company,[168] Dickson CJ concluded, "the facts at bar provide no evidence that the business arrangement was an attempt at tax avoidance, but rather that it was the product of a business contract made for adequate consideration."[169] In other words, although the majority did not make the point explicitly, the payment of the dividends was not a "benefit" within the meaning of subsection 56(2).[170]

[163] *McClurg*, supra footnote 5, at 5011; 183-84.

[164] Ibid., at 5011; 184.

[165] Ibid., at 5012; 184.

[166] Ibid.

[167] Ibid., at 5012; 185.

[168] Ibid.

[169] Ibid., at 5013; 185.

[170] For a similar interpretation of this part of the decision, see *Neuman*, supra footnote 5, at 6304; 192.

While the outcome in *McClurg* may have been sound, the majority's reasons are not. As an initial matter, it does not follow from the assumed purpose of the provision, "to prevent avoidance by the taxpayer, through the direction to a third party, of receipts which he or she otherwise would have obtained," that dividend payments are necessarily beyond the scope of subsection 56(2). On the contrary, although it is true that a dividend payment, if not made to one class of shareholders, remains the property of the corporation until another dividend is declared, it is also true that the non-payment of dividends to one class of shareholders will increase the cash available for the payment of dividends on other classes of shares or increase the value of those other share classes if retained by the company. In either case, to the extent that other shareholders have a prospective, though not immediate, right to the profits from which a dividend is paid, it is arguable that but for the payment of a dividend on one class of shares, shareholders of other classes would have obtained these profits in one form or another.

Indeed, this interpretation of subsection 56(2) is consistent with the express wording of the fourth requirement of the provision, which applies "to the extent that [the payment or transfer of property] would be [included in computing the taxpayer's income] if the payment or transfer *had been made* to the taxpayer [emphasis added]," not if the taxpayer *would have received* the payment or transfer directly. It is also consistent with two prior decisions in which the provision was held to apply to shareholders of closely held companies who directed or concurred in the payment or transfer of property to third parties, notwithstanding that the shareholders were not immediately entitled to the property themselves.[171] As a result,

[171] See *MNR v. Bronfman*, 65 DTC 5235; [1965] CTC 378 (Ex. Ct.), applying the predecessor provision, subsection 16(1), to attribute to certain shareholders a pro rata amount of the value of certain gifts made by a closely held corporation to various family members, former employees, and their dependants; and *Winter et al. v. The Queen*, 90 DTC 6681; [1991] 1 CTC 113 (FCA), applying subsection 56(2) to the controlling shareholder of an investment holding company that transferred shares to the shareholder's son-in-law for proceeds much less than their fair market value. In *Bronfman*, the court specifically considered and rejected the taxpayer's argument that the application of subsection 16(1) required "personal ownership of the moneys . . . paid out" in the form of gifts. According to Dumoulin J (at 5238; 384), "I would think not, because . . . the section's clear enough purpose is the taxation of indirect payments under circumstances such as the instant ones. If so, then, a norm or basis of assessment must be set, and this was done by Parliament assimilating payer's funds, corporate body or third party of any other description, to the personal income of the taxpayer directing these payments or merely concurring in their performance, to the extent that they would have increased his income had they been made to him." In addition, he explained, citing the decision of the Tax Appeal Board in *No. 494 v. MNR* (1958), 18 Tax ABC 456, at 464, "[B]y payments of the amounts in question herein, the amount of the distributable surplus of the company which might be on hand for some future distribution is thereby reduced." Likewise, in *Winter*, the court specifically considered and rejected the view that subsection 56(2) requires the taxpayer to have been immediately entitled to the property that is paid or transferred to a third party. According to Marceau JA (at 6683-84; 116-17),

(The footnote is continued on the next page.)

to exclude all dividends from the scope of subsection 56(2) "because, in the corporate law context, until a dividend is declared, the profits belong to a corporation as a juridical person" is contrary both to "economic and commercial reality" and to the language and purpose of the provision itself.

In *McClurg*, of course, the majority did not exclude *all* dividend payments from the scope of subsection 56(2) but concluded "as a general rule" that "a dividend payment cannot reasonably be considered a benefit diverted from a taxpayer to a third party within the contemplation of s. 56(2)."[172] Indeed, since the provision "reasonably cannot have been intended to cover benefits conferred for adequate consideration in the context of a legitimate business relationship,"[173] it follows that subsection 56(2) should not apply to the declaration and payment of dividends in the context of ordinary commercial relationships between arm's-length parties.[174] Where a company is closely held, however, and discretionary dividends are paid to non-arm's-length persons such as a taxpayer's spouse or minor children, it is conceivable, depending on the facts, that the dividends might constitute a benefit within the meaning of subsection

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[171] Continued . . .

> [t]he fact that [the taxpayer] had no direct right to the shares would have a bearing if the provision was to be construed as covering only cases of diversion of income receivable by the taxpayer and there is no indication whatever that the provision was meant to be so confined. . . .
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> It is generally accepted that the provision . . . is rooted in the doctrine of "constructive receipt" and was meant to cover principally cases where a taxpayer seeks to avoid receipt of what in his hands would be income by arranging to have the amount paid to some other person either for his own benefit (for example the extinction of a liability) or for the benefit of that other person (see the reasons of Thurlow, J. in *Miller*, *supra*, and of Cattanach, J. in *Murphy*, *supra*). There is no doubt, however, that the wording of the provision does not allow to its being confined to such clear cases of tax avoidance. The *Bronfman* judgment, which upheld the assessment, under the predecessor of subsection 56(2), of a shareholder of a closely held private company, for corporate gifts made over a number of years to family members, is usually cited as authority for the proposition that it is not a precondition to the application of the rule that the individual being taxed have some right or interest in the payment made or the property transferred. The precedent does not appear to me quite compelling, since gifts by a corporation come out of profits to which the shareholders have a prospective right. But the fact is that the language of the provision does not require, for its application, that the taxpayer be initially entitled to the payment or transfer of property made to the third party, only that he would have been subject to tax had the payment or transfer been made to him.

These cases are discussed in Robert E. Beam and Stanley N. Laiken, "Recent Developments on Subsection 56(2): Indirect Payments," Personal Tax Planning feature (1995), vol. 43, no. 2 *Canadian Tax Journal* 447-69, at 448-53.

[172] *McClurg*, supra footnote 5, at 5012; 184. See also ibid., at 5013; 185: "[T]he declaration of a dividend is *normally* beyond the scope of s. 56(2) [emphasis added]."

[173] Ibid., at 5011; 184.

[174] For this reason, it does not follow, as Dickson CJ suggests, that if the court were to apply subsection 56(2) to dividends, "corporate directors potentially could be found liable for the tax consequences of any declaration of dividends made to a third party." Ibid., at 5012; 184.

56(2). More specifically, where, as part of an income-splitting arrangement, discretionary dividends are paid on a single class of shares in an amount greatly exceeding the consideration paid for the shares when issued, it seems reasonable to regard the payment as a benefit within the meaning of subsection 56(2).

Although unclear, it is in this light that one should read Dickson CJ's emphasis on Mrs. McClurg's "very real contributions, financial and operational" to the company[175] and his obiter statement that

> [i]n my opinion, if a distinction is to be drawn in the application of s. 56(2) between arm's length and non-arm's length transactions, it should be made between the exercise of a discretionary power to distribute dividends when the non-arm's length shareholder has made no contribution to the company (in which case s. 56(2) may be applicable), and those cases in which a legitimate contribution has been made. In the case of the latter, of which this appeal is an example, I do not think it can be said that there was no legitimate purpose to the dividend distribution.[176]

While the minority in *McClurg* criticized this passage for ignoring "a fundamental principle of corporate law that a dividend is a return on capital which attaches to a share, and is in no way dependent on the conduct of a particular shareholder,"[177] the better view is that Dickson CJ's comments relate not to any dividend entitlement at corporate law, but to the third statutory requirement in subsection 56(2) that the payment or transfer of property be for the benefit of the taxpayer or the benefit of some other person on whom the taxpayer desired to confer a benefit. Notwithstanding that a non-arm's-length shareholder has received discretionary dividends paid by a closely held company on a single class of shares in an amount greatly exceeding the consideration paid for the shares when issued, these dividends ought not to be characterized as a benefit within the meaning of subsection 56(2) if the non-arm's-length shareholder has made a "legitimate contribution" to the company. Notwithstanding that Mrs. McClurg received $30,000 over three years in discretionary dividends on class B shares for which she paid only $100, these dividends were not a benefit within the meaning of subsection 56(2) because of "the very real contributions, financial and operational, made by Wilma McClurg" to the success of Northland Trucks.

Neuman

In contrast to *McClurg*, where the payment of the dividends at issue was characterized as "a legitimate *quid pro quo* and . . . not simply an attempt to avoid the payment of taxes,"[178] the transactions in *Neuman* lacked any such character and appear to have been designed primarily to split income.

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175 Ibid., at 5012; 185.

176 Ibid., at 5012-13; 185.

177 Ibid., at 5020; 195.

178 Ibid., at 5012; 185.

In this case, the taxpayer, a lawyer practising with a Winnipeg firm, transferred his 1,285.714 shares in the firm's management company (Newmac), valued at $120,000, to a newly incorporated holding company (Melru) in exchange for 1,285.714 voting class G shares of Melru, which also issued one common voting share to the taxpayer for $1 and 99 class F shares to the taxpayer's wife, Ruby, for $1 per share. As in *McClurg*, dividends could be declared at the sole discretion of the directors and distributed selectively among the various classes of shares.

In 1982, Melru received $20,000 in dividends on the Newmac shares, whereupon Mrs. Neuman, who had been elected sole director of Melru, declared a dividend of $5,000 on the taxpayer's class G shares and $14,800 on her own class F shares. Upon receiving the dividends, Mrs. Neuman immediately loaned the $14,800 to the taxpayer, receiving a demand promissory note as security. Mrs. Neuman died in 1988 and the loan was never repaid. At the Supreme Court of Canada, the decision turned on the application of subsection 56(2).

Writing for a unanimous court, Iacobucci J employed a purposive interpretation of subsection 56(2), observing that it "strives to prevent tax avoidance through income splitting" but emphasizing that "it is a *specific* tax avoidance provision and not a general provision against income splitting."[179] On this basis, he concluded, subsection 56(2) should be interpreted strictly to apply "only . . . where the four preconditions to its application are specifically met,"[180] namely, that

> (1) the payment must be to a person other than the reassessed taxpayer;
>
> (2) the allocation must be at the direction of or with the concurrence of the reassessed taxpayer;
>
> (3) the payment must be for the benefit of the reassessed taxpayer or for the benefit of another person whom the reassessed taxpayer wished to benefit; and
>
> (4) the payment would have been included in the reassessed taxpayer's income if it had been received by him or her.[181]

For the purpose of the decision, however, Iacobucci J found it necessary to consider only the fourth requirement, which in his view was dispositive.[182]

Consistent with his purposive approach to the interpretation of subsection 56(2), Iacobucci J's analysis of this fourth precondition is based not on the words of the statutory text, but on the court's prior decision in

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[179] *Neuman*, supra footnote 5, at 6301; 187 (emphasis in original). For a more detailed analysis of the Supreme Court's decision in *Neuman*, see David G. Duff, "Neuman and Beyond: Income-Splitting, Tax Avoidance, and Statutory Interpretation at the Supreme Court of Canada," *Canadian Business Law Journal* (forthcoming).

[180] Ibid.

[181] Ibid., at 6301; 186.

[182] Ibid.

McClurg. Referring to Dickson CJ's conclusion in that case that "as a general rule, a dividend payment cannot reasonably be considered a benefit diverted from a taxpayer to a third party within the contemplation of s. 56(2),"[183] Iacobucci J inferred that in *McClurg*, "this Court implicitly interpreted the fourth precondition to include an *entitlement* requirement [emphasis added]," according to which "entitlement is used in the sense that the reassessed taxpayer would have otherwise received the payments in dispute."[184] As a result, he concluded:

> In essence, dividend income does not satisfy this prerequisite to attribution since the reassessed taxpayer would not have received the income had it not been paid to the shareholder. . . .
>
> Dividend income cannot pass the fourth test because the dividend, if not paid to a shareholder, remains with the corporation as retained earnings; the reassessed taxpayer, as either director or shareholder of the corporation, has no entitlement to the money.[185]

On this basis, the court concluded, subsection 56(2) did not apply to the dividend income received by Mrs. Neuman.[186]

Given the previous analysis of *McClurg*,[187] there are at least three grounds on which one might question the decision in *Neuman*.

First, by including a strict "entitlement requirement" in the fourth precondition, the decision transforms what was a qualified rule in *McClurg*, according to which "the declaration of a dividend is *normally* beyond the scope of s. 56(2) [emphasis added],"[188] into an absolute rule according to which subsection 56(2) can never apply to dividends unless the reassessed taxpayer had a pre-existing entitlement to them.[189] Moreover, in so doing, it misinterprets Dickson CJ's emphasis on the dividend recipient's "legitimate contribution" to the payer corporation as an unwarranted "exception" to this rule,[190] rather than a limitation on the "general rule" in circumstances where the payment of a dividend might reasonably be considered to be a benefit within the meaning of subsection 56(2).

Second, by affirming an "entitlement requirement" according to which "entitlement is used in the sense that the reassessed taxpayer would have otherwise received the payments in dispute," the decision in *Neuman* either ignores prior cases specifically rejecting such an immediate entitlement requirement[191] or distinguishes them on the questionable basis that

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183 *McClurg*, supra footnote 5, at 5012; 184.

184 *Neuman*, supra footnote 5, at 6303; 190.

185 Ibid., at 6303; 189-90.

186 Ibid., at 6305; 194.

187 See supra footnotes 146 to 177 and accompanying text.

188 *McClurg*, supra footnote 5, at 5013; 185.

189 *Neuman*, supra footnote 5, at 6303; 191.

190 Ibid., at 6304; 193.

191 See *Bronfman*, supra footnote 171, to which the court does not refer in *Neuman*.

they "concerned the conferral of a benefit which was not in the form of dividend income."[192] Since subsection 56(2) refers to a "payment or transfer of property," it is unclear on what principled basis any such distinction might rest.

Finally, and most significantly, by reading the fourth precondition as if it required that the payment would have been "received by the taxpayer," not (as the provision actually reads) "included in computing the taxpayer's income . . . if the payment or transfer had been made to the taxpayer," the decision effectively rewrites the text of the Act in the context of dividend payments. While purposive interpretation requires courts to *interpret* statutory provisions in a manner consistent with their purposes, it does not permit courts to *rewrite* statutory provisions in light of these purposes. Moreover, as explained in the earlier analysis of *McClurg*, the addition of an immediate entitlement requirement as affirmed in *Neuman* is contrary not only to the language of subsection 56(2), but also to "economic and commercial reality" and to the purpose of the provision itself.[193]

PLAIN MEANING RULE

Notwithstanding the purposive decisions reviewed in the previous section, recent Supreme Court of Canada decisions have also employed a plain meaning approach to interpret specific provisions of the Act.[194] In *Stubart* itself, in fact, Estey J suggested that "[c]ourts today apply to this statute the plain meaning rule," adding, however, that the rule should be applied "in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable."[195]

Doctrine

While purposive interpretation begins with the objectives underlying the statutory text and the reasons for which it was enacted, and interprets the text in light of these objectives and reasons, the plain meaning approach to statutory interpretation begins with the words of the text, which are to be given their ordinary or literal meaning unless they are ambiguous, in which case the court may then consider "the scheme of the Act, the object of the Act, and the intention of Parliament" in order to resolve the ambiguity.[196] As Ruth Sullivan explains,

> [w]here the literal meaning of the text is clear or "plain," the task of interpretation is done and the court should not worry about legislative

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[192] *Neuman*, supra footnote 5, at 6303; 191 (distinguishing *Winter*, supra footnote 171).

[193] See supra footnote 171 and accompanying text.

[194] See *Antosko*, supra footnote 6, and the majority decision in *Friesen*, supra footnote 6.

[195] *Stubart*, supra footnote 3, at 6323; 316.

[196] For a thorough analysis of recent Supreme Court of Canada cases referring to the plain meaning rule, see Roger Taylor, "The Interpretation of Fiscal Statutes: The 'Plain Meaning' Approach in Recent Supreme Court of Canada Decisions," in *Report of Proceedings of the Forty-Eighth Tax Conference*, 1996 Conference Report, vol. 2 (Toronto: Canadian Tax Foundation, 1997), 64:1-13. For a critical evaluation of this rule, see Arnold, supra footnote 84.

> purpose or look to other aids to interpretation. Another way of stating this point is to say that the courts may not rely on purpose or other sources of meaning to create doubt or ambiguity but only to resolve it.[197]

Although similar to strict construction in its emphasis on the literal meaning of the statutory text, the plain meaning rule differs from this traditional rule by resolving ambiguities by reference to legislative intentions and statutory purposes rather than the application of rigid presumptions. Nonetheless, to the extent that it is combined with a residual presumption in favour of the taxpayer, it may be regarded as a modified version of the traditional strict construction approach.[198]

Among the clearest expressions of the plain meaning rule by the Supreme Court of Canada is Lamer CJ's majority decision in *R v. McIntosh*,[199] in which the Crown argued that section 34(2) of the Criminal Code,[200] which establishes an excuse where a person "is unlawfully assaulted" and "causes death or grievous bodily harm in repelling the assault," should be read to apply only where a person is unlawfully assaulted "without having provoked the assault." Notwithstanding that this interpretation was arguably more compatible with section 34(1), which excuses use of force "not intended to cause grievous bodily harm" only where a person "is unlawfully assaulted without having provoked the assault," and with section 35, which excuses the use of force only under more narrowly defined circumstances,[201] the majority concluded that the accused should not be denied the excuse afforded by the plain words of the provision read in isolation. According to Lamer CJ,

> where no ambiguity arises on the face of a statutory provision, then its clear words should be given effect. . . . [A] statute should be interpreted in a manner consistent with the plain meaning of its terms. Where the language of the statute is plain and admits of only one meaning, the task of interpretation does not arise.[202]

Moreover, he added:

> [W]here, by the use of clear and unequivocal language capable of only one meaning, anything is enacted by the legislature, it must be enforced however harsh or absurd or contrary to common sense the result may be. . . .

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[197] Sullivan, supra footnote 64, at 1.

[198] See the text accompanying footnotes 85 to 98.

[199] [1995] 1 SCR 686.

[200] RSC 1985, c. C-46, as amended.

[201] Section 35 states, "Every one who has without justification assaulted another but did not commence the assault with intent to cause death or grievous bodily harm, or has without justification provoked an assault on himself by another, may justify the use of force subsequent to the assault" only if, among other things, "he declined further conflict and quitted or retreated from it as far as it was feasible to do so before the necessity of preserving himself from death or grievous bodily harm arose." In *McIntosh*, supra footnote 199, the accused did not attempt to quit the conflict and was therefore not justified in killing the deceased under section 35.

[202] *McIntosh*, supra footnote 199, at 697.

> The fact that a provision gives rise to absurd results is not, in my opinion, sufficient to declare it ambiguous and then embark upon a broad-ranging interpretive analysis.[203]

Since the text of section 34(2) alone was not ambiguous, the majority refused to read in the additional words proposed by the Crown, even though they were arguably more compatible not only with "the scheme of the Act, the object of the Act, and the intention of Parliament," but also with "common sense."

Application

Among income tax cases, the leading applications of the plain meaning rule are *Antosko et al. v. The Queen*[204] and the majority decision in *Friesen v. The Queen*.[205] In *Antosko*, the court was called upon to interpret subsection 20(14) of the Act, which prevents the double taxation of accrued interest that might otherwise occur on the assignment or transfer of a debt obligation by apportioning the interest between the transferor and transferee.[206] According to the provision as it read during the years at issue,

> [w]here, by virtue of an assignment or other transfer of a bond, debenture or similar security . . . the transferee has become entitled to interest in respect of a period commencing before the time of transfer and ending after that time that is not payable until after the time of the transfer, an amount equal to that proportion of the interest that the number of days in the portion of the whole period that preceded the day of the transfer is of the number of days in the whole period
>
> (a) shall be included in computing the transferor's income for the taxation year in which the transfer was made, and
>
> (b) may be deducted in computing the transferee's income for a taxation year in the computation of which there has been included
>
> (i) the full amount of the interest under section 12, or
>
> (ii) a portion of the interest under paragraph (a).

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[203] Ibid., at 704.

[204] Supra footnote 6. For a different interpretation of the decision in *Antosko*, emphasizing the role of context and purpose in determining the "clear and plain meaning" of statutory language, see Arnold, supra footnote 84, at 6:17-18. See also Taylor, supra footnote 196, at 64:6, concluding that Iacobucci J's attention to the consequences of alternative interpretations distinguishes the method of interpretation from "the 'plain language' approach per se."

[205] Supra footnote 6.

[206] Without subsection 20(14), this double taxation would result from the inclusion of accrued interest in computing the income of the transferor under subsection 12(3) or (4) and the inclusion of the same interest when received by the transferee under paragraph 12(1)(c). To the extent that the accrued interest is reflected in the consideration for which the transferee acquires the debt obligation, its subsequent inclusion in computing the transferee's income under paragraph 12(1)(c) will be offset to some extent by a higher adjusted cost base in the debt obligation. Accordingly, where an amount is deductible to the transferee under subsection 20(14), the adjusted cost base of the debt obligation is correspondingly reduced under paragraph 53(2)(l).

In *Friesen*, the court considered the inventory valuation rule in subsection 10(1) of the Act as it then read[207] and the definition of "inventory" in subsection 248(1). Subsection 10(1) provided, "For the purpose of computing income from a business, inventory shall be valued at its cost to the taxpayer or its fair market value, whichever is the lower." Subsection 248(1) defines "inventory" as "a description of property the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year."

Antosko

In *Antosko*, the two taxpayers (Antosko and Trzop) acquired the indebtedness of a failing provincial corporation under an agreement with the New Brunswick Industrial Finance Board dated March 1, 1975. According to this agreement, the taxpayers acquired the common shares of the company for $1 and "promised to operate the company . . . in a good and businesslike manner" for a two-year period, in consideration for which the board covenanted to ensure that the company would be debt-free except for indebtedness to the board of $5 million plus accrued interest, and to postpone payments on this indebtedness, including interest, for two years, after which it would sell the $5 million debt plus accrued interest for $10.

Following the acquisition of the indebtedness on July 6, 1977, each of the taxpayers received $38,335 as partial payment of interest that had accrued before the transfer, including this interest in income under paragraph 12(1)(c) and claiming a deduction under paragraph 20(14)(b). In 1980, Trzop received a further $283,363 as a partial payment of accrued interest, again including the amount in income under paragraph 12(1)(c) and claiming a deduction under paragraph 20(14)(b). In each case, the minister disallowed the deductions.

At trial,[208] the court accepted the minister's argument that the deduction under paragraph 20(14)(b) was unavailable to the taxpayer transferees because the interest had not been included in computing the income of the transferor board, which was exempt from tax under paragraph 149(1)(d). According to McNair J,

> [a]ccepting the modern principle of statutory interpretation . . . it seems to me that one cannot blithely ignore the mandatory requirement of paragraph 20(14)(a) that the amount of accrued interest must be included in the transferor's income before the transferee of the debt obligation can deduct it under paragraph 20(14)(b). In my view, the section was designed to provide for the apportionment of accrued interest as between the transferor and transferee of a bond or other debt obligation where the same is transferred between interest dates, thus avoiding the incidence of double taxation. In my opinion, the defendant taxpayers are disentitled from relying on the deduction provision afforded by paragraph 20(14)(b) because there is no

[207] Subsection 10(1) was amended and subsection 10(1.01) enacted specifically to reverse the decision in *Friesen*, supra footnote 6. See SC 1998, c. 19, section 70(1). These amendments are discussed further below in the text accompanying footnote 268.

[208] 90 DTC 6111; [1990] 1 CTC 208 (FCTD).

> evidence that the amounts of interest sought to be deducted thereunder were included in the income of the transferor of the debt obligation during the taxation years in question, as required by paragraph 20(14)(a).[209]

On appeal,[210] the Federal Court of Appeal agreed that the deduction under paragraph 20(14)(b) required a corresponding inclusion of interest in the transferor's income under paragraph 20(14)(a) but affirmed the trial decision on the basis of a more general conclusion that subsection 20(14) was "not intended to apply" to transactions such as that between the taxpayers and the New Brunswick Industrial Finance Board, in which the transferee had not clearly paid an amount equivalent to the interest that had accrued on the debt obligation before the time of the transfer.[211] In each decision, therefore, the court employed a purposive interpretation to disallow the deduction.

At the Supreme Court of Canada, Iacobucci J, writing for a unanimous panel of the court, relied on the plain meaning approach to allow the deduction. Accepting the minister's view that the purpose of subsection 20(14) was "the avoidance of double taxation,"[212] he nonetheless held that the transaction satisfied the two conditions set out in the opening words of subsection 20(14):

> First, there must be an assignment or transfer of a debt obligation. Second, the transferee must become entitled, as a result of the transfer, to interest accruing before the date of the transfer but not payable until after that date.[213]

Since the transaction was "not a sham" and met "[t]he terms of the section . . . in a manner that was not artificial," he concluded, "the transaction at issue comes within s. 20(14)."[214] Moreover, he continued, since the text of subsection 20(14) does not make paragraph (b) conditional on the application of paragraph (a),[215] the taxpayers could claim the deduction notwithstanding that the accrued interest had not been included in computing the income of the transferor.[216] In sum, he stated:

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[209] Ibid., at 6115; 213.

[210] 92 DTC 6388; [1992] 2 CTC 350 (FCA).

[211] Ibid., at 6393; 357.

[212] *Antosko*, supra footnote 6, at 6321; 33.

[213] Ibid., at 6319; 30.

[214] Ibid., at 6321; 33.

[215] Ibid., at 6321; 34, citing M.D. Templeton, "Subsection 20(14) and the Allocation of Interest—Buyers Beware," Current Cases feature (1990), vol. 38, no. 1 *Canadian Tax Journal* 85-90, at 87-88, who observes that "the grammatical construction of subsection 20(14) suggests that paragraph (a) and (b) become applicable, independent of one another, once the conditions set out in the paragraph of subsection 20(14) that precedes paragraphs (a) and (b) are met" and further notes that "[t]he grammatical structure of subsection 20(14) is similar to a number of other provisions in the Act in which Parliament lists the income tax consequences that arise when certain preconditions are met."

[216] Ibid., at 6321-22; 33-35, concluding (at 6322; 35) that "on the plain meaning of the section, the ability of a taxpayer to claim a deduction pursuant to s. 20(14)(b) is not dependent on the inclusion by the transferor pursuant to s. 20(14)(a) of the same amount in his or her calculation of income."

> While it is true that the courts must view discrete sections of the *Income Tax Act* in light of the other provisions of the Act and of the purpose of the legislation, and that they must analyze a given transaction in the context of economic and commercial reality, such techniques cannot alter the result where the words of the statute are clear and plain and where the legal and practical effect of the transaction is undisputed. . . .
>
> Where the words of the section are not ambiguous, it is not for this Court to find that the appellants should be disentitled to a deduction because they do not deserve a "windfall," as the respondent contends. In the absence of a situation of ambiguity, such that the Court must look to the results of a transaction to assist in ascertaining the intent of Parliament, a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts.[217]

Although the court's decision as to the proper reading of subsection 20(14) is unqualified and persuasive,[218] its initial holding that the transaction fell within the scope of the provision is much less certain. First, as the court itself indicates, this conclusion depends on a prior judgment that the transaction was neither a "sham" nor "artificial."[219] While the minister conceded that the transaction was not a sham as it has been defined for the purposes of Canadian income tax law,[220] the issue of artificiality does not appear to have been seriously argued. Nonetheless, on at least some interpretations of the word as contrary to normal business practice,[221] the

[217] Ibid., at 6320 and 6321; 31 and 33.

[218] In addition to the textual arguments outlined supra at footnote 215, the court (at 6322; 34) also questioned "the consequences that would ensue were s. 20(14) not read in this straightforward manner," concluding (at 6322; 35) that it would be "unworkable to require market purchasers to discern whether the vendor of the bond is tax-exempt in order to be able to assess whether a s. 20(14)(b) deduction is permitted." The court added that "[w]ithout this knowledge, the prospective purchaser would . . . be unable to gauge the true value of the security" and that "a debt instrument held by a non-taxable entity would be worth less than an identical instrument held by a body that was liable to tax."

[219] Supra footnote 214 and accompanying text. The issue of artificiality relates to former subsection 245(1) of the Act, which stated, "In computing income for the purposes of this Act, no deduction may be made 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 the income." Although repealed with the enactment of the general anti-avoidance rule in 1988, this provision applied to the years at issue in *Antosko*.

[220] See supra footnote 144. As Iacobucci J explained in *Antosko*, supra footnote 6, at 6319; 30, "[i]n this case, the respondent agrees that this transaction cannot be characterized as a sham. There was a legally valid transfer of the assets of the company to the appellants, and a subsequent transfer to them of the company's debt obligations."

[221] See, for example, *Shulman v. MNR*, 61 DTC 1213; [1961] CTC 385 (Ex. Ct.); *Don Fell Limited et al. v. The Queen*, 81 DTC 5282; [1981] CTC 363 (FCTD); and *The Queen v. Fording Coal Limited*, 95 DTC 5672; [1996] 1 CTC 230 (FCA). For other cases in which the artificiality test in former subsection 245(1) and its predecessors has been defined more strictly as "simulated" or "fictitious," see *Spur Oil Ltd. v. The Queen*, 81 DTC 5168; [1981] CTC 336 (FCA); and *The Queen v. Irving Oil Limited*, 91 DTC 5106; [1991] 1 CTC 350 (FCA). On the latter account, as the court suggested in *Des Rosiers v. The Queen*, 75 DTC 5298; [1975] CTC 416 (FCTD), the rule in former subsection 245(1) and its predecessors is no different from the sham doctrine.

acquisition of $5 million of debt plus accrued interest for a cash payment of $10 might be construed as artificial.[222] Moreover, as Estey J had suggested in *Stubart*, "the formal validity of [a] transaction may also be insufficient where . . . 'the object and spirit' of [an] allowance or benefit provision is defeated by . . . procedures blatantly adopted by the taxpayer to synthesize a loss, delay or other tax saving device, although these actions may not attain the heights of 'artificiality.' "[223] While the court in *Antosko* concluded that the transaction at issue was not "so blatantly synthetic as to be effectively artificial,"[224] this point also does not appear to have been seriously argued.[225]

For these reasons alone, the court's conclusion that "clear and plain" words of a statutory provision must be applied regardless of "other provisions of the Act" and "the purpose of the legislation" must be read cautiously—contingent as it is on a prior conclusion that the transaction at issue is neither a "sham," nor "artificial," nor "blatantly synthetic." Moreover, since the enactment of the general anti-avoidance rule in 1988,[226] this conclusion is further subject to an explicit "object and spirit" test in subsection 245(4) where the transaction may be characterized as an "avoidance transaction" within the meaning of subsection 245(3).[227] In this

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[222] On the other hand, see *Antosko*, supra footnote 6, at 6321; 33, where the court noted that "the consideration for the transfer at issue in this appeal included not only the nominal $10, but also the undertaking to operate the company in a good and business-like manner." Moreover, in order to have applied former subsection 245(1), it would have been necessary for the minister to establish that the deduction that the taxpayers claimed under paragraph 20(14)(b) was made "in respect of a disbursement or expense made or incurred in respect of a transaction."

[223] Supra footnote 3, at 6324; 317.

[224] *Antosko*, supra footnote 6, at 6319; 31.

[225] Notwithstanding Estey J's guidelines in *Stubart*, there do not appear to have been any cases in which the courts have disallowed a deduction on the grounds that the taxpayer engaged in "procedures blatantly adopted . . . to synthesize a loss, delay or other tax saving device" without attaining the height of "artificiality" within the meaning of former subsection 245(1). For a case in which both tests were satisfied, see *Fording Coal*, supra footnote 221. For cases in which neither test was satisfied, see *Friedberg v. The Queen*, 89 DTC 5115; [1989] 1 CTC 274 (FCTD), aff'd. 92 DTC 6031; [1992] 1 CTC 1 (FCA), aff'd. 93 DTC 5507; [1993] 2 CTC 306 (SCC); and *The Queen v. Mara Properties Limited*, 96 DTC 6309; [1996] 2 CTC 54 (SCC), aff'g. 95 DTC 5168, at 5171; [1995] 2 CTC 86, at 92 (FCA), per McDonald JA (dissenting).

[226] SC 1988, c. 55, section 185, generally applicable with respect to transactions entered into on or after September 13, 1988.

[227] Subsection 245(2) states, "Where a transaction is an avoidance transaction, the tax consequences to a person shall be determined as is reasonable in the circumstances in order to deny a tax benefit that, but for this section, would result, directly or indirectly, from that transaction or from a series of transactions that includes that transaction." Subsection 245(3) defines an "avoidance transaction" generally as a transaction that results in a "tax benefit" and cannot reasonably be considered to have been undertaken or arranged "primarily for *bona fide* purposes other than to obtain the tax benefit." Subsection 245(1) defines a "tax benefit" as "a reduction, avoidance or deferral of tax or other amount

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context, therefore, any emphasis on the plain meaning of a statutory provision has been legislatively overruled.

Despite these important qualifications, the Supreme Court's decision in *Antosko* signalled a noticeable shift from Dickson CJ's purposive interpretation of the Act, to a textual approach emphasizing the "plain meaning" of the statutory provision at issue.[228] To the extent that "the words of the statute are clear and plain" and "the legal and practical effect of the transaction is undisputed," the court emphasized, these words must be applied notwithstanding "the scheme of the Act, the object of the Act, and the intention of Parliament." Consequently, as Hogg and Magee explained in their 1995 commentary:

> When a provision is couched in specific language that admits of no doubt or ambiguity in its application to the facts, then the provision must be applied regardless of its object and purpose. Only when the statutory language admits of some doubt or ambiguity in its application to the facts is it useful to resort to the object and purpose of the provision.[229]

This is the plain meaning approach.

Friesen

In *Friesen*, the taxpayer, together with other investors, purchased a parcel of land in January 1982 with the intention of reselling it at a profit. With a decline in the real estate market, however, the value of the property decreased substantially, and the mortgage was foreclosed in 1986. Although the taxpayer did not realize a loss until 1986, he sought to rely on the "lower of cost and market" rule in subsection 10(1) as it then read to

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[227] Continued . . .
payable under this Act or an increase in a refund of tax or other amount under this Act." However, subsection 245(4) provides, "For greater certainty, subsection (2) does not apply to a transaction where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of this Act or an abuse having regard to the provisions of this Act, other than this section, read as a whole."

[228] See, for example, Al Meghji and Gerald Grenon, "An Analysis of Recent Avoidance Cases," in the 1996 Conference Report, vol. 2, supra footnote 196, 66:1-54, concluding (at 66:8) that "*Antosko* is significant because it rejects the expansive role given to the purpose underlying the provision and takes us back somewhat to reliance on the actual text of the statute rather than reliance on the perceived policy objective of a particular provision."

[229] Peter W. Hogg and Joanne E. Magee, *Principles of Canadian Income Tax Law* (Scarborough, Ont.: Carswell, 1995), 454. For a similar statement, cited infra at footnote 246, see *Friesen*, supra footnote 6, at 5561; 388, per Major J. In the second edition of their book, supra footnote 84, at 476, footnote 21, Hogg and Magee adopt a more pragmatic approach, deleting the second of these sentences and explaining that "*Antosko* may go too far in implying that one can rely on plain meaning *to the exclusion of* legislative purpose. After all, language can never be interpreted independently of its context, and legislative purpose is part of the context. It would seem to follow that consideration of legislative purpose may not only *resolve* patent ambiguity, but may, on occasion, *reveal* ambiguity in apparently plain language." In this respect, like the Supreme Court of Canada itself, Hogg and Magee appear to have rejected the plain meaning rule in favour of a words-in-total-context approach.

deduct as business losses, in computing his income for his 1983 and 1984 taxation years, decreases in the fair market value of his interest in the land in each of these years. The minister disallowed the losses on the basis that the property was not "inventory" in a "business" within the meaning of the valuation rule in subsection 10(1) and the definition of inventory in subsection 248(1).[230]

At the Supreme Court of Canada, the court was unanimous in holding that the taxpayer was engaged in a business under the extended definition in the Act[231] on the basis that the land was held as an adventure in the nature of trade.[232] It split, however, on the questions whether the property was "inventory" in 1983 and 1984, and whether the taxpayer could use the lower of cost and market rule in subsection 10(1).

Writing for the minority, Iacobucci J (Gonthier J concurring) employed a purposive approach to reject the taxpayer's arguments. Emphasizing the purpose of inventory accounting, to enable businesses in which "it is neither possible nor desirable to keep a running total of the cost of goods being sold on a daily basis . . . to determine the cost of all the goods sold in an accounting period,"[233] he held that the lower of cost and market rule in subsection 10(1) was available only to "dealers in stock-in-trade,"[234] not "adventurers" such as the taxpayer for whom "the actual cost and sale price of each particular piece of property are well established."[235] On the contrary, he concluded, endorsing the minister's submission:

> The introduction of section 10 in the Act was intended only to recognize statutorily the rule that only "ordinary trading businesses" . . . could properly use the lower of cost or market rule. The section was not intended to extend the use of that rule to cases such as the present one where there is only a single transaction.[236]

Moreover, Iacobucci J continued, while the property may have been inventory in 1986 when the loss was ultimately realized, it was not inventory in 1983 and 1984 when the taxpayer sought to deduct decreases in the fair market value of his interest in the land. Referring to the statutory

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230 *Friesen*, supra footnote 6, at 5565; 394.

231 See subsection 248(1), which defines a "business" to include, among other things, "an adventure or concern in the nature of trade."

232 *Friesen*, supra footnote 6, at 5554 and 5568-69; 374-76 and 399-401.

233 Ibid., at 5570; 403, explaining that in these circumstances "the only feasible way to determine the cost of all the goods sold in an accounting period is to add the value of the inventory on hand at the beginning of the period to the cost of the inventory purchased during the period and then subtract the value of the inventory on hand at the end of the period." For an excellent overview of inventory accounting, see Arnold, supra footnote 162, at 298-380.

234 *Friesen*, supra footnote 6, at 5570; 403.

235 Ibid., at 5570; 404, citing obiter dicta in *Irwin v. MNR*, 64 DTC 5227; [1964] CTC 362 (SCC).

236 *Friesen*, supra footnote 6, at 5570; 404.

definition in subsection 248(1), which defines inventory as "a description of property the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year," he stated:

> In my mind the key element of this definition is that the property, in order to be properly classified as "inventory," must have a cost or value which, in the particular taxation year in question, bears some relevance to the amount of the taxpayer's income (profit or loss) for that particular year.[237]

Since the cost or value of the property was not relevant in computing the taxpayer's income until 1986, it followed that the property was "not inventory for the taxation years in question under the *Income Tax Act*'s definition."[238]

In contrast to Iacobucci J's minority judgment, the majority decision, written by Major J (Sopinka and L'Heureux-Dubé JJ concurring), was based on a "plain reading" of the statutory text.[239] Referring to *Stubart* and *Antosko*, Major J began by affirming the plain meaning rule as the "correct approach" to interpreting the Act,[240] and adopting the statement by Hogg and Magee, quoted earlier,[241] that unambiguous provisions must be applied regardless of their object or purpose.[242] Looking at subsection 10(1), he then concluded, "The plain reading of this section is that it is a mandatory provision requiring a taxpayer who computes income from a business to value the inventory at the lower of cost or market value."[243] On this basis, it followed, "*[P]rima facie*, the taxpayer must meet two requirements in order to use this section: the venture at issue must be a 'business' and the property in question must be 'inventory.' "[244]

As indicated earlier, the court was unanimous in holding that the taxpayer was engaged in a business under the Act's extended definition of the word on the basis that the property was held as an adventure in the nature of trade.[245] For the majority, therefore, the decision then turned on whether the property was "inventory" in 1983 and 1984 under the statutory definition in subsection 248(1).[246]

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237 Ibid., at 5573; 408.

238 Ibid., at 5574; 410-11.

239 Ibid., at 5553; 374.

240 Ibid., at 5553; 373.

241 See the text accompanying footnote 229.

242 *Friesen*, supra footnote 6, at 5553; 373-74.

243 Ibid., at 5553; 374.

244 Ibid.

245 See the text accompanying footnotes 231 to 232.

246 Although the majority also discussed a number of "policy considerations" and considered whether the valuation rule in subsection 10(1) should be regarded as a codification of common law principles and therefore limited to stock-in-traders, these considerations are strictly obiter to its conclusion based on its "plain reading" of subsection 10(1) and the definition of inventory in subsection 248(1). See *Friesen*, supra footnote 6, at 5561; 388,

(The footnote is continued on the next page.)

Here again, Major J relied on the plain meaning of the statutory provision. Noting that the definition stipulates that the cost or value of the property "is relevant in computing a taxpayer's income from a business for *a* taxation year [emphasis added]," not *the* taxation year in which the characterization of the property is at issue, he concluded that the property was indeed inventory in 1983 and 1984 because its cost was relevant in computing the taxpayer's business income when the property was ultimately disposed of in 1986.[247] According to Major J,

> an item of property sold as part of an adventure in the nature of trade is relevant to the computation of the taxpayer's income from a business in the taxation year of disposition and so is inventory according to the plain language of the definition in s. 248(1). . . .
>
> The plain meaning of the definition in s. 248(1) is that an item of property need only be relevant to business income in a single year to qualify as inventory: "relevant in computing the taxpayer's income from a business for *a* taxation year."[248]

Moreover, he added, this interpretation was consistent with (1) the scheme of the Act, which categorizes property as either inventory (where the property is held for the purpose of resale) or capital property (where the property is held as an investment or for personal use);[249] (2) the language of other provisions requiring amounts to be determined on an annual basis;[250] and (3) the ordinary meaning of the word, according to which "an item of property which a business keeps for the purpose of offering it for sale constitutes inventory at any time prior to the sale of that item."[251]

Finally, he argued, to restrict the lower of cost and market rule to "ordinary trading businesses" as the minority proposed was consistent neither with the language of the provision, which contained no such qualification, nor with its "object and purpose."[252] With respect to the language of the provision, he concluded:

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[246] Continued . . .
per Major J: "[T]he object and purpose of a provision need only be resorted to when the statutory language admits of some doubt or ambiguity. In this case, there is no doubt or ambiguity in the statutory language of s. 10(1) which clearly applies to the inventory of a business including an adventure in the nature of trade."

[247] Ibid., at 5555-57; 376-79.

[248] Ibid., at 5555; 376-77 (emphasis in original).

[249] Ibid., at 5556; 378-79, concluding (at 5557; 379) that under the interpretation adopted by the minority, "an item of property would not be inventory in a year in which it was not relevant to income and thus would cease to exist for purposes of the *Income Tax Act* in that year. This runs contrary to the scheme of the Act which classifies every piece of property owned by a taxpayer into one of the two broad classes."

[250] Ibid., at 5556-57; 377-78, citing sections 9 and 38, each of which refers to the computation of amounts "for a taxation year" and "for the year."

[251] Ibid., at 5557; 380.

[252] Ibid., at 5562; 388.

> If Parliament had wanted to simply codify the common law [which restricted the lower of cost and market rule to trading businesses] it could and would have used the term "ordinary trading business" or "stock-in-trader" both of which had judicially established definitions. Since Parliament chose to use the broader term "business," there is simply no basis on which to assume that s. 10(1) was no more than a codification of the common law rule. To place such a judicial limit on the clear and unambiguous wording of the statute is a usurpation of the legislative function of Parliament.[253]

With respect to the purpose of the provision, he argued:

> [T]he object and purpose of s. 10(1) is fully consistent with allowing the valuation method in that section to be used for adventures in the nature of trade. Section 10(1) is specifically designed as an exception to the principles of realization and matching in order to reflect the well-accepted principle of accounting conservatism. In addition to recognizing accounting conservatism, the section is designed to stop a business from accumulating pregnant losses from declines in the value of inventory. The object and purpose of the section is to prevent businesses from artificially inflating the value of inventory by continuing to hold it at cost when the market value of that inventory has already fallen below cost.[254]

As a result, the majority concluded, the taxpayer was "entitled to make use of the inventory valuation method in s. 10(1) in order to recognize a business loss . . . in the taxation years in question, namely 1983 and 1984."[255]

While the majority's conclusion that the property was inventory in 1983 and 1984 is convincing,[256] the same cannot be said of its decision that the taxpayer was entitled to make use of the lower of cost and market rule in subsection 10(1).[257] On the contrary, by reading this provision as a "mandatory provision requiring a taxpayer who computes income from a business to value the inventory at the lower of cost or market value,"[258] the majority ignores its key opening words "[f]or the purpose of computing income from a business" and hence its context in relation to other rules and principles governing the computation of business income.[259] To

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[253] Ibid., at 5560; 386.

[254] Ibid., at 5561-62; 388.

[255] Ibid., at 5564; 392.

[256] Note that what makes this part of the majority's decision so convincing is not only its textual analysis of the statutory definition of inventory in subsection 248(1), but also the compatibility of this textual analysis with the scheme of the Act, the language of other statutory provisions, and the ordinary meaning of the word "inventory." See supra footnotes 247 to 251 and accompanying text.

[257] For a similar conclusion, see Daniel Sandler, "Character Rolls: Property Transfers and Characterization Issues" (1996), vol. 44, no. 3 *Canadian Tax Journal* 605-79, at 614-15.

[258] *Friesen*, supra footnote 6, at 5553; 374.

[259] In this respect, see *The Queen v. Cyprus Anvil Mining Corporation*, 90 DTC 6063, at 6067; [1990] 1 CTC 153, at 158 (FCA), emphasizing the opening words "[f]or the purpose of computing income from a business" and concluding on this basis that subsection 10(1) "must be construed within the context of the Act and be harmonious with its scheme and with the object and intention of Parliament."

the extent that subsection 10(1) is read, as it should be, as a valuation rule that is brought into play only where a taxpayer is already computing income from a business under the more general rules in section 9,[260] it follows that a taxpayer with a single item of property held as an adventure in the nature of trade should not be able to employ the lower of cost and market rule to recognize a business loss on decreases in the fair market value of the property since, until the property is ultimately disposed of, there is no business income or loss for the computation of which the inventory valuation rule in subsection 10(1) is at all relevant.[261] As a result, the fact that subsection 10(1) is not specifically limited to "ordinary trading businesses" or "stock-in-traders" is irrelevant, since these limitations are inherent in the general principles by which a taxpayer's business income is computed under section 9.[262]

As for the purpose of the lower of cost and market rule, the majority rightly explains that it is designed "as an exception to the principles of realization and matching" in order both "to reflect the well-accepted principle of accounting conservatism" and "to stop a business from accumulating pregnant losses from declines in the value of inventory."[263] As the traditional restriction to ordinary trading businesses suggests, however, these exceptions are not unlimited and were never, as Major J contends, "fully consistent" with allowing this valuation method "to be used for adventures in the nature of trade."[264] On the contrary, as the minister argued, the limitation to ordinary trading businesses reflects an important distinction between these enterprises and adventures in the nature of trade:

[260] See subsection 9(1), which defines a taxpayer's income for a taxation year from a business or property as "the taxpayer's profit from that business or property for the year," and subsection 9(2), which defines a taxpayer's loss for a taxation year from a business or property as "the amount of the taxpayer's loss, if any, for the taxation year from that source computed by applying the provisions of this Act respecting computation of income from that source with such modifications as the circumstances require." In applying these provisions, Canadian courts have long held that the computation of business income is subject to "ordinary principles of commercial trading" or "well accepted principles of business practice." See, for example, *The Royal Trust Co. v. MNR*, 57 DTC 1055; [1957] CTC 32 (Ex. Ct.). For the most recent statement of this general approach, see *Canderel Limited v. The Queen*, 98 DTC 6100; [1998] 2 CTC 35 (SCC).

[261] As Iacobucci J points out in his dissenting judgment in *Friesen*, supra footnote 6, at 5569-70; 402-3, this conclusion stems from the realization principle, according to which "in the computation of income from an adventure in the nature of trade, gains or losses must be realized in order for them to be included in the computation of income for tax purposes"—a situation that stands in contrast to that of the stock-in-trader who computes income on an annual basis and relies on inventory accounting as "the only feasible way to determine the cost of all the goods sold in an accounting period." Having concluded that the property was inventory during the years before its sale, the majority misses this point, arguing (at 5559; 384) that "the value of inventory is relevant to the computation of income in years prior to sale since it comprises part of the cost of sale." While this is true of stock-in-traders, it is not true of taxpayers engaged in an adventure in the nature of trade.

[262] See supra footnote 260.

[263] *Friesen*, supra footnote 6, at 5562; 388.

[264] Ibid., at 5571; 406.

> In the case of isolated transactions, the use of the lower of cost or market method typically would significantly distort profit from such transactions. For example, where the sale of a particular piece of property does not occur for several years, the taxpayer would be permitted to deduct over the several years losses in respect of unrealized depreciations in the value of the property. By contrast, with ordinary trading businesses, the stock-in-trade of the particular business typically turns over in the next fiscal period and, hence, the anticipated losses deducted at the end of any one year are more likely (because of the continuing activity of the trading business) to be in fact realized in the next year. The distortion of profit in such cases is therefore likely to be substantially less than in the case of an adventure in the nature of trade where the realization of the profit or loss may not take place for a number of years.[265]

On this account, therefore, the purpose of the lower of cost and market rule is to permit a limited exception to the principles of realization and matching that does not extend to adventures in the nature of trade.

Finally, as Iacobucci J explains, by concluding that the lower of cost and market rule applies to adventures in the nature of trade, the majority decision leads to a situation in which "any property acquired for the purpose of resale at a profit . . . outside of the normal carrying on of a business . . . would constitute a source of income, in each year, thus requiring, in the absence of a sale of the property, an annual computation of profit or loss in which . . . a valuation of the fair market value of the property would have to be undertaken."[266] Since the realization principle is designed, among other things, to prevent the need for such annual valuations, Iacobucci J rightly questions whether it was "the intent of the drafters of . . . s. 10(1)" to require such annual appraisals.[267]

In light of these criticisms of the majority's conclusion, it is not surprising that the *Friesen* decision was quickly reversed by legislative amendment.[268] As amended, subsection 10(1) of the Act now reads:

> For the purpose of computing a taxpayer's income for a taxation year from a business *that is not an adventure or concern in the nature of trade*, property described in an inventory shall be valued at the end of the year at the cost at which the taxpayer acquired the property or its fair market value at the end of the year, whichever is lower, or in a prescribed manner [emphasis added].

Moreover, for the purpose of computing a taxpayer's income from an adventure or concern in the nature of trade, subsection 10(1.01) now stipulates that "property described in an inventory shall be valued at the cost at which the taxpayer acquired the property."

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[265] Ibid., at 5572; 406.

[266] Ibid., at 5571; 405.

[267] Ibid., at 5571; 405-6.

[268] SC 1998, c. 19, section 70(1), generally applicable to taxation years ending after December 20, 1995.

WORDS-IN-TOTAL-CONTEXT APPROACH

Although referring to both "the object and spirit" of the Act and "the plain meaning rule," Estey J's decision in *Stubart* endorsed Driedger's "modern rule," according to which "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."[269] Since *Stubart*, the Supreme Court of Canada has employed this "modern rule"—described by the Federal Court of Appeal[270] as "the words-in-total-context approach"—to interpret the Act as often as it has used purposive interpretation or the plain meaning rule.[271] Most recently, a majority of the court appears to have favoured this interpretive doctrine over either alternative.[272]

Doctrine

Unlike purposive interpretation, which considers "the scheme of the Act, the object of the Act, and the intention of Parliament" to be the key elements of statutory meaning, and the plain meaning rule, which regards "the words of the Act" alone as the primary constituent of statutory meaning, the words-in-total-context approach affirms a more pragmatic view, according to which the meaning of a statutory provision is best understood, as Driedger explained, by reading the words of the provision "in their entire context . . . harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament."[273] While the words of the Act are central to this approach, they are read not literally, as strict construction and the plain meaning rule suggest, but contextually in light of the statutory scheme, statutory purposes, and legislative intentions.

Besides Driedger's own comments, one of the clearest statements of the words-in-total-context approach appears in MacGuigan JA's decision in *British Columbia Telephone Company v. The Queen*.[274] In that case, the minister assessed the taxpayer on the basis that its fibre optic telephone transmission system was "telephone, telegraph or data communication equipment . . . that is . . . a wire or cable" subject to a 5 percent CCA rate under class 3(j) of schedule II of the Income Tax Regulations, not "tangible capital property that is not included in another class" eligible for a 20 percent CCA rate under class 8(i).[275] Although rejecting the taxpayer's

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[269] *Stubart*, supra footnote 3, at 6323; 316, citing Driedger, supra footnote 4, at 87.

[270] See the cases cited supra at footnote 7.

[271] Leading examples of this approach include the majority opinion in *Golden*, supra footnote 8; majority and minority decisions in *Symes*, supra footnote 8; and the majority decision in *Alberta Treasury Branches*, supra footnote 8.

[272] *Alberta Treasury Branches*, supra footnote 8.

[273] Driedger, supra footnote 4, at 87.

[274] Supra footnote 7.

[275] Property that is a "fibre optic cable" is now subject to a 12 percent CCA rate under class 42. Class 42 was added by PC 1994-139, SOR/94-140 (1994), vol. 128, no. 3 *Canada Gazette Part II* 1024-44, section 28, applicable to property acquired after December 23, 1991.

arguments that the words "wire or cable" could not include fibre optic systems, which were little known outside scientific circles when the CCA rules were amended in 1976,[276] and that the 20 percent rate was more compatible with the purpose of the CCA rules to reflect "actual physical depreciation,"[277] the court considered numerous sources of statutory meaning—the text of the Act, dictionary definitions,[278] evidence of scientific usage,[279] the federal Interpretation Act,[280] and the budget paper accompanying proposed amendments to the CCA rules in 1976[281]—before settling on an "open-textured" interpretation of the word "cable" to include subsequent technological developments having the same "purpose and function" as the copper or coaxial cable generally used in 1976.[282] Referring to the words-in-total-context approach, MacGuigan JA explained:

> Four separate elements, in fact, may be distinguished within it: the words themselves, their immediate context, the purpose of the statute as manifested throughout the legislation, and extrinsic evidence of parliamentary intent to the extent admissible. These elements are not always concordant, and a Court has the obligation of weighing them against each other in order to arrive at a proper construction. Sometimes this task will be very simple, when . . . the plain meaning of the words is obvious and there is nothing else to be taken into account. In other cases, as in the case at bar, it is a somewhat more complex process. There is, in my opinion, no simple rule that can effectively make the problem disappear or resolve a Court's intellectual difficulty. The issue as to weight must be squarely faced and honestly

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[276] *British Columbia Telephone Company*, supra footnote 7, at 6131; 30, referring to the rule in *Sharpe v. Wakefield* (1888), 22 QBD 239 (CA), aff'd. [1891] AC 173 (HL), according to which the words of a statute must be construed as they would have been the day after the statute was passed.

[277] Ibid., at 6133; 33.

[278] Ibid., at 6132; 31. According to the court,

> *Webster's Third New International Dictionary*, in 1976, defined "cable," *inter alia*, as
>
> > An assembly of electrical conductors insulated from each other but laid up together usually by being twisted around a central core.
>
> How well such a definition accommodates glass fibre is shown by the fact that even by 1983, *Webster's Third New Collegiate Dictionary* includes the following in its definition of "cable":
>
> > something resembling or fashioned like a cable "a fibre-optic [cable]."

[279] Ibid., at 6130; 28, footnote 2. According to the court, "[i]n cross-examination of Dr. Koichi Abe, a witness for the appellant, it was established (*Transcript of Verbal Testimony* at page 43) that the concept and the phrase 'fibre optic cable' was 'in existence in the early 70's among the scientific community in the telephone communications industry,' but there is no evidence as to Parliament's awareness of this fact."

[280] Ibid., at 6132; 32, noting that "[a]n open-textured interpretation is more in keeping with s. 10 of the *Interpretation Act*, R.S.C. 1985, c. I-21, according to which 'the law shall be considered as always speaking.' "

[281] Ibid., at 6133; 32-33.

[282] Ibid., at 6132-33; 31-33. It is not irrelevant to the court's decision that the taxpayer, in its own financial statements through 1988, "never used a depreciation rate higher than 4.65% for fibre optic cable and moved only to 6.30% in 1989." Ibid., at 6130; 29, footnote 3.

> answered. Nevertheless, in my view it is a fair conclusion from several centuries of statutory interpretation in England and Canada that, in its balancing exercise, a court should give greater weight to clear words supported by their immediate context than to larger assertions of parliamentary intention, particularly those based on extrinsic evidence, which our Courts have always approached with extreme caution.[283]

Although it is not obvious that contextual analysis should be limited to the "immediate context" of the statutory words, as this passage appears to suggest,[284] the emphasis on multiple constituents of statutory meaning, the need to weigh these factors when they appear to conflict, and the priority accorded to "clear words supported by their immediate context" are hallmarks of the words-in-total-context approach.

Application

While the Supreme Court of Canada has yet to adopt the expression "words-in-total-context approach," it has employed this method to interpret provisions of the Act on several occasions.[285] In *Golden*,[286] for example, a majority of the court relied upon a words-in-total-context approach to interpret the anti-avoidance rule in section 68 as it then read, which allocated proceeds of disposition in a reasonable manner "[w]here an amount can reasonably be regarded as being in part the consideration for the disposition of any property of a taxpayer and as being in part consideration for something else."[287] Likewise in *Symes v. The Queen et al.*,[288] the court employed this interpretive method to decide whether child care expenses could be deducted under the general rules governing the computation of business income,[289] as opposed to the specific statutory provision in section 63.[290]

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[283] Ibid., at 6132; 31.

[284] The appropriate scope of contextual analysis is examined in part 2 of this article.

[285] See the cases cited supra at footnote 8.

[286] Supra footnote 8.

[287] This provision, which applies "irrespective of the form or legal effect of the contract or agreement," is designed to prevent unreasonable allocations of a global amount of proceeds, to which parties to a transaction may agree in order to achieve a combined tax advantage by minimizing income inclusions to the vendor (for example, through recaptured depreciation) or maximizing deductions (for example, CCA) to the purchaser. Although the interests of parties to a transaction are generally opposed when it comes to allocating proceeds (for example, while purchasers will typically favour a larger allocation to depreciable property with a high CCA rate in order to benefit from future deductions, vendors will generally oppose such an allocation to the extent that it results in a substantial income inclusion from recaptured depreciation), differences in relative tax positions may create opportunities to minimize the combined tax burden of both parties, resulting in a net benefit that can be shared between the parties.

[288] Supra footnote 8.

[289] See subdivision b of division B of part I of the Act. For this purpose, the key statutory provisions are subsection 9(1), which stipulates that "a taxpayer's income for a taxation year from a business or property is the taxpayer's profit from that business or

([289, 290] Continued on the next page.)

Golden

In *Golden*, the taxpayers sold an apartment complex for $5,850,000 in March 1973, under an agreement of purchase and sale allocating $5,100,000 to the land and $750,000 to "equipment, buildings, roads, sidewalks, etc.," shortly after receiving an unsolicited offer for $5,600,000 based on estimated values of $2,600,000 for the land, $2,400,000 for the buildings, and $600,000 for "trucks, equipment, roads, etc."[291] As a result of the allocation stipulated in the agreement of purchase and sale, the taxpayers realized a small capital gain and were not required to include any recaptured depreciation in respect of depreciable property on which they had claimed substantial CCA in previous years.[292]

Based on the estimate of an expert land appraiser, who valued the land at the time of the sale at $2,320,000, rather than the $5,100,000 stipulated in the agreement, the minister reassessed the taxpayers to include substantial recaptured depreciation on the depreciable property, relying on section 68, which then read as follows:

> Where an amount can reasonably be regarded as being in part the consideration for the disposition of any property of a taxpayer and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be proceeds of disposition of that property irrespective of the form or legal effect of the contract or agreement; and the person to whom

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[289, 290] Continued . . .
property for the year"; paragraph 18(1)(a), which limits deductible outlays or expenses to the amount that is "made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property" in respect of which the deduction is claimed; and paragraph 18(1)(h), which prohibits the deduction of "personal or living expenses of the taxpayer, other than travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business."

[290] This provision allows taxpayers to claim a limited deduction, in computing their net income from all sources, for eligible "child care expenses" as defined in subsection 63(3). According to this definition, the expenses must be incurred to provide child-care services to enable the taxpayer, or the eligible supporting person, either "to perform the duties of an office or employment," "to carry on a business either alone or as a partner actively engaged in the business," "to carry on research or any similar work in respect of which the taxpayer or supporting person received a grant," or "to attend a designated educational institution . . . or a secondary school" under specified circumstances. The deduction itself is limited to specific annual dollar amounts per child (currently $7,000 for children under 7 years of age or disabled, and $4,000 for each other child under 16 years of age), must be claimed by the parent or other supporting person with the lower income, and is further limited to two-thirds of that person's "earned income" (defined in subsection 63(3) to include, among other amounts, all amounts included in computing a taxpayer's income from an office or employment, and the income from "all businesses carried on either alone or as a partner actively engaged in the business").

[291] *Golden*, supra footnote 8, at 6141; 278.

[292] See subsection 13(1) of the Act, which requires taxpayers to include in computing their income for a taxation year the amount by which deductions in computing the undepreciated capital cost of a prescribed class of depreciable property exceeds additions in computing this undepreciated capital cost. The definition of "undepreciated capital cost" appears in subsection 13(21) of the Act.

the property was disposed of shall be deemed to have acquired the property at the same part of that amount.[293]

At the Supreme Court of Canada, the taxpayers argued, first, that the provision did not apply to the transaction and, second, that the allocation stipulated in the agreement of purchase and sale was "reasonable" within the meaning of the section.

While the majority accepted the taxpayers' second argument that the proceeds were allocated in a reasonable manner, it rejected the first argument that the section did not apply.[294] The minority, in contrast, concluded that the section did not apply and found it unnecessary to consider the alternative argument that the allocation stipulated in the agreement of purchase and sale was "reasonable" within the meaning of section 68.[295] The different opinions on the application of section 68 reflect different approaches to the interpretation of the Act.

Writing for the minority, Wilson J (Chouinard J and Lamer J, as he then was, concurring) employed a plain meaning approach to conclude that the section did not apply. Rejecting the minister's argument that section 68 as it then read was "an ambiguously worded successor" to paragraph 20(6)(g) of the 1952 Income Tax Act,[296] which applied "[w]here an amount can reasonably be regarded as being in part the consideration for the disposition of *depreciable property* of a taxpayer of a prescribed class and as being in part consideration for something else [emphasis added],"[297] she held that section 68, which applied only "[w]here an amount

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[293] Section 68 was amended by SC 1988, c. 55, section 47, generally applicable with respect to amounts received or receivable after June 1988, to confirm the decision in *Golden*.

[294] *Golden*, supra footnote 8, at 6139-40; 275-78, aff'g. 83 DTC 5138; [1983] CTC 112 (FCA), where the court held that the allocation was not unreasonable, given the trial judge's specific finding of fact that $5,100,000 was not an unreasonable price for the purchaser to pay for the land alone.

[295] *Golden*, supra footnote 8, at 6140-45; 278-84.

[296] Ibid., at 6144; 282.

[297] RSC 1952, c. 148, as amended. The structure of former paragraph 20(6)(g) was virtually identical to that of section 68 as it read in the years applicable to the decision in *Golden*. Paragraph 20(6)(g) stated, "Where an amount can reasonably be regarded as being in part the consideration for the disposition of depreciable property of a taxpayer of a prescribed class and as being in part consideration for something else, the part of the amount that can reasonably be regarded as being the consideration for such disposition shall be deemed to be the proceeds of disposition of depreciable property of that class irrespective of the form or legal effect of the contract or agreement; and the person to whom the depreciable property was disposed of shall be deemed to have acquired the property at a capital cost to him equal to the same part of that amount." With respect to this provision, the court had concluded in *Malloney's Studio Limited*, supra footnote 12, at 5127; 210, that "[t]he rule . . . applies to the situation where the taxpayer has disposed of two types of property, first depreciable property and secondly, something else." For other leading cases on the application of former paragraph 20(6)(g), see *Herb Payne Transport Ltd. v. MNR*, 63 DTC 1075; [1963] CTC 116 (Ex. Ct.); *Klondike Helicopters Ltd. et al. v. MNR*, 65 DTC 5253; [1965] CTC 427 (Ex. Ct.); *MNR v. Clement's Drug Store (Brandon)*

(The footnote is continued on the next page.)

can reasonably be regarded as being in part the consideration for the disposition of *any property* of a taxpayer and as being in part consideration for something else [emphasis added]," applied "on its plain meaning . . . only to transactions in which there has been a disposition of property and *something else other than property* [emphasis added]."[298] According to Wilson J,

> [i]t seems to me fairly clear . . . that when the legislature contrasts "something else" with "depreciable property" the "something else" will include non-depreciable property as well as things which are not property at all. But, by the same token, when the legislature contrasts "something else" with "any property" then the "something else" must be something other than property.[299]

Since the transaction involved the sale of property only and not "something else other than property," it followed that section 68 did not apply.[300]

Moreover, Wilson J added, although this result might undermine the legislative policy of including recaptured depreciation in computing a taxpayer's income, it was not the court's responsibility to fill a statutory "gap" resulting from the repeal of paragraph 20(6)(g) and the enactment of section 68 in 1972.[301] In any event, she argued, the purpose of section 68 was not to include recaptured depreciation on the sale of depreciable property, but "to allow the Minister to deem an allocation between the proceeds of disposition of property and sums received by the taxpayer in return for something other than property."[302] Thus, she suggested:

> Section 68, being a general rule relating to the computation of income, would not appear to be the successor of s. 20(6)(g) in the sense of embodying

297 Continued . . .
Ltd., 68 DTC 5053; [1968] CTC 53 (Ex. Ct.); *Stanley v. MNR*, 72 DTC 6004; [1972] CTC 34 (SCC); *Canadian Propane Gas & Oil Ltd. v. MNR*, 73 DTC 5019; [1972] CTC 566 (FCTD); *The Queen v. Waldorf Hotel (1958) Ltd. et al.*, 75 DTC 5109; [1975] CTC 162 (FCTD); and *The Queen v. Leclerc et al.*, 79 DTC 5440; [1979] CTC 527 (FCTD).

298 *Golden*, supra footnote 8, at 6145; 283.

299 Ibid., at 6143; 281.

300 Ibid., at 6144; 282: "As the subject matter of the transaction before us encompassed land, buildings, equipment, roads, sidewalks and other property, there was nothing sold that could be characterized as non-property so as to trigger s. 68."

301 Ibid., at 6144; 283, arguing that this "gap" was resolved through the enactment of subsection 13(21.1) following the taxation years at issue in *Golden*. Subsection 13(21.1), which was enacted applicable with respect to dispositions occurring after November 12, 1981, applies to the combined sale of buildings and subjacent or contiguous land, and prohibits an allocation that results in a gain on the sale of the land and a terminal loss on the sale of the buildings. As a result, as the majority explained, subsection 13(21.1) "would have no application . . . to a single contract under which disposition is made of different classes of depreciable property attracting different rates of capital cost allowance or different taxation treatment under the Act. Furthermore, the section would not appear to relate . . . to those situations where the taxpayer has disposed of buildings described in s. 13(21.1) for more than their undepreciated capital cost, but in the view of the taxing authority for less (under the contract allocation of price) than the reasonable value of the depreciable property in question." Ibid., at 6140; 277.

302 Ibid., at 6143; 282.

> the same policy objective. The function of s. 68 is to allow income receipts to be allocated to various sources (i.e. property or non-property) rather than to allow for, or have anything to do with, the recapture of capital cost allowances upon the disposition of depreciable property.[303]

Indeed, she concluded, "The fact that s. 68 was enacted as part of a general reform package in the same year as s. 20(6)(g) was repealed" was "irrelevant to the question of the section's applicability."[304]

In contrast to the minority, the majority opinion, written by Estey J (Dickson CJ and Beetz and LaForest JJ concurring), employed a words-in-total-context approach to conclude that section 68 applied to the transaction at issue. Emphasizing that the Supreme Court of Canada had, in *Stubart*,[305] "recognized that in the construction of taxation statutes the law is not confined to a literal and virtually meaningless interpretation of the Act where the words will support on a broader construction a conclusion which is workable and in harmony with the evident purposes of the Act in question,"[306] Estey J interpreted the words "any property" and "something else" in light of their immediate context in section 68, the evolution of the statute, and the location of section 68 among other "Rules Relating to Computation of Income."[307]

Beginning with their immediate context, Estey J noted that the words "any property" and "something else" in the opening clause of section 68 as it then read were followed by references to "that property" and "the property."[308] On this basis, he concluded:

> While "any property" can reasonably be understood as particular (any piece of property as opposed to any other piece of property) or general (any property as opposed to any thing which is not property), this potential ambiguity is resolved with reference to the other words of the section, which must all be given meaning. . . . With due respect to those who may reach a conclusion to the contrary, the use in the section of the expressions "that property" and "the property," in association with the opening reference to "any property," leads me to the conclusion that "the disposition of any property" means the sale of a particular item or items of property.[309]

Moreover, this conclusion was supported by the French version of the Act, which used the singular terms "de tout bien," "ce bien," and "le bien" in the place of "any property," "that property," and "the property," rather than the plural word "biens" meaning "property in general."[310]

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303 Ibid.

304 Ibid.

305 Supra footnote 3.

306 *Golden*, supra footnote 8, at 6140; 277.

307 Subdivision f of division B of part I of the Act.

308 *Golden*, supra footnote 8, at 6139; 276.

309 Ibid.

310 Ibid., emphasizing that "[t]he singular form is chosen because it is not 'biens,' or property in general, that is contrasted with 'something else,' but rather particular property."

More generally, Estey J reasoned, by restricting section 68 to "at most a minuscule part of commercial transactions,"[311] the minority's interpretation would contradict the legislative policy underlying former paragraph 20(6)(g), which was to tax recaptured depreciation on the sale of depreciable property. According to Estey J,

> [i]t would seem unlikely that Parliament, in the 1972 amendment, intended to abandon the aims achieved by s. 20(6)(g) and enact a new section having very similar wording but no similar application.[312]

Likewise, he observed, if the words "something else" were interpreted "to refer only to non-property items," it would be "unusual" to find "such a narrowly tuned taxing provision" under the heading "Rules Relating to Computation of Income" in subdivision f of the Act.[313] On the contrary, he concluded, a broad interpretation of the words "something else" to include "different items and classes of property as well as the rarer class of non-property . . . would justify the inclusion of s. 68 in the 'Rules Relating to Computation of Income,' as the section would have a wide and useful application in the determination of taxability across the commercial spectrum."[314]

While the minority's construction of section 68 may seem plausible on an initial reading of the provision, its view that the provision should apply only where the taxpayer has disposed of property and "something else other than property" is less convincing when section 68 is read in light of "the scheme of the Act, the object of the Act, and the intention of Parliament." In particular, Wilson J's conclusion that section 68 should not be regarded as a successor to former paragraph 20(6)(g) "in the sense of embodying the same policy objective,"[315] seems implausible given the remarkably similar language of the two provisions and the concurrent repeal of paragraph 20(6)(g) and enactment of section 68. In contrast, by interpreting the words of section 68 in the immediate context of the provision itself and the broader contexts of legislative evolution, commercial practice, and the structure of the Act, the majority's construction is more persuasive. Not surprisingly, therefore, subsequent amendments to section 68 have confirmed the majority's interpretation.[316]

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[311] Ibid., at 6140; 277, referring to subsection 248(1), which defines "property" broadly to mean "property of any kind whatever whether real or personal or corporeal or incorporeal," including "a right of any kind whatever, a share or a chose in action."

[312] Ibid.

[313] Ibid.

[314] Ibid.

[315] Ibid., at 6143; 282.

[316] Supra footnote 293. Section 68 now applies "[w]here an amount received or receivable from a person can reasonably be regarded as being in part the consideration for the disposition of *a particular property* of a taxpayer *or* as being in part consideration for the provision of particular services by a taxpayer [emphasis added]."

Symes

In *Symes*, the taxpayer, a practising lawyer and mother of one child from 1982 to 1984 and of two children in 1985, employed a nanny at a salary of $10,075 in 1982, $11,200 in 1983, $13,173 in 1984, and $13,359 in 1985, which she sought to deduct in computing her professional income from her legal practice. Characterizing these payments as "personal or living expenses" the deduction of which is prohibited in computing a taxpayer's income from a business under paragraph 18(1)(h),[317] Revenue Canada disallowed these amounts, substituting lesser deductions of $1,000 in 1982, $2,000 in each of 1983 and 1984, and $4,000 in 1985, as then allowed under the specific statutory rule in section 63.[318] The taxpayer appealed.

At the Supreme Court of Canada, the court divided on gender lines, with the male majority concluding that the taxpayer was limited to the statutory amounts permitted under section 63 and the female minority holding that the taxpayer should be allowed to deduct child-care expenses in computing her professional income under the general rules governing the computation of business income. Notwithstanding these opposing conclusions, both opinions employed a words-in-total-context approach to interpret the relevant provisions of the Act.[319]

Writing for the majority, Iacobucci J (Lamer CJ and LaForest, Sopinka, Gonthier, Cory, and Major JJ concurring) began by examining the various rules governing the computation of business income in light of the changing social context in which these rules are interpreted. Noting that the deduction of child-care expenses was traditionally disallowed on the basis that these amounts were non-deductible "personal or living expenses,"[320] he considered it appropriate to re-examine this issue in recognition of "a significant social change in the late 1970's and into the 1980's, in terms of the influx of women of child-bearing age into business and into the workplace."[321] According to Iacobucci J,

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[317] See supra footnote 289.

[318] See supra footnote 290.

[319] For a similar view of the interpretive approach used in *Symes*, see Pierre Barsalou, "Review of Judicial Anti-Avoidance Doctrines in Selected Foreign Jurisdictions and Supreme Court of Canada Decisions on Tax Avoidance and Statutory Interpretation," in *Report of Proceedings of the Forty-Seventh Tax Conference*, 1995 Conference Report (Toronto: Canadian Tax Foundation, 1996), 11:1-41, at 11:27-28.

[320] *Symes*, supra footnote 8, at 6010; 53, citing the English decision of *Bowers v. Harding*, [1891] 1 QB 560 (QB). For Canadian cases that adopted the same conclusion, see *No. 68 v. MNR*, 52 DTC 333; (1952), 7 Tax ABC 110; *Nadon v. MNR*, 66 DTC 1; (1965), 40 Tax ABC 33; *Macquistan v. MNR*, 65 DTC 236; (1965), 38 Tax ABC 23; *Pipe v. MNR*, 66 DTC 388; (1966), 41 Tax ABC 132; *Lawlor v. MNR*, 70 DTC 1248; [1970] Tax ABC 369; and *King v. MNR*, 71 DTC 18; [1970] Tax ABC 1270. For a similar decision under the US Internal Revenue Code, see *Henry C. Smith*, 40 BTA 1038 (1939), aff'd. without reasons 113 F.2d 114 (2d Cir. 1940). These cases are discussed in Brian J. Arnold, "The Deduction for Child Care Expenses in the United States and Canada: A Comparative Analysis" (1973), 12 *Western Ontario Law Review* 1-46.

[321] *Symes*, supra footnote 8, at 6011; 54, citing the decision of the trial judge, 89 DTC 5243, at 5248; [1989] 1 CTC 476, at 483 (FCTD).

> [t]he decision to characterize child care expenses as personal expenses was made by judges. As part of our case law, it is susceptible to re-examination in an appropriate case. In *R. v. Salituro*, [1991] 3 S.C.R. 654, this Court had occasion to state the following (at p. 670):
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> > Judges can and should adapt the common law to reflect the changing social, moral and economic fabric of the country. Judges should not be quick to perpetuate rules whose social foundation has long since disappeared. Nonetheless, there are significant constraints on the power of the judiciary to change the law. . . . The judiciary should confine itself to those incremental changes which are necessary to keep the common law in step with the dynamic and evolving fabric of our society.
>
> The increased participation of women in the Canadian workforce is undoubtedly a change in the "social foundation" within the meaning of *Salituro*. Accordingly, I do not feel that I must slavishly follow those cases which have characterized child care expenses as personal in nature.[322]

Similarly, Iacobucci J concluded, to the extent that courts have traditionally conflated the needs of businessmen with the needs of business, "it might be correct to assert that the changing composition of the business class and changing social structure demand a reconceptualization" of the traditional view that child-care expenses are incurred to make the taxpayer *available* to the business, not "for the purpose of gaining or producing income from the business" within the meaning of paragraph 18(1)(a).[323]

Notwithstanding these conclusions, Iacobucci J held that the general rules governing the deduction of business expenses could not be interpreted to allow for the deduction of child-care expenses in light of the specific statutory deduction in section 63.[324] In this respect, although referring to the social context in which these rules are interpreted, the majority decision ultimately turned on its interpretation of "the scheme of the Act, the object of the Act, and the intention of Parliament."

With respect to the scheme of the Act, Iacobucci J noted that the statutory deduction in section 63 "specifically comprehends the purpose for which the [taxpayer] incurred her nanny expenses."[325] The definition of

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[322] *Symes*, supra footnote 8, at 6011-12; 55.

[323] Ibid., at 6017; 62, citing Audrey Macklin, "Symes v. M.N.R.: Where Sex Meets Class" (1992), vol. 5, no. 2 *Canadian Journal of Women and the Law* 498-517, at 507-8: "[A]s long as business has been the exclusive domain of men, the commercial needs of business have been dictated by what men (think they) need to expend in order to produce income. The fact that these expenditures also have a 'personal' element was never treated as a complete bar. . . . It seems closer to the truth to suggest that these practices inhere in the way men, or some men, engage in business. Of course, since men have (until very recently) been the only people engaging in business, it is easy enough to conflate the needs of businessmen and the needs of business. Women's needs in doing business will necessarily be different, and one might reasonably demand a reconceptualization of 'business expenses' that reflects the changing composition of the business class."

[324] *Symes*, supra footnote 8, at 6017; 62.

[325] Ibid., at 6017; 63. On this basis, Iacobucci J distinguished the decision in *Olympia Floor & Wall Tile (Quebec) Ltd. v. MNR*, 70 DTC 6085; [1970] CTC 99 (Ex. Ct.), in which

(The footnote is continued on the next page.)

"child care expenses" in subsection 63(3) includes expenses incurred "to carry on a business either alone or as a partner actively engaged in the business," while the definition of "earned income" according to which the deduction may be limited under subparagraph 63(1)(e)(i) includes "the taxpayer's incomes from all businesses carried on either alone or as a partner actively engaged in the business." On this basis, he concluded:

> The fact that this language accurately describes the situation at hand—i.e., a law partner paying child care in order to work—is itself persuasive reason to suppose that ss. 9, 18(1)(a) and 18(1)(h) cannot be interpreted to permit a child care business expense deduction.[326]

Moreover, he added, this conclusion was supported by subsection 4(2), which for the years at issue stipulated that "no deductions permitted by ss. 60 to 63 are applicable either wholly or in part to a particular source." Although emphasizing that he did "not wish to overstate the importance" of this provision to his analysis, Iacobucci J suggested that this provision, though "obviously mean[ing] that the child care expense deduction in s. 63 is not referable to a particular source of income," might also mean that "the *type* of deduction provided for in s. 63 (i.e., *any* deduction in respect of child care expenses) cannot occur within the source calculations."[327] As a result, he concluded, the scheme of the Act suggested that "s. 63 is intended to be a complete legislative response to the child care expense issue."[328]

Iacobucci J found further support for this conclusion both in the structure and purpose of section 63 and in extrinsic evidence of parliamentary intent. Noting that the deduction of child-care expenses in section 63 is limited to specific annual dollar amounts per child,[329] must be claimed by the parent or other supporting person with the lower income,[330] and is further limited to two-thirds of that person's "earned income,"[331] he suggested that the taxpayer's position could "substantially undermine" the effect of the provision to provide a limited deduction on these specific terms.[332] According to Iacobucci J,

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325 Continued . . .
the taxpayer was allowed to deduct charitable contributions in computing its business income notwithstanding the limited deduction permitted under former paragraph 27(1)(a) (now paragraph 110.1(1)(a)). Iacobucci J stated, ibid., at 6019; 65, "In my view, what that case says is that a particular expenditure, such as a charitable donation, may be made for more than one purpose. In such a case, it will be relevant to consider whether the actual purpose of the expenditure is addressed in the Act. If a specific provision exists which limits deductibility in respect of that purpose, then that should be the end of the matter. If, however, the purpose is not addressed in a specific provision, recourse may be had to the more general rules governing deductibility."

326 *Symes*, supra footnote 8, at 6018; 63.

327 Ibid., at 6018; 64 (emphasis in original).

328 Ibid.

329 Subparagraph 63(1)(e)(ii).

330 Subsection 63(2).

331 Subparagraph 63(1)(e)(i).

332 *Symes*, supra footnote 8, at 6018; 63.

> [t]he approach of the appellant clearly invites this couple to make a "family decision" in order to establish that the cost of child care is the sole responsibility of the taxpayer with business income. Without casting aspersions upon the appellant, I fear that in many cases there would be more bookkeeping than reality about such a decision. The courts being poorly suited to assess the validity of "family decisions" of this sort, I am inclined to believe that the intent of s. 63 is to prevent the need for such assessments.[333]

This conclusion, finally, was supported by a passage from the white paper that preceded the introduction of section 63 in 1972, in which the federal government proposed "on social as well as economic grounds to permit a tax deduction for child care expenses, *under carefully controlled terms*" to "assist many mothers who *work or want to work* to provide or supplement the family income, but are discouraged by the cost of having their children cared for."[334] In sum, Iacobucci J concluded:

> [T]he *Income Tax Act* intends to address child care expenses, and does so in fact, entirely within s. 63. . . . Given s. 63, . . . it is clear that child care cannot be considered deductible under principles of income tax law applicable to business deductions.[335]

As a result, he held, the taxpayer could not deduct child-care expenses as a business expense.

Like the majority decision, the minority opinion, written by L'Heureux-Dubé J (McLachlin J concurring), considered the changing social context in which the Act must be interpreted. Noting that the distinction between "business and family life" is less apparent for women than for men, "since a woman's ability to even participate in the work force may be completely contingent on her ability to acquire child care,"[336] L'Heureux-Dubé J concluded that child-care expenses could no longer be characterized as "personal or living expenses" within the meaning of paragraph 18(1)(h):

> The reality of Ms. Symes' business life necessarily includes child care. The 1993 concept of business expense must include the reality of diverse business practices and needs of those who have not traditionally participated fully in the world of business.[337]

Likewise, she reasoned, to the extent that "generally women, rather than men, fulfil the role of sole or primary caregiver to children,"[338] child-care expenses should be recognized as an expense incurred for the purpose of gaining or producing income within the meaning of paragraph 18(1)(a):

> To be available for the business is the first requirement of doing business, otherwise, there can be no business. In this regard, it would be unthinkable for

333 Ibid.

334 Ibid., at 6019-20; 65-66, citing E.J. Benson, *Proposals for Tax Reform* (Ottawa: Department of Finance, 1969), paragraphs 2.7 and 2.9 (emphasis added by the court).

335 *Symes*, supra footnote 8, at 6020; 66.

336 Ibid., at 6038; 91.

337 Ibid., at 6039; 93.

338 Ibid., at 6035; 87.

> a business person's special needs, for example those associated with a disability, to be ineligible for a deduction because they satisfy a "personal need." A woman's need for child care in order to do business is no different. . . .
>
> In 1993, the world of business is increasingly populated by both men and women and the meaning of "business expense" must account for the experiences of all participants in the field.[339]

On the initial interpretation of these provisions, therefore, the differences between the majority and minority decisions were relatively minor.[340]

Unlike the majority, however, the minority considered the changing social context relevant not only to the interpretation of the rules governing the computation of business income, but also to the interpretation of section 63. Referring to Driedger's statement that "the words of an Act are to be read in their *entire* context [emphasis added],"[341] L'Heureux-Dubé J explained:

> [I]n this light, many of the same questions, that were examined with regard to the above analysis of ss. 9(1), 18(1)(a) and 18(1)(h), must take place in the context of s. 63. Just as these sections of the Act have developed with regard solely to the needs of a traditionally male practice of business, so has the history of s. 63 been tainted by a specific view of the world. . . .
>
> As the interpretation of "business expense" has been shown to be wrought with male perspective and subjectivity, so is an interpretation of business expense that is limited by s. 63 of the Act. Section 63 was implemented in order to adapt to the needs of a society at that time. In 1972, when that section was enacted, societal ideals with regard to equality of the sexes and the equal participation of women in all aspects of society had not evolved to the point where they have today.[342]

Moreover, she added, since principles of gender equality are now enshrined in the Canadian Charter of Rights and Freedoms,[343] the context in which provisions of the Income Tax Act are interpreted should also include these Charter values.[344]

On this basis, L'Heureux-Dubé J reasoned, to the extent that section 63 is itself shaped by the traditional assumption that child-care expenses were non-deductible personal expenses,[345] the deduction of child-care expenses

339 Ibid., at 6035 and 6037; 87 and 91.

340 Affirming her "substantial agreement" with the approach taken by Iacobucci J to the definition of "business expenses," L'Heureux-Dubé J suggested, ibid., at 6033; 85, that "the logical conclusion to my colleague's analysis, although he does not state it as such, is that ss. 9, 18(1)(a) and 18(1)(h) do not prevent the deduction of child care expenses as a business expense."

341 *Symes*, supra footnote 8, at 6040; 94, citing Driedger, supra footnote 4, at 87.

342 Ibid., at 6040; 95.

343 See section 15 of the Charter, supra footnote 109.

344 *Symes*, supra footnote 8, at 6045; 100-1, citing *Hills v. Canada (AG)*, [1988] 1 SCR 513; and *Slaight Communications Inc. v. Davidson*, [1989] 1 SCR 1038.

345 According to L'Heureux-Dubé J, "one must not lose track of the fact that section 63, which is general in nature, was drafted at a time when . . . child care expenses were

(The footnote is continued on the next page.)

as a business expense should not be prohibited, absent clear statutory language indicating that this provision displaces the application of the general rules governing the computation of business income.[346] On the contrary, she emphasized:

> When Parliament enacted s. 63, a new benefit, not then allowed under any other section of the Act, was conferred to taxpayers generally in order to better the position of working parents in society. From this perspective, it seems obvious that Parliament could not have intended to prohibit the deduction of child care as a business expense. To conclude that s. 63 intends to limit the opportunity for a business woman to deduct child care expenses is antithetical to the whole purpose of the legislation, which was aimed at helping women and their families bear the high cost of child care.[347]

In this light, she concluded, since the Act does not explicitly preclude the application of the general rules governing the computation of business income,[348] "Ms. Symes should be able to deduct her child care expenses as a business expense."[349]

While the majority made a strong case that the deduction of child-care expenses as a business expense could "substantially undermine" the effect of section 63 to provide a limited deduction "under carefully controlled terms," it is difficult to dispute the minority's conclusion that this provision is itself shaped by the traditional assumption that child-care expenses are non-deductible personal expenses and should not, in an era in which "the world of business is increasingly populated by both men and women," be interpreted to preclude the possibility of a business expense deduction under the general rules governing the computation of business income. To

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345 Continued . . .
considered an entirely personal expense. . . . It is highly probable that the legislators did not even put their mind to the fact that women may some day enter into business and the professions in large numbers and that these women may approach the world of business differently than did their male predecessors. Most importantly, it was certainly not within the legislators' frame of mind that child care would be viewed as anything other than a personal expense." *Symes*, supra footnote 8, at 6042-43; 98-99.

346 Ibid., at 6042; 97, referring to the residual presumption that "ambiguities are to be resolved in favour of the taxpayer."

347 Ibid., at 6042-43; 98.

348 According to L'Heureux-Dubé J, "[s]ection 63 provides general relief to parents, but nothing in its wording implies that deductions available under s. 9(1) are abolished or restricted in this respect." As for subsection 4(2), she concluded, "In providing that none of the deductions permitted by ss. 60 to 63 are applicable to a particular source of income, s. 4(2) clearly provides for some deductions which may legitimately fall under two sections of the Act." Ibid., at 6041; 95. Indeed, although the minority does not make this argument, this conclusion is supported by the language of paragraph 3(c), which allows, in the computation of a taxpayer's net income from all sources, the deduction of amounts permitted by subdivision e (which includes section 63) "except to the extent that those deductions, if any, have been taken into account" in computing the taxpayer's income from specific sources under paragraph 3(a).

349 Ibid., at 6045; 101.

the extent that the words-in-total-context approach recommends that the words of the Act are to be read in their "entire context," therefore, it is difficult to accept the majority's conclusion that section 63 unambiguously precludes the deduction of child-care expenses as a business expense.[350] On the contrary, as the minority concludes, since the words of the Act do not explicitly preclude the business deductibility of child-care expenses, the resulting ambiguity might reasonably have been resolved in the taxpayer's favour.[351]

If the taxpayer had won, of course, Parliament would likely have responded by eliminating disparities in the resulting tax treatment of child-care expenses incurred by businesspersons (for whom child-care expenses would be fully deductible) and employees (for whom child-care expenses would be subject to the limits in section 63). Such a response, however, would have highlighted a more pervasive inequity in the Act arising from the general limitation on the deductibility of employment expenses under subsection 8(2),[352] and necessitated a more contemporary explanation of the purpose and structure of the statutory deduction in section 63. In each respect, accepting the taxpayer's argument in *Symes* would have fostered democratic debate and placed the ultimate tax policy decision in the hands of the legislature, where it properly belongs.

CONCLUSION

Although the Supreme Court of Canada has formally rejected the traditional rule according to which tax statutes should be strictly construed, subsequent decisions have failed to settle on a single interpretive doctrine, alternating among purposive interpretation, the plain meaning rule, and the words-in-total-context approach. Moreover, elements of the strict construction approach arguably persist in the literalism of the plain meaning rule and the residual presumption in favour of the taxpayer.

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350 Ibid., at 6020; 67, concluding that "s. 63 eliminates any question of ambiguity, and by so doing, also eliminates the need for recourse to Charter values in this case."

351 Ibid., at 6042; 97, citing *Johns-Manville Canada Inc.*, supra footnote 95. While the minority invoked the traditional residual presumption in favour of the taxpayer to support this conclusion, such a result might also have been justified under an alternative default rule, proposed in part 2 of this article, according to which ambiguities are best resolved in a manner likely to promote political accountability and democratic decision making.

352 According to this provision, "no deductions [except those specifically permitted by section 8] shall be made in computing a taxpayer's income for a taxation year from an office or employment." For useful discussions of these inequities in the context of child-care expenses, see Faye Woodman, "A Child Care Expense Deduction, Tax Reform and the Charter: Some Modest Proposals" (1989), vol. 8, no. 2 *Canadian Journal of Family Law* 371-87; Claire F.L. Young, "Symes v. The Queen," Notes of Cases feature [1991], no. 1 *British Tax Review* 105-9; and Claire F.L. Young, "Child Care—A Taxing Issue?" (October 1994), 39 *McGill Law Journal* 539-67. See also the minority opinion in *Symes*, supra footnote 8, at 6043; 99, noting that "the concern that employed persons and business people will not be treated in the same manner is a fact which stems from the rationale of the Act itself: business deductions generally are restricted to those in business and are not available to an employed person."

While the court's actual practice of statutory interpretation is implicitly pragmatic, considering a variety of relevant factors, which include the practical consequences of different interpretations, the doctrines to which the court refers can have a significant impact on the manner in which a decision is reached and the substance of the decision itself. In *Neuman*,[353] for example, the court's purposive approach arguably led to a decision contrary to the text of subsection 56(2), the economic and commercial reality of the transaction, and the very purpose of the provision itself.[354] In *Friesen*,[355] on the other hand, the majority's reliance on the plain meaning rule arguably produced a decision at odds both with the purpose of the inventory valuation rule in subsection 10(1) (as it then read) and with the opening words of this provision when read in the context of the statutory scheme governing the computation of business income.[356]

While the words-in-total-context approach affirms a more pragmatic outlook according to which the words of the statute are properly read "harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament," the Supreme Court of Canada has yet to acknowledge this approach as a separate interpretive doctrine in addition to purposive interpretation and the plain meaning rule. Moreover, to the extent that the words-in-total-context approach limits the scope of contextual analysis and disregards the practical consequences of alternative interpretations, it is only partly pragmatic and fails to fully describe the interpretive process that the court implicitly employs. The second part of this article evaluates each of the interpretive doctrines examined in this part, outlines the essential features of an explicitly pragmatic approach to statutory interpretation, and advances an argument for this pragmatic approach as an alternative to the interpretive doctrines currently employed.

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353 Supra footnote 5.

354 See the analysis at footnotes 178 to 193 and accompanying text.

355 Supra footnote 6.

356 See the analysis at footnotes 230 to 268 and accompanying text.