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Justice Iacobucci and the 'Golden and Straight Metwand' of Canadian Tax Law

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JUSTICE IACOBUCCI AND THE 'GOLDEN AND STRAIGHT METWAND' OF CANADIAN TAX LAW†

I *Introduction*

Among the many areas of law that Justice Iacobucci has shaped through his judgments at the Supreme Court of Canada, perhaps none has felt his influence as greatly as Canadian income tax law. Of twenty-seven substantive income tax cases decided by the Court while he was a member,[1]

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† I am greatly indebted to Ben Alarie for valuable insights that helped shape the analysis in Part III of the paper.

1 In chronological order, these decisions are *Sie-Mac Pipeline Contractors v. M.N.R.*, [1993] 1 C.T.C. 226 (S.C.C.) [*Sie-Mac Pipelines*]; *Friedberg v. The Queen*, [1993] 2 C.T.C. 306, 93 D.T.C. 5507 (S.C.C.) [*Friedberg*]; *Symes v. The Queen*, [1994] 1 C.T.C. 40, 94 D.T.C. 6001 (S.C.C.) [*Symes*]; *Antosko v. The Queen*, [1994] 2 C.T.C. 25, 94 D.T.C. 6314 (S.C.C.) [*Antosko*]; *Crown Forest Industries v. Canada*, [1995] 2 C.T.C. 64, 95 D.T.C. 5389 (S.C.C.) [*Crown Forest Industries*]; *Friesen v. The Queen*, [1995] 2 C.T.C. 369, 95 D.T.C. 5551 (S.C.C.) [*Friesen*]; *Tennant v. The Queen*, [1996] 1 C.T.C. 290, 96 D.T.C. 6121 (S.C.C.) [*Tennant*]; *Schwartz v. The Queen*, [1996] 1 C.T.C. 303, 96 D.T.C. 6103 (S.C.C.) [*Schwartz*]; *Mara Properties Ltd. v. The Queen* [1996] 2 C.T.C. 54, 96 D.T.C. 6309 (S.C.C.) [*Mara Properties*]; *Hickman Motors Ltd. v. The Queen*, [1998] 1 C.T.C. 213, 97 D.T.C. 5363 (S.C.C.) [*Hickman Motors*]; *Canderel Ltd. v. Canada*, [1998] 2 C.T.C. 35, 98 D.T.C. 6100 (S.C.C.) [*Canderel*]; *Toronto College Park v. The Queen*, [1998] 2 C.T.C. 78, 98 D.T.C. 6088 (S.C.C.) [*Toronto College Park*]; *IKEA Ltd. v. The Queen* [1998] 2 C.T.C. 61, 98 D.T.C. 6092 (S.C.C.) [*IKEA*]; *Neuman v. The Queen*, [1998] 3 C.T.C. 177, 98 D.T.C. 6297 (S.C.C.) [*Neuman*]; *Duha Printers (Western) Ltd. v. The Queen*, [1998] 3 C.T.C. 303, 98 D.T.C. 6334, (S.C.C.) [*Duha Printers*]; *The Queen v. Continental Bank of Canada*, [1998] 4 C.T.C. 77, 98 D.T.C. 6505 (S.C.C.) [*Continental Bank*]; *Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.*, [1999] 2 C.T.C. 1, 99 D.T.C. 5034 (S.C.C.) [*Vancouver Society*]; *65302 British Columbia Ltd. v. Canada*, [2000] 1 C.T.C. 57, 99 D.T.C. 5799 (S.C.C.) [*65302 BC*]; *Shell Canada Limited v. The Queen*, [1999] 4 C.T.C. 313, 99 D.T.C. 5669 (S.C.C.) [*Shell Canada*]; *Will-Kare Paving & Contracting Ltd. v. The Queen*, [2000] 3 C.T.C. 463, 2000 D.T.C. 6467 (S.C.C.) [*Will-Kare*]; *Backman v. The Queen* [2001] 2 C.T.C. 11, 2001 D.T.C. 5149 (S.C.C.) [*Backman*]; *Spire Freezers v. The Queen*, [2001] 2 C.T.C. 40, 2001 D.T.C. 5158 (S.C.C.) [*Spire Freezers*]; *Singleton v. The Queen*, [2002] 1 C.T.C. 121, 2001 D.T.C. 5533 (S.C.C.) [*Singleton*]; *Ludmer v. M.N.R.*, [2002] 1 C.T.C. 95, 2001 D.T.C. 5505 (S.C.C.) [*Ludmer*]; *The Queen v. Walls*, [2002] 3 C.T.C. 421, 2002 D.T.C. 6960 (S.C.C.) [*Walls*]; *Stewart v. The Queen*, [2002] 3 C.T.C. 439, 2002 D.T.C. 6969 (S.C.C.) [*Stewart*]; and *Gifford v. The Queen*, [2004] 2 C.T.C. 1, 2004 D.T.C. 6120 (S.C.C.) [*Gifford*]. Justice Iacobucci participated in all of these decisions except *Gifford*.

Justice Iacobucci individually wrote decisions in sixteen[2] and co-authored judgments in four.[3] Of these twenty decisions, fifteen were unanimous,[4] three were majority decisions,[5] and only two were dissents.[6] During his years at the Supreme Court of Canada, Justice Iacobucci dominated Canadian income tax law as no other member of the Court before him ever did.

More importantly, Justice Iacobucci's tax judgments effected a fundamental shift in the Supreme Court of Canada's approach to Canadian tax law – away from the emphasis of the late 1970s to the early 1990s on the purpose of the relevant legislation and the economic or commercial reality of transactions toward an emphasis on the statutory text and the legal form of transactions characteristic of traditional Anglo-Canadian tax jurisprudence. As an examination of some of his most important tax decisions makes clear, this shift was motivated by a conception of the rule of law (at least as applied to Canadian tax law) that emphasized judicial restraint, legal certainty, and individual liberty. In this respect, in the words of Elizabethan jurist Sir Edward Coke, Justice Iacobucci's tax decisions consistently sought to replace the 'the incertain and crooked cord of discretion' with 'the golden and straight metwand of the law.'[7]

The paper proceeds as follows. Part II provides essential background to Justice Iacobucci's tax decisions by explaining the traditional approach to tax statutes adopted by English and Canadian courts and the more purposive and substantive approach adopted by US courts and favoured by

2 These cases are *Sie-Mac Pipelines*, *Friedberg*, *Antosko*, *Symes*, *Crown Forest Industries*, *Friesen*, *Tennant*, *Hickman Motors*, *Canderel*, *Toronto College Park*, *IKEA*, *Neuman*, *Duha Printers*, *Vancouver Society*, *65302 BC*, and *Ludmer* (all cases, supra note 1).

3 These cases are *Backman*, *Spire Freezers*, *Walls*, and *Stewart* (all cases, supra note 1). Each of these decisions was co-authored with Justice Bastarache.

4 *Sie-Mac Pipelines*, *Friedberg*, *Antosko*, *Crown Forest Industries*, *Tennant*, *Canderel*, *Toronto College Park*, *IKEA*, *Neuman*, *Duha Printers*, *Backman*, *Spire Freezers*, *Ludmer*, *Walls*, and *Stewart* (all cases, supra note 1). Justice LeBel wrote a concurring decision in *Ludmer*, supra note 1 at paras. 81–2, agreeing with the Court's disposition of the appeal but dissenting from Justice Iacobucci's approach to the interpretation of tax statutes.

5 *Symes*, supra note 1; *Vancouver Society*, supra note 1; and *65302 BC*, supra note 1.

6 *Friesen*, supra note 1; *Hickman Motors*, supra note 1.

7 Sir Edward Coke, *Institutes*, vol. 4 at 41, cited in John Marshall Gest, 'The Writings of Sir Edward Coke' (1909), 18 Yale L.J. 504 at 523. This expression appears in the seminal tax case of *Commissioner of Inland Revenue v. Duke of Westminster*, [1936] A.C. 1 (H.L.) [*Duke of Westminster*], in which Lord Tomlin refused to adopt a broad anti-avoidance doctrine emphasizing the economic substance of transactions and relationships over their legal form, on the basis that it would 'involve substituting "the incertain and crooked cord of discretion" for "the golden and straight metwand of the law."' For those who are not familiar with the word (and I confess that I fell into this category until I taught tax law!), a 'metwand' is defined as a 'measuring rod' or 'standard by which something is measured or judged' (*Oxford English Dictionary*, *s.v.* 'metewand,' online: ⟨http://www.oed.com/⟩).

the Supreme Court of Canada from the late 1970s to early 1990s. Part III reviews four key tax decisions written by Justice Iacobucci and released by the Court between 1994 and 2002, showing how their emphasis on the text of the relevant statutory provision and the legal form of transactions differed from the Court's purposive and substantive approach of the late 1970s to the early 1990s. Part IV evaluates the merits of this renewed emphasis on the statutory text and legal forms, examining the reasons why Justice Iacobucci adopted this approach to tax statutes and its connection to his conception of the rule of law. Part V concludes.

II *Background*

Judicial approaches to the application of tax statutes involve two related aspects: interpretation of the relevant statutory text and characterization of the various transactions and relationships to which the statute applies.[8] To the extent that taxpayers engage in tax-motivated transactions that contradict the scheme or purpose of the relevant statutory text, these aspects are necessarily linked, since textual interpretive approaches are apt to characterize transactions without regard to taxpayer motivations, while purposive approaches are more likely to characterize or re-characterize transactions in light of the statutory scheme. As background to Justice Iacobucci's tax decisions, this part of the paper reviews the traditional Anglo-Canadian and American judicial approaches to tax statutes, as well as the approach favoured by the Supreme Court of Canada from the late 1970s to the early 1990s.

A TRADITIONAL ANGLO-CANADIAN AND AMERICAN JUDICIAL APPROACHES TO TAX STATUTES

Following early UK tax decisions, Canadian courts originally adopted a narrow approach to tax legislation, interpreting tax statutes in a strict and literal manner and resolving any ambiguous taxing provisions in favour of the taxpayer. In his judgment in the House of Lords 1869 decision in *Partington v. Attorney-General*,[9] for example, Lord Cairns declared that 'the principle of all fiscal legislation' was that

> 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

8 See David G. Duff, Benjamin Alarie, Kim Brooks, & Lisa Philipps, *Canadian Income Tax Law*, 2d ed. (Toronto: LexisNexis Butterworths, 2006), c. 2, 3.

9 (1869), 4 L.R. 100 (H.L.).

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 little more than twenty years later, Lord Halsbury expressed a similar view in *Tennant v. Smith*,[11] stating that

[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. . . . [I]nasmuch 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 subjects of taxation, you must see whether a tax is expressly imposed.[12]

In 1922, the Supreme Court of Canada affirmed the same approach in Canada, explaining that '[a] law imposing taxation should always be construed strictly against the taxing authorities since it restricts the public in the enjoyment of its property.'[13]

Together with this strict approach to the interpretation of tax statutes, English and Canadian courts also adopted an approach to the characterization of transactions to which a tax statute might apply that assessed tax consequences according to the legal form of transactions and relationships notwithstanding that they may have been entered into primarily or solely in order to minimize taxes otherwise payable. In the leading English decision of *Commissioner of Inland Revenue v. Duke of Westminster*,[14] for example, where the Duke of Westminster had entered into a deed of covenant designed to convert otherwise non-deductible remuneration to his gardener Allman into deductible 'annual payments' under the UK Income Tax Act, 1918, a majority of the House of Lords upheld the Duke's appeal against an assessment characterizing the payments as non-deductible remuneration on the grounds that the deed itself stated that Allman was not prevented from 'being entitled to and claiming full remuneration for such further work as you may do' – even though the document also added that 'it is expected that in practice you will be content with the provision which is being legally made for you for so long as the deed takes effect with the addition of such sum, if any, as may be necessary to bring the total periodical payments while you are still in the Duke's service up to the amount of the salary or wages which you have lately been receiving.'[15] Rejecting the Commissioner's

10 Ibid. at 122.

11 [1892] A.C. 50 (H.L.).

12 Ibid. at 154.

13 *Canadian Northern Railway. Co. v. The Queen* (1922), 64 S.C.R. 264 at 275 [*Canadian Northern Railway*], *per* Brodeur J.

14 Supra note 7.

argument that the payments were in substance non-deductible remuneration, Lord Tomlin held that 'the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles'[16] and denounced the 'supposed doctrine' that a Court may 'ignore the legal position and regard what is called "the substance of the matter"'on the basis that 'the doctrine seems to involve substituting "the incertain and crooked cord of discretion" for "the golden and streight metwand of the law."'[17] Concurring, Lord Russell of Killowen drew a clear connection between the characterization of transactions and relationships for tax purposes and the interpretation of tax statutes, criticizing 'the doctrine that in taxation cases the subject is to be taxed if, in accordance with a Court's view of what it considers the substance of the transaction, the Court thinks that the case falls within the contemplation of the statute' on the basis that '[t]he subject is not taxable by inference or analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case.'[18]

In contrast to the Anglo-Canadian approach represented by the House of Lords decisions in *Partington*, *Tennant v. Smith*, and the *Duke of Westminster*, US courts adopted a more purposive approach to the interpretation of tax legislation and a correspondingly more substantive approach to the characterization of tax-motivated transactions that contradict the scheme or purpose of the relevant legislation. In the leading American case of *Gregory v. Helvering*,[19] for example, where the taxpayer engaged in a tax-motivated corporate reorganization intended to distribute to herself publicly traded shares held by a private holding company without incurring any tax on the distribution, the US Supreme Court upheld an assessment characterizing the reorganization as a taxable dividend on the basis that the transactions were 'outside the plain intent of the statute,' notwithstanding that they adhered to the text of the statutory definition for a tax-free reorganization.[20] According to Justice Sutherland,

> [F]ixing on the character of the proceeding by what actually occurred, what do we find? Simply an operation having no business or corporate purpose – a mere device which put on the form of a corporate reorganization as a disguise for concealing its true character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business, but to transfer a parcel of corporate shares to the petitioner. . . .

15 Ibid. at 11–2.
16 Ibid. at 20.
17 Ibid. at 19.
18 Ibid. at 24.
19 293 U.S. 465 (1935) [*Gregory*].
20 Ibid. at 470.

In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of the [statute], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. . . . To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.[21]

Based on its purposive interpretation of the relevant legislation, therefore, the Court held that the transactions were properly characterized as a taxable dividend rather than as a tax-free corporate reorganization.

Not surprisingly, as the *Duke of Westminster* case itself illustrates, the Anglo-Canadian emphasis on literal interpretation of tax statutes and characterization of transactions and relationships according to their legal form was highly conducive to tax avoidance.[22] Although English and Canadian courts were prepared to ignore 'sham' transactions 'intended to give to third parties or 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,'[23] they would not re-characterize transactions like those in the *Duke of Westminster* case that created real legal rights and obligations – no matter that they were primarily or solely tax-motivated and contrary to the scheme or purpose of the relevant legislation. On the contrary, as Lord Tomlin declared in the *Duke of Westminster* case,

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciated the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.[24]

In marked contrast to this *laissez-faire* approach to tax avoidance, US courts relied on the reasons in the *Gregory v. Helvering* decision to develop broad judicial anti-avoidance doctrines in the form of a 'business purpose test' and 'substance over form doctrine.' According to the former, tax benefits otherwise available under the relevant legislation could be denied to taxpayers who entered into transactions or

21 Ibid. at 469–70.

22 See, *e.g.*, Douglas J. Sherbaniuk, 'Tax Avoidance – Recent Developments' in *Report of the Proceedings of the Twenty-First Tax Conference*, 1968 Conference Report (Toronto: Canadian Tax Foundation, 1969) 430 at 430–2 (describing literalism and formalism as the two 'pillars of tax planning') [Sherbaniuk, 'Tax Avoidance'].

23 *Snook v. London & West Riding Investments Ltd.*, [1967] 1 All E.R. 518 at 528 (C.A.), *per* Lord Diplock. This definition of a 'sham' was approved by the Supreme Court of Canada in *M.N.R. v. Cameron*, [1972] C.T.C. 380, 72 D.T.C. 6325 (S.C.C.).

24 *Duke of Westminster*, supra note 7 at 19–20.

relationships solely or primarily to obtain tax benefits not clearly intended by the legislation.[25] According to the latter, transactions should be characterized for tax purposes according to their commercial or economic substance rather than their legal form.[26] As a result, although the judgment of the US Supreme Court in *Gregory v. Helvering* had, like the judgment of the House of Lords in the *Duke of Westminster* case, affirmed '[t]he legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits,'[27] this right was not unfettered but subject to significant judicial constraints.

B THE SUPREME COURT OF CANADA'S APPROACH TO TAX STATUTES FROM THE LATE 1970S TO THE EARLY 1990S

Despite its initial adherence to the principles established in the *Duke of Westminster* case, the Supreme Court of Canada began to depart from this approach in the late 1970s. In *Moldowan v. The Queen*,[28] for example, the Court fashioned a purposive interpretation of a provision limiting the deduction of farm losses '[w]here the taxpayer's chief source of income for a taxation year is neither farming nor a combination of farming and some other source of income.'[29] Rejecting a literal interpretation of the provision, according to which it would either always apply (since farming could not be a 'chief source of income' in a taxation year in which it resulted in a loss) or almost never apply (since the arithmetic 'combination' of a farm loss and income from the taxpayer's most important other source would generally constitute a 'chief source'), then Justice Dickson began by noting that 'the only way in which the section can have meaning is to place emphasis on the words "source of income."'[30] Suggesting that a 'source of income' in this context must require either 'a profit or a reasonable expectation of profit,'[31] it therefore followed that a taxpayer's 'chief source' of income is 'decidedly not a pure quantum measurement' but depends on 'the

25 See, *e.g.*, *Bazley v. Commission of Internal Revenue*, 331 U.S. 737 (1947); and *Goldstein v. Commissioner of Internal Revenue*, 364 F2d 734 (2d Cir. 1966), cert. denied 385 U.S. 1005 (1967).

26 See, *e.g.*, *Commissioner of Internal Revenue v. Court Holding*, 324 U.S. 331 (1945); and *Waterman Steamship Corporation v. Commissioner of Internal Revenue*, 430 F2d 1185 (5th Cir. 1970), cert. denied 401 U.S. 939 (1971).

27 *Gregory*, supra note 19 at 469.

28 [1977] C.T.C. 310; 77 D.T.C. 5213 (S.C.C.) [*Moldowan*].

29 This language appears in *Income Tax Act (ITA)*, R.S.C. 1985, c. 1 s.s. 31(1) (as am.). As the facts of the case occurred prior to 1972, the decision dealt with identical language in then s.s. 13(1) of the 1952 ITA.

30 *Moldowan*, supra note 28 at para. 10.

31 Ibid. at para. 11.

taxpayer's reasonable expectation of income from his various revenue sources and his ordinary mode and habit of work.'[32] On this basis, he concluded, a taxpayer whose chief source of income is farming can reasonably expect to rely on farming 'to provide the bulk of income' and 'the centre of work routine,'[33] while a taxpayer whose chief source of income is 'a combination of farming and some other source of income' looks to farming as a 'major preoccupation' while also having 'other pecuniary interests ... such as income from investments, or income from a sideline employment or business.'[34]

Three years later, in *Jodrey Estate v. Nova Scotia (Minister of Finance)*,[35] then Justice Dickson returned to the interpretation of tax statutes in a case involving a bequest to an Alberta corporation that was intended to avoid Nova Scotia succession duty. Although dissenting from the majority judgment which upheld an assessment of Nova Scotia residents who owned the shares of an Alberta holding company which in turn held the shares of the company that received the bequest, Justice Dickson questioned the appellants' propositions that courts should construe tax statutes strictly and consider only the 'legal effect' of transactions, without regard to their 'true substance.'[36] According to Justice Dickson, as he then was,

> If the submissions made on behalf of the appellants, as to the proper principles to be applied in constructing fiscal legislation, simply mean that it is impermissible to bring to the task of construing a fiscal statute a bias in favour of the Crown, then I am in entire accord. A Court of justice must act as a neutral umpire, impartially and objectively, between the taxpayer and the taxing authority. Neither occupies a preferred position.
>
> If, on the other hand, the submissions of the appellants mean that there are special principles of construction governing the interpretation of fiscal legislation, or that a court must uncritically and supinely accept the form of the transaction, blind as to what is actually happening, then, with respect, I disagree.
>
> Fiscal legislation does not stand in a category by itself. Persons whose conduct a statute seeks to regulate should know in advance what it is that the statute prescribes. A court should ask – what would the words of the statute be reasonably understood to mean by those governed by the statute. Unnatural or artificial constructions are to be avoided.

32 Ibid. at para. 13.
33 Ibid. at para. 16.
34 Ibid. at para. 17.
35 [1980] C.T.C. 437, 81 D.T.C. 5344 (S.C.C.).
36 Ibid. at paras. 86–7.

> The correct approach, applicable to statutory construction generally, is to construe the legislation with reasonable regard to its object and purpose and to give it such interpretation as best ensures the attainment of such object and purpose.[37]

Although Justice Dickson did not challenge the appellants' further proposition that taxpayers may order their affairs so as to attract the least amount of tax,[38] his words clearly suggested that the literalism and formalism of the traditional Anglo-Canadian approach should no longer prevail.

Following Justice Dickson's opinions in *Moldowan* and *Jodrey Estate*, it was up to Justice Estey to formally pronounce the death of strict construction, in his judgment *Stubart Investments Ltd. v. The Queen*.[39] Commenting that the income tax is 'no longer a simple device to raise revenue to meet the cost of governing the community' but 'is also employed by government to attain selected economic policy objectives,'[40] Justice Estey declared that

> Gradually, the role of the tax statute in the community changed, . . . and the application of strict construction to it receded. Courts today apply to this statute the plain meaning rule, but in a substantive sense so that if a taxpayer is within the spirit of the charge, he may be held liable.[41]

As a result, he concluded, tax statutes should be interpreted according to Professor Elmer Driedger's 'modern rule' – by reading the words of an Act '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.'[42] Two years later, in *Golden v. The Queen*,[43] Justice Estey reaffirmed this conclusion, stating for a majority of the Court that

> In *Stubart* . . . 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. . . .[44]

37 Ibid. at paras. 89–92.
38 Ibid. at para. 91, stating that this proposition was 'not open to challenge.'
39 [1984] C.T.C. 294, 84 D.T.C. 6305 (S.C.C.) [*Stubart*].
40 Ibid. at para. 55.
41 *Stubart*, supra note 39 at para. 60.
42 Elmer A. Driedger, *Construction of Statutes*, 2d ed. (Toronto: Butterworths, 1983) at 87, cited in *Stubart*, supra note 39 at para. 61.
43 [1986] 1 C.T.C. 274, 86 D.T.C. 6138 (S.C.C.).
44 Ibid. at para. 10.

With these decisions, it seemed, literalist interpretation of tax statutes had been relegated to the proverbial dust heap of history.

Notwithstanding this rejection of strict construction, the Supreme Court of Canada was reluctant in *Stubart* to abandon the traditional Anglo-Canadian emphasis on the legal character of transactions and relationships, regardless of whether they were entered into primarily or solely to minimize taxes otherwise payable. Although acknowledging that legislatures and courts may legitimately balance 'the taxpayer's freedom to carry on his commercial and social affairs however he may choose, and the state interest in revenue, equity in the raising of revenue, and economic planning,'[45] Justice Estey rejected the minister's argument that the Court should disregard a tax-motivated series of transactions solely because they lacked 'a valid business purpose,'[46] on the basis that a business-purpose test would contradict Parliament's apparent intent to use tax incentives to encourage specific activities.[47] Instead, he proposed,

> It seems more appropriate to turn to an interpretation test which would provide a means of applying the Act so as to affect only the conduct of a taxpayer which has the designed effect of defeating the expressed intention of Parliament. In short, the tax statute, by this interpretative technique, is extended to reach conduct of

45 *Stubart*, supra note 39 at para. 53.

46 Ibid. at para. 9. The transactions involved a sale of the taxpayer's business to a related company, pursuant to an agreement whereby the taxpayer continued to operate the business as the purchaser's agent, remitting the net income from the business to the purchaser, which used accumulated tax losses from prior years to shelter the income from tax. After the accumulated tax losses were exhausted, the business was sold back to the taxpayer.

47 Ibid. at para. 55. According to Justice Estey:

> A strict business purpose test in certain circumstances would run counter to the apparent legislative intent which, in the modern taxing statutes, may have a dual aspect. Income tax legislation, such as the federal Act in our country, is no longer a simple device to raise revenue to meet the cost of governing the community. Income taxation is also employed by government to attain selected economic policy objectives. Thus, the statute is a mix of fiscal and economic policy. The economic policy element of the Act sometimes takes the form of an inducement to the taxpayer to undertake or redirect a specific activity. Without the inducement offered by the statute, the activity may not be undertaken by the taxpayer for whom the induced action would otherwise have no *bona fide* business purpose. Thus, by imposing a positive requirement that there be such a *bona fide* business purpose, a taxpayer might be barred from undertaking the very activity Parliament wishes to encourage.

In a concurring judgment, Justice Wilson rejected the adoption of a business purpose test (at paras. 71–2) on the grounds that it is 'a complete rejection' of Lord Tomlin's principle from *Duke of Westminster*, supra note 7, that taxpayers may order their affairs to minimize tax and that 'Lord Tomlin's principle is far too deeply entrenched in our tax law for the courts to reject it in the absence of clear statutory authority.'

the taxpayer which clearly falls within 'the object and spirit' of the taxing provisions.[48]

In this light, he declared, the 'formal validity' of a transaction might be ignored where, among other circumstances, '"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. . . .'[49] Otherwise, he concluded, '[W]here the substance of the Act, when the clause in question is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question.'[50]

In summary, therefore, while Justice Estey concluded that taxpayers were free to arrange their affairs solely to obtain tax advantages from beneficial tax provisions, this freedom did not extend to 'procedures blatantly adopted by the taxpayer' to 'synthesize' a tax allowance or benefit in a manner contrary to the 'object and spirit' of the allowance or benefit provision. On the facts of the case, however, Justice Estey concluded that the transactions did not contradict any apparent legislative intent.[51]

Although Justice Estey suggested in *Stubart* that his interpretive approach would be 'appropriate to reduce the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction,'[52] the federal government of the day was not convinced. Three years later, it announced that it would introduce a statutory business-purpose test in the form of a general anti-avoidance rule (GAAR).[53] As subsequently enacted, this provision allows the revenue authorities to determine a person's tax consequences 'as is reasonable in the circumstances in order to deny a tax benefit'; whenever the tax benefit results from a transaction or series of transactions of which the transaction is a part, the transaction may reasonably be considered to have been undertaken or arranged primarily to obtain the tax benefit, and the transaction may reasonably be considered to result in a misuse of specific provisions of the Income Tax Act (ITA) or an abuse, having regard to these provisions read as a whole.[54] As the GAAR generally

48 Ibid. at para. 56.
49 Ibid. at para. 65.
50 Ibid. at para. 66.
51 Ibid. at para. 67.
52 Ibid.
53 Canada, Department of Finance, *The White Paper: Tax Reform 1987* (Ottawa: Department of Finance, 18 June 1987), as reproduced in *White Paper on Tax Reform* (Don Mills, ON: CCH, 1987) 23 at 70.
54 *ITA*, supra note 29, s. 245. In order to reverse two Tax Court of Canada decisions questioning whether the GAAR would apply to the misuse or abuse of other relevant

applies only to transactions entered into on or after 13 September 1988, however, it was not until 2005 that the Supreme Court of Canada first considered this provision.[55]

Despite the Supreme Court of Canada's reluctance to disregard the formal validity of the specific transactions in *Stubart,* subsequent tax decisions in the 1980s and early 1990s displayed a much greater willingness to question the characterization of transactions and relationships according to their legal form. In *Johns-Manville Canada Inc. v. The Queen,*[56] for example, Justice Estey stated on behalf of a unanimous panel of the Court that the distinction between a current expenditure (which is fully deductible in the year in which it is incurred) and a capital expenditure (the cost of which is generally deductible only over a number of years) should depend on 'a commonsense appreciation of all the guiding features' of the expenditure,[57] or 'what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of legal rights. . . .'[58] In *Imperial General Properties Ltd. v. The Queen,*[59] where the taxpayer was assessed on the grounds that it was 'controlled' by and therefore 'associated' with a family holding company that held 90 per cent of its common shares but only 50 per cent of its voting shares,[60] a majority of the Court dismissed the taxpayer's appeal on the basis that the holding company's

enactments such as regulations or tax treaties, the provision was amended in 2005 to mention these other enactments as well.

55 *Canada Trustco Mortgage Co. v. The Queen,* [2005] 5 C.T.C. 215, 2005 D.T.C. 5523 (S.C.C.) [*Canada Trustco*]; and *Mathew v. The Queen* [2005] 5 C.T.C. 244, 2005 D.T.C. 5538 (S.C.C.). For detailed analyses of these decisions, see David G. Duff, 'The Supreme Court of Canada and the General Anti-Avoidance Rule: *Canada Trustco* and *Mathew*' (2006), 60 Bulletin for International Taxation 54; and Jinyan Li, '"Economic Substance": Drawing the Line between Legitimate Tax Minimization and Abusive Tax Avoidance' (2006), 54 Can. Tax J. 23; and Brian J. Arnold, 'Confusion Worse Confounded: The Supreme Court's GAAR Decisions' (2006) 54 Can. Tax J. 167. For more general discussions of the impact of the cases on tax avoidance in Canada, see Benjamin Alarie, Sanjana Bhatia, & David G. Duff, 'Symposium on Tax Avoidance after *Canada Trustco* and *Mathew*: Summary of Proceedings' (2005), 53 Can. Tax J. 1010; and David G. Duff & Harry Erlichman, eds., *Tax Avoidance in Canada after* Canada Trustco *and* Mathew (Toronto: Irwin Law, forthcoming).

56 [1985] 2 C.T.C. 111, 85 D.T.C. 5373 (S.C.C.) [*Johns-Manville*].

57 Ibid. at para. 41, citing the decision of the Privy Council in *B.P. Australia Ltd. v. Commissioner of Taxation of the Commonwealth of Australia,* [1966] A.C. 224 (P.C.) at 264, *per* Lord Pearce.

58 *Johns-Manville,* supra note 56 at para. 42, citing the decision of the Australian High Court in *Hallstroms Pty. Ltd. v. Federal Commissioner of Taxation,* (1946), 72 C.L.R. 634 (Aust. H.C.) at 648, *per* Dixon J.

59 [1985] 2 C.T.C. 299, 85 D.T.C. 5500 (S.C.C.) [*Imperial General Properties*].

60 The effect of this assessment was that the taxpayer corporation and the holding company were required to share the amount eligible for a low rate of corporate tax under the 'small business deduction': *ITA,* supra note 29, s. 125.

ability to cause the taxpayer to be wound up on economically favourable terms gave it '[c]ontrol, in the real sense of the term,'[61] notwithstanding that it did not own a majority of the voting shares. Although earlier Supreme Court of Canada decisions had generally interpreted the concept of corporate control as the *de jure* 'right of control that rests in ownership of such a number of shares as carried with it the right to a majority of the votes in the election of the board of directors,'[62] Justice Estey (Beetz, Chouinard, and La Forest JJ., concurring) characterized the Court's approach as 'the ordinary progression of the judicial process,'[63] concluding that

> [i]n determining the proper application of [the relevant statutory provision] to circumstances before a court, the court is not limited to a highly technical and narrow interpretation of the legal rights attached to the shares of a corporation. Neither is the court constrained to examine those rights in the context only of their immediate application in a corporate meeting.[64]

In each of these cases, therefore, the Court's more purposive approach to the interpretation of the ITA was complemented by a more substantive approach to the characterization of transactions and relationships for tax purposes.

61 *Imperial General Properties*, supra note 59 at para. 14.

62 *Buckerfield's Ltd. v. M.N.R.*, [1964] C.T.C. 504, 64 D.T.C. 5301 (Exch. Ct.) at para. 10 [*Buckerfield's*], cited with approval in *Dworkin Furs (Pembroke) Ltd. v. M.N.R.*, [1967] C.T.C. 50, 67 D.T.C. 5035 (S.C.C.) [*Dworkin Furs*]; *Vina-Rug (Can.) Ltd. v. M.N.R.*, [1968] C.T.C. 1, 68 D.T.C. 5021 (S.C.C.); and *Donald Applicators Ltd. v. M.N.R.*, [1969] C.T.C. 98, 69 D.T.C. 5122 (S.C.C.) [*Donald Applicators*]. The Supreme Court of Canada departed from this approach in *Oakfield Developments (Toronto) Ltd. v. M.N.R.*, [1971] C.T.C. 283, 71 D.T.C. 5175 (S.C.C.) [*Oakfield*], concluding on facts similar to those in *Imperial General Properties*, supra note 59, that common shareholders holding 50 per cent of the voting shares controlled a company by virtue of their ability to cause the corporation to be wound up on economically favourable terms.

63 *Imperial General Properties*, supra note 59 at para. 16.

64 Ibid. at para. 11. In a strongly worded dissent, Justice Wilson (McIntyre J. and Lamer J., as he then was, concurring) acknowledged that 'the scope of scrutiny under the *de jure* test has been extended beyond a mere examination of the share register in order to determine who really has voting control,' but insisted that the Court's decision in *Oakfield*, supra note 62, represented a 'departure by the courts from a well-settled line of authority' according to which 'voting control is the proper *indicium* of control.' According to Justice Wilson: 'I am of the view, therefore, that the decision in *Oakfield* is anomalous and should not be followed. For the courts suddenly to change direction in the face of well-settled and long-standing authority in our tax jurisprudence is, in my view, quite inappropriate.... I do not think that this is a suitable area for judicial creativity. People plan their personal and business affairs on the basis of the existing law and they are entitled to do so' (all passages, ibid. at para. 35).

While the Supreme Court of Canada's decisions in *Johns-Manville* and *Imperial General Properties* demonstrated that the Court was increasingly willing to characterize transactions and relationships in light of their commercial or economic reality, the high point of this substantive approach was its 1987 decision in *Bronfman Trust v. The Queen*.[65] Writing for a unanimous panel of the Court, Chief Justice Dickson dismissed the taxpayer's appeal against an assessment disallowing the deduction of interest expenses on borrowed money used to finance capital distributions to its sole beneficiary, on the basis that the borrowed money was not 'used for the purpose of earning income from a business or property' as required by the relevant statutory provision.[66]

Rejecting the taxpayer's main argument that the borrowed funds were used *indirectly* to earn income from property, since they allowed it to 'retain income-producing investments,'[67] the Court concluded as a matter of statutory interpretation that the deduction should be limited to *direct* income-earning uses and, as a matter of fact, that the borrowed funds were not used to earn income even indirectly. According to Chief Justice Dickson,

> In 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 capacity. This, in my view, precludes the allowance of a deduction for 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.'[68]

Indeed, he emphasized,

> One need only contemplate the consequences of the interpretation sought by the trust in order to reach the conclusion that it cannot have been intended by Parliament. In order for the trust to succeed, subparagraph 20(1)(c)(i) would have to be interpreted so that a deduction would be permitted for borrowings by any taxpayer who owned income-producing assets. Such a taxpayer could, on this view, apply the proceeds of a loan to purchase a life insurance policy, to take a vacation, to buy speculative properties, or to engage in any other non-income-earning or ineligible activity. Nevertheless, the interest would be deductible. A less wealthy taxpayer, with no income-earning assets, would not be able to deduct interest payments on loans used in the identical fashion. Such an interpretation would be unfair as between taxpayers and would make

65 [1987] 1 C.T.C. 117, 87 D.T.C. 5059 (S.C.C.) [*Bronfman Trust*].

66 *ITA*, supra note 29, subpara. 20(1)(c)(i).

67 *Bronfman Trust*, supra note 65 at para. 9.

68 Ibid. at para. 51; see also ibid. at para. 50: '. . . despite the fact that it can be characterized as indirectly preserving income, borrowing money for an ineligible direct purpose ought not entitle a taxpayer to deduct interest payments.'

a mockery of the statutory requirement that, for interest payments to be deductible, borrowed money must be used for circumscribed income-earning purposes.[69]

Furthermore, he continued, even if there were 'exceptional circumstances' in which, 'on a real appreciation of a taxpayer's transactions,' a deduction might be appropriate for borrowed funds that were indirectly used to preserve a taxpayer's 'income-earning capacity,' these circumstances were not present in the specific case.[70] On the contrary, he explained, since the interest expenses that the taxpayer incurred on the borrowed funds vastly exceeded the investment income that it derived from the corresponding value of assets that it was able to retain,[71] the taxpayer had not, in fact, demonstrated that its '*bona fide* purpose in using the funds was to earn income.'[72]

Rejecting the taxpayer's alternative argument that it could have deducted the interest expenses if it 'had sold assets to pay the allocations and then borrowed money to replace them,'[73] the Court observed as an initial matter 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,'[74] but also emphasized, as a more substantive response, that the hypothetical transactions would be 'the epitome of formalism' and might well be regarded as 'a formality or a sham designed to conceal the essence of the transaction, namely that the money was borrowed and used to fund a capital allocation to the beneficiary.'[75] With respect to each of the taxpayer's arguments, therefore,

69 Ibid. at para. 38.

70 Ibid. at para. 52.

71 According to Chief Justice Dickson (ibid. at para. 52): 'In 1970, the interest costs on the $2.2 million of loans amounted to over $110,000 while the return from an average $2.2 million of trust assets (the amount of capital "preserved") was less than $10,000'.

72 Ibid; according to Chief Justice Dickson (ibid.):

> The 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.

73 Ibid. at para. 9.

74 Ibid. at para. 53.

75 Ibid., citing *Zwaig v. M.N.R.*, [1974] C.T.C. 2172 (T.R.B.), in which the taxpayer sold securities, used the proceeds to purchase a life insurance policy, and then borrowed on the policy to repurchase the securities. According to Chief Justice Dickson: 'The Tax Review Board rightly disallowed the deduction sought for interest payments, notwithstanding that the form of the taxpayer's transactions created an aura of compliance with the requirements of the interest deduction provision.'

the Court bolstered its initial conclusion – that the borrowed funds were not directly used to earn income and that the hypothetical transactions were not carried out – with a more substantive argument based on 'a real appreciation of the taxpayer's transactions'[76] and the 'essence' of the hypothetical transactions.[77]

In addition to these substantive responses to the taxpayer's arguments, the Supreme Court of Canada decision in *Bronfman Trust* also stands out for its explicit disapproval of the traditional Anglo-Canadian approach, according to which tax consequences should depend on the legal form of transactions and relationships regardless of their commercial or economic reality. According to the Court,

> just as there has been a recent trend away from strict construction of statutes (see *Stubart* ... and ... *Golden* ...), so too has the recent trend in tax cases been towards attempting to ascertain the true commercial and practical nature of the taxpayer's transactions. There has been, in this country and elsewhere, a movement away from tests based on the form of transactions and towards tests based on what Lord Pearce has referred to as a 'common sense appreciation of all the guiding features' of the events in question: *B.P. Australia Ltd. v. Commissioner of Taxation of Australia*, [1966] A.C. 224 at 264; [1965] 3 All E.R. 209 at 218 (P.C.).[78]

Welcoming this development as 'a laudable trend provided that it is consistent with the text and purposes of the taxation statute,'[79] Chief Justice Dickson concluded that this substantive approach to the characterization of transactions and relationships could help to promote tax fairness by limiting opportunities for tax avoidance:

> [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.[80]

As the Supreme Court of Canada's decision in *Stubart* rejected the literalism of traditional Anglo-Canadian tax jurisprudence, therefore, its decision in *Bronfman Trust* challenged its emphasis on the legal form of transactions and relationships, irrespective of their 'commercial and economic realities.'

Three years later, in *McClurg v. Minister of National Revenue*,[81] Chief Justice Dickson briefly summarized the development of Canadian tax

76 *Bronfman Trust*, supra note 65 at para. 53; see text accompanying note 70.
77 Ibid. at para. 53; see text accompanying note 75.
78 *Bronfman Trust*, supra note 65 at para. 48.
79 Ibid. at para. 49.
80 Ibid. at para. 49.

jurisprudence from *Stubart* to *Bronfman Trust*,[82] concluding that the interpretive approach that the Supreme Court of Canada had adopted in these decisions required the Court 'to determine both the purpose of the legislative provision and the economic and commercial reality of the taxpayer's actions.'[83] The Court had travelled a very long road from the traditional Anglo-Canadian approach to tax statutes.

III *Justice Iacobucci and the Transformation of Canadian Tax Jurisprudence*

Justice Iacobucci was appointed to the Supreme Court of Canada on 7 January 1991, less than three weeks after the Court released its judgment in *McClurg*.[84] By the time he left the Court on 30 June 2004, the Supreme Court of Canada had moved sharply away from the purposive and substantive approach that it had adopted from the late 1970s to the early 1990s, toward an emphasis on the text of the relevant statutory provision and the legal form of transactions and relationships that more closely resembled the traditional Anglo-Canadian approach to tax statutes. In this transformation of Canadian tax jurisprudence, Justice Iacobucci's tax decisions played a central role.

This part of the paper reviews four of Justice Iacobucci's tax decisions that contributed to this transformation during his tenure on the Court: *Antosko*, *Duha Printers*, *Ludmer*, and *Stewart*.[85] The first three of these decisions were written by Justice Iacobucci alone; *Stewart* was co-authored with Justice Bastarache; each was a unanimous judgment of the Court.[86] More importantly, each of these judgments allowed the taxpayer's appeal from a Federal Court of Appeal decision employing a more purposive and substantive approach characteristic of the Supreme Court of Canada's tax decisions from the late 1970s to the early 1990s. After reviewing these decisions, a final section summarizes the differences between Justice Iacobucci's approach to tax statutes and the approach adopted by the Supreme Court of Canada from the late 1970s to the early 1990s. As the descriptions of the facts and reasons in these cases are, like the ITA itself, lengthy and complicated, readers who are not interested in the specific details of the cases are advised to skip ahead to the summary.

81 [1991] 1 C.T.C. 169, 91 D.T.C. 5001 (S.C.C.) [*McClurg*].

82 Ibid. at paras. 44–5.

83 Ibid. at para. 46.

84 Ibid. The judgment in *McClurg*, supra note 81, was released on 20 December 1990, almost six months after Chief Justice Dickson retired from the Court.

85 Supra note 1.

86 As explained supra note 4, Justice LeBel wrote a concurring decision in *Ludmer*, supra note 1 at paras. 81–2, agreeing with the Court's disposition of the appeal but dissenting from Justice Iacobucci's approach to the interpretation of tax statutes.

A ANTOSKO

Although *Antosko* was not the first of Justice Iacobucci's tax decisions at the Supreme Court of Canada,[87] it was the first to signal a shift away from the purposive and substantive approach that the Court had affirmed in *McClurg*.[88] The case involved two individuals (Antosko and Trzop) who entered into an agreement in 1975 with a tax-exempt provincial finance agency (the New Brunswick Industrial Finance Board), which at the time held 80 per cent of the shares and $5 million of indebtedness of a company that had defaulted on a bank loan guaranteed by the board. Pursuant to the agreement, Antosko and Trzop purchased the board's shares for $1 and operated the company in 'a good and businesslike manner' for two years, after which they acquired the indebtedness and accrued interest owing to the board for the sum of $10.[89] Later in 1977, both Antosko and Trzop received $38,335 from the company as partial payment of interest that had accrued on the indebtedness prior to the transfer. In 1980, Trzop received a further amount of $283,363 as partial payment of interest.

In computing their incomes for the relevant taxation years, Antosko and Trzop included the amounts that he had received as interest income but deducted these same amounts under the authority of s.s. 20(14), which deals with the transfer of indebtedness, thereby avoiding any tax liability on the payments. According to this provision:

> [w]here, by virtue of an assignment or other transfer of a debt obligation . . . the transferee has become entitled to an amount of interest that accrued on the debt obligation for a period commencing before the time of transfer and ending at that time that is not payable until after that time, that amount
>
> (a) shall be included as interest in computing the transferor's income for the transferor's taxation year in which the transfer occurred, except to the extent that it was otherwise included in computing the transferor's income for the year or a preceding taxation year; and
>
> (b) may be deducted in computing the transferee's income for a taxation year to the extent that the amount was included as interest in computing the transferee's income for the year.

The minister disallowed the deductions on two grounds: (a) that the provision was not intended to apply to transactions such as that between the taxpayers and the board, where the transferee had not

87 The decision was released on 26 May 1994, more than a year after *Sie-Mac Pipelines*, supra note 1 (24 March 1993), and several months after *Friedberg*, supra note 1 (5 November 1993) and *Symes*, supra note 1 (16 December 1993).

88 Supra note 81; see text accompanying note 83.

89 *Antosko*, supra note 1 at paras. 3–4.

paid for the accrued interest; and (b) that the availability of the deduction to the transferee in para. 20(14)(b) depended on the inclusion of a corresponding amount in computing the income of the transferor under para. 20(14)(a), which had not occurred because the board was exempt from tax.

Relying on the purposive and substantive approach to tax statutes that the Supreme Court of Canada had affirmed in *McClurg*,[90] the Federal Court of Appeal dismissed the taxpayers' appeals.[91] Writing for a unanimous panel of the Court, Justice Stone (Isaac C.J. and Heald J., concurring) began his analysis by invoking the interpretive approach that the Supreme Court of Canada had developed in the 1980s:

> In my view, it is important at the outset to discern the purpose of s.s. 20(14) at the time it was adopted by Parliament with an eye to the economic and commercial reality of a taxpayer's actions. To do so, it seems to me, would be in harmony with the recent guidance for interpreting the provisions of the *Income Tax Act* developed by the Supreme Court of Canada, beginning with its decision in *Stubart*. . . .[92]

Beginning with the purpose of s.s. 20(14), he observed,

> My reading of subsection 20(14) ... leads me to conclude that its purpose is to apportion, as between a transferor and a transferee, interest which accrues on a debt obligation which is transferred at some point in time between interest dates specified therein so as to avoid taxation of the same amount in both the hands of the transferor and the transferee. The effect is that, ordinarily, interest which accrues before the transfer date becomes taxable in the hands of the transferor only and that the transferee is taxable on the interest which accrues after that date.[93]

In other words, he explained, 'the purpose of subsection 20(14) is to avoid double taxation of the same amount of interest once it is apportioned in the manner required by that subsection.'[94]

Having determined the purpose of s.s. 20(14), the Court considered the relevant transactions, having regard to their economic and commercial reality. According to Justice Stone,

> As I understand the transactions, ... the Board did not receive payment for the interest which had accrued on the debt obligations which committed itself to transfer in the agreement. ... Nominal consideration for the transfer was provided for in that agreement, but what bound the Board to carry out the transfer was that the appellant and Mr. Trzop had kept their promise to make 'reasonable

90 *McClurg*, supra note 81; see text accompanying note 83.
91 *Antosko v. M.N.R.*, [1992] 2 C.T.C. 350, 92 D.T.C. 6399 (F.C.A.).
92 Ibid. at para. 14.
93 Ibid. at para. 17.
94 Ibid. at para. 18.

efforts to operate the company in a good an businesslike manner' during the two year period following acquisition of the common shares. The objective of the purchasers, it seems, was not so much to purchase accrued interest by acquiring debt obligations, although that did occur, as to take control of a corporation in distress with a view to turning its fortunes around, to making its business profitable and coincidentally, to preserving jobs in the community where the business was located.[95]

On this basis, he concluded, '[i]n my opinion, the subsection was not intended to apply in such unique circumstances.'[96] Alternatively, he declared,

If, on the other hand, the debt obligation could be viewed as one to which the subsection applies, I would agree [with the Minister's submission] that a deduction under paragraph (b) is not available because it has not been shown that the Board ... included the same amount in computing its income. In my view, the word 'and' at the end of paragraph (a) and the object and spirit of the subsection support this construction.[97]

For both of these reasons, therefore, the Court dismissed the appeals.

At the Supreme Court of Canada, Justice Iacobucci (La Forest, L'Heureux-Dubé, Gonthier, and Major JJ., concurring) rejected both of these reasons for disallowing the deductions and allowed the taxpayers' appeals. With respect to the Federal Court of Appeal's conclusion that the deduction under paragraph 20(14)(b) depends on the inclusion of the same amount under paragraph 20(14)(a), Justice Iacobucci relied on a 'straightforward grammatical reading' of the statutory provision,[98] according to which paragraphs (a) and (b) appear to operate independently of one another once the conditions set out in the preamble are satisfied.[99] In addition, he explained, '[W]here specific provisions of the *Income Tax Act* intend to make the tax consequences for one party conditional on the acts or position of another party, the sections are drafted so that this interdependence is clear....[100] As a result, he concluded,

95 Ibid.
96 Ibid.
97 Ibid.
98 *Antosko*, supra note 1 at para. 46.
99 Ibid. at para. 41, citing M.D. Templeton, 'Subsection 20(14) and the Allocation of Interest: Buyers Beware' (1990), 38 Can. Tax J. 85 at 87–8:

... no words in subsection 20(14) or the Act as a whole make paragraph (b) of the subsection conditional on the application of paragraph (a). On the contrary, the grammatical construction of subsection 20(14) suggests that paragraphs (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.

100 *Antosko*, supra note 1 at para. 41.

I am of the view that, on the plain meaning of the section, the ability of a taxpayer to claim a deduction pursuant to paragraph 20(14)(b) is not dependent on the inclusion by the transferor pursuant to paragraph 20(14)(a) of the same amount in his or her calculation of income.[101]

Unlike that of the Court of Appeal, therefore, his interpretation turned on the grammatical structure of the statutory text rather than on its purpose.

Regarding the Federal Court of Appeal's more general conclusion that s.s. 20(14) was not intended to apply to the transactions that the taxpayers had carried out, Justice Iacobucci responded that '[a]n evaluation of the correctness of this conclusion requires first, a review of the proper approach to the interpretation of taxing statutes and, second, a closer scrutiny of the transaction that took place between the appellants and the board.'[102]

With respect to the interpretation of tax statutes, he explained that, although the Supreme Court of Canada decision in *Stubart* had rejected strict construction,[103] Justice Estey had also 'reaffirmed the traditional position that the taxpayer is entitled to structure his or her affairs so as to avoid liability for tax.'[104] Furthermore, he added, while Justice Estey had stated that courts could disregard transactions that are either 'a sham or ... so blatantly synthetic as to be effectively artificial,'[105] he had also declared that 'where the substance of the Act, when the clause in question is contextually construed, is clear and unambiguous and there is no prohibition in the Act which embraces the taxpayer, the taxpayer shall be free to avail himself of the beneficial provision in question.'[106]

As a result, Justice Iacobucci concluded,

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

101 Ibid. Justice Iacobucci's interpretation was bolstered (ibid. at para. 44) by an assessment of 'the consequences that would ensure were subsection 20(14) note read in this manner.' Explaining that the Court of Appeal's interpretation 'would be equally applicable in open-market bond transactions,' Justice Iacobucci stated that '[i]t is simply 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 paragraph 20(14)(b) deduction is permitted. Without this knowledge, the prospective purchaser would thus be unable to gauge the true value of the security.'

102 Ibid. at para. 23.

103 Ibid. at para. 28.

104 Ibid. at para. 24.

105 Ibid. at para. 29.

106 Ibid., citing *Stubart*, supra note 39 at para. 66; see text accompanying note 44.

the statute are clear and plain and where the legal and practical effect of the transaction is undisputed.[107]

On the contrary, he emphasized,

> 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.[108]

In contrast to the interpretive approach that the Supreme Court of Canada had affirmed in *McClurg*,[109] therefore, this statement suggested the purpose of the relevant statutory provision and the economic and commercial reality of the transactions at issue are relevant only where the words of the statute are ambiguous or the legal and practical effect of the transaction uncertain.[110]

Turning finally to the transactions themselves, Justice Iacobucci could find nothing in the facts to suggest that their 'legal and practical effect' was unclear. Although acknowledging that 'the motivation of the parties was not specifically to buy and sell accrued interest,'[111] he explained that '[t]he motives of the parties . . . are simply not determinative of the application of the subsection.'[112] On the contrary, he emphasized,

> In order to come within the opening words of the subsection, two conditions must be satisfied. First, there must be an assignment or a 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. All of the courts below agreed that these two conditions were met in fact.
>
> The Court of Appeal found, as did the other courts below, that a purchase of accrued interest by the appellants in the acquisition of debt obligations did occur. Once that is established, the adequacy of the consideration is not relevant, absent allegations of artificiality or sham.[113]

107 *Antosko*, supra note 1 at para. 29.
108 Ibid. at para. 38.
109 *McClurg*, supra note 81; see text accompanying note 83.
110 Indeed, Justice Iacobucci's analysis of the proper approach to the interpretation of tax statutes did not mention Chief Justice Dickson's judgments in *Bronfman Trust*, supra note 65, or *McClurg*, supra note 81.
111 *Antosko*, supra note 1 at para. 30.
112 Ibid.
113 Ibid. at paras. 22, 37.

Since the transactions were 'obviously not a sham' and the conditions for the provision to apply 'were met in a manner that was not artificial,' it therefore followed that the transactions satisfied the requirements of s.s. 20(14).[114] As a result, Justice Iacobucci concluded, '[t]he appellants are entitled to a deduction of interest accruing prior to the transfer and payable thereafter.'[115]

B DUHA PRINTERS

While the transactions in *Antosko* may or may not have been deliberately intended to avoid tax, the transactions in *Duha Printers* were clearly tax-motivated. In order to enable the taxpayer corporation (Duha Printers) to acquire the accumulated tax losses of an inactive company (Outdoor Leisureland) to shelter its own income from tax, the taxpayer entered into a complicated series of transactions intended to avoid the application of a provision that disallows the deduction by a corporation of the accumulated losses of a business, whenever control of the corporation is acquired by a person who was not related to the corporation immediately before the share acquisition, unless the corporation continues to carry on the business for profit or with a reasonable expectation of profit.[116] Relying on subparagraph 251(2)(c)(i) of the ITA,[117] which provides that two corporations are related if they are 'controlled' by the same person, the taxpayer sought to avoid the statutory requirement that it must continue to carry on the business for profit or with a reasonable expectation of profit by issuing sufficient voting shares to the inactive company's controlling parent company (Marr's) that the taxpayer and Outdoor Leisureland would both be controlled by the same person (Marr's) and would therefore be related immediately before Duha Printers acquired the shares of Outdoor Leisureland. To this end, the

114 Ibid. at para. 38.

115 Ibid. at para. 54.

116 *ITA*, supra note 29, s.s. 111(5). According to this provision:

> Where at any time, control of a corporation has been acquired by a person or persons ... such portion of the corporation's non-capital loss ... for a taxation year ending before that time as may reasonably be regarded as its loss from carrying on a business is deductible by the corporation for a particular taxation year ending after that time ... only if throughout the particular year and after that time that business was carried on by the corporation for profit or with a reasonable expectation of profit.... For the purpose of this provision, s.s. 256(7) stipulates that 'where shares of a particular corporation have been acquired by a person after March 31, 1977, that person shall be deemed not to have acquired control of the particular corporation by virtue of such share acquisition if that person ... was immediately before such share acquisition related ... to the particular corporation. ...'

117 Supra note 29.

following transactions were carried out in February and March of 1984 and in January and February of 1985:

(1) On 8 February 1984, the articles of Duha Printers were amended to increase the authorized capital of the company by creating an unlimited number of Class ‘C’ preferred shares, which entitled each holder to non-cumulative dividends equal to 9 per cent of their redemption price, and the right to one vote which would terminate either upon a transfer of the share or upon the death of the holder. These shares were redeemable by Duha Printers with the consent of the holder, or without the consent of the holder in the event that the shares were transferred.

(2) Later on 8 February 1984, Marr’s subscribed for 2,000 Class ‘C’ shares for one dollar each ($2,000 in total), giving Marr’s 55.71 per cent of the voting shares of the taxpayer corporation.

(3) Also on 8 February 1984, an agreement described as a ‘unanimous shareholders’ agreement’ was entered into among all the shareholders of Duha Printers, stipulating among other things that (a) the shareholders could not sell, assign transfer, or otherwise encumber their shares in any manner; (b) new shares could only be issued with the unanimous consent of the existing shareholders; (c) the affairs of Duha Printers were to be managed by a board of directors elected by the shareholders and comprising any three of Emeric and Gwendolyn Duha (who, together with their three children, held all of Duha Printers’ common shares), William Marr (who, together with his wife, held a majority of the voting shares of Marr’s), and Paul Quinton (a close friend of Emeric Duha and William Marr, who had served as a director of the taxpayer corporation since 1974); and (4) disputes regarding the business, accounts, or transactions of Duha Printers were to be resolved by arbitration.

(4) On 9 February 1984, Duha Printers purchased all the shares of Outdoor Leisureland for $1. At the time, Outdoor Leisureland’s accumulated business losses amounted to $541,044.

(5) Also on 9 February 1984, a wholly-owned subsidiary of Duha Printers purchased from a wholly owned subsidiary of Marr’s a receivable in the amount of $441,253 that was owed to it by Outdoor Leisureland. The purchase price for this receivable was $34,559, half of which was payable on 1 June 1984, with the balance payable upon the redemption of the taxpayer’s Class ‘C’ shares held by Marr’s.

(6) On 10 February 1984, Duha Printers and Outdoor Lesisureland effected a statutory amalgamation under the Manitoba Corporations Act. The shares of Outdoor Leisureland were cancelled

and the shareholders of the amalgamated company (also called Duha Printers) received the same number and class of shares as they had previously owned in the taxpayer. After the amalgamation, Duha Printers never carried on the business of Outdoor Leisureland for profit or with a reasonable expectation of profit.

(7) On 12 March 1984, the shareholders of the amalgamated company elected Emeric Duha, Gwendolyn Duha, and Paul Quinton as the three directors of Duha Printers.

(8) On 4 January 1985, Duha Printers, with the consent of Marr's, redeemed the 2,000 Class 'C' shares held by Marr's for a redemption amount of $2,000.

(9) On 15 February 1985, the shareholders' agreement was terminated and Paul Quinton resigned as a director of Duha Printers.

In computing its income for its 1985 taxation year, Duha Printers deducted $460,786 in accumulated tax losses that Outdoor had incurred in previous taxation years. The minister disallowed the deduction on the grounds that Marr's did not control Duha Printers immediately before Duha Printers acquired the shares of Outdoor Leisureland, as a consequence of which Duha Printers and Outdoor Leisureland were not related within the meaning of the Act.

In a unanimous decision, the Federal Court of Appeal affirmed the minister's assessment.[118] Suggesting that the 'reality' of the transactions was that 'Marr's had sold the potential right to deduct approximately one-half million dollars of losses in return for the payment of $34,559,'[119] Justice Linden relied on the 'object and spirit' of the relevant statutory provisions and the commercial and economic reality of the transactions to conclude that Marr's did not control Duha Printers immediately before Duha Printers acquired the shares of Outdoor Leisureland. In a concurring decision, Justice Stone concluded that the agreement among the shareholders of Duha Printers was a 'unanimous shareholder agreement' (USA) within the meaning of the Manitoba Corporation Act,[120] the terms of which nullified the *de jure* control that Marr's would otherwise have obtained by holding a majority of the taxpayer corporation's voting shares.[121] Chief Justice

118 *Duha Printers (Western) Ltd. v. The Queen*, [1996] 3 C.T.C. 19, 98 D.T.C. 6323 (F.C.A.) [*Duha Printers (FCA)*].

119 Ibid. at para. 77.

120 R.S.M. 1987, c. C225.

121 According to Justice Stone (*Duha Printers (FCA)*, supra note 118 at para. 105), the shareholders agreement 'was a "unanimous shareholder agreement" as defined in the Manitoba statute because it did restrict the powers of the Board of Directors of [the taxpayer corporation] to manage the business of the corporation as required by s.s. 97(1) of that statute.' In addition, he stated (ibid. at para. 106), 'the ability to elect a

Isaac concurred with the reasons of both Justice Linden and Justice Stone.[122]

In order to appreciate Justice Iacobucci's decision at the Supreme Court of Canada, it is useful to review Justice Linden's judgment at the Court of Appeal in detail. After quickly dismissing the Crown's argument that the transactions should be disregarded as a sham,[123] Justice Linden began his analysis with 'a few words' about the interpretation of tax legislation,[124] before turning to the issue of corporate control. Although rejecting the Crown's argument that 'the transactions should fail [solely] because they violate the object and spirit of the relevant provisions,'[125] he nonetheless emphasized that the purpose of a statutory provision is essential to its interpretation:

> [i]t seems to me that an interpretation of any given section of the *Income Tax Act* should reflect the objects intended by it. This seems only reasonable, and is merely to repeat here what has been affirmed by this Court in the past as the proper approach to interpreting tax legislation.[126]

Observing that the Supreme Court of Canada decision had affirmed this approach in a recent decision,[127] he also acknowledged that other decisions

board of directors which could manage only the "affairs" and not the "business" of [the taxpayer corporation] cannot be seen as an exercise of *de jure* control by Marr's.'

122 Ibid. at para. 113.

123 Ibid. at para. 22. Justice Linden (ibid. at para. 23) said that he had 'not been persuaded that this transaction can be classified as a sham. To be found to be a sham, the transaction must have been conducted "so as to create an illusion calculated to lead the tax collector away from the taxpayer or the true nature of the transaction" *Stubart Investments Ltd. v. R.* (*sub nom. Stubart Investments Ltd. v. The Queen*), [1984] 1 S.C.R. 536, [1984] C.T.C. 294, 84 D.T.C. 6305, at page 545 (C.T.C. 298), *per* Estey J.' This is a narrow test that has not been met here. No illusion was created by the transaction. Despite the failure to register the unanimous shareholders agreement, which of itself is of little probative value, the legal obligations created by the parties were real. They accomplished a sale of a certain type of company stock for a specified price and subject to the various obligations set out in the shareholders agreement. No deception is apparent.

124 *Duha Printers (FCA)*, supra note 118 at para. 25.

125 Ibid.

126 Ibid.

127 *Corp. Notre-Dame de Bon-Secours v. Québec (Communanté urbaine)*, [1995] 1 C.T.C. 241, 95 D.T.C. 5017 (S.C.C.). According to Justice Gonthier (at para. 32):

> there is no longer any doubt that the interpretation of tax legislation should be subject to the ordinary rules of construction. At page 87 of his text *Construction of Statutes* (2nd ed. 1983), Driedger fittingly summarizes the basic principles: '... 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.' The first consideration should therefore be to determine the purpose of the legislation, whether as a whole or as expressed in a particular provision.

by the Court had questioned the relevance of statutory purposes 'where the words of the statute are clear and plain and where the legal and practical effect of the transaction is undisputed.'[128] As a result, he concluded,

> Where the meaning and application of a section is entirely clear and free from ambiguity or doubt, and where nothing external to that section suggests anything otherwise, one can reasonably be sure that the object and spirit of the section is apparent on the face of its wording, and that the section is to be applied accordingly. But where any ambiguity or doubt in either the meaning or application of the section are apparent, the Court must resort to looking and determining for itself what application Parliament must be seen to have intended as derived in part from the purposes of the section, from the scheme, if any, of which the section forms a part, and from the overall intention of Parliament so far as it can be discerned.[129]

On the facts at issue, it seems, Justice Linden considered that the purpose of the statutory provisions governing the transfer of tax losses was relevant to their interpretation.

Regarding the concept of corporate control, Justice Linden relied on Justice Estey's judgment in *Imperial General Properties*,[130] which, in his opinion, 'recognized that a variety of legally relevant factors may have a bearing on any given analysis of corporate control.'[131] In addition, he explained, relying on Chief Justice Dickson's judgment in *Bronfman Trust*,[132] 'parties must demonstrate the existence of a substantive legal reality in all the relevant circumstances of the case.'[133] As a result, he concluded,

A control analysis must not be foreshortened by an oversimplified view of '*de jure*.' Transactions must be assessed in the context in which they appear and with 'an eye to commercial and economic realities.' This is merely to say that corporate control must be real, effective control over the company in question.[134]

Turning to the transactions themselves, Justice Linden found several reasons why, despite owning a majority of its voting shares, Marr's did not control Duha Printers immediately before Duha Printers acquired the shares of Outdoor Leisureland. First and foremost, he noted, Marr's was subject to a shareholders' agreement which 'restricted

128 *Duha Printers (FCA)*, supra note 118 at paras. 27–8, citing *Antosko*, supra note 1 at para. 29; and *Piggott Project Management Ltd. v. Land-Rock Resources Ltd.*, [1996] 1 C.T.C. 395 (S.C.C.) at para. 15.

129 *Duha Printers (FCA)*, supra note 118 at para. 29.

130 Supra note 58.

131 *Duha Printers (FCA)*, supra note 118 at para. 61.

132 Supra note 64.

133 *Duha Printers (FCA)*, supra note 118 at para. 61.

134 Ibid. at para. 62.

Marr's voting rights in a singularly important manner' by stipulating that 'three directors were to be elected to the Board of Directors and were to be chosen from a list of four candidates that included Emeric and Gwendolyn Duha, Paul Quinton, and William Marr.'[135] According to Justice Linden,

There is little question why these four persons were named: the choice of any three of them would necessarily ensure a majority of Duha family nominees on the board of Duha Printers. Emeric and Gwendolyn Duha were husband and wife owners of Duha Printers, and Paul Quinton was a long time friend of Emeric Duha. Paul Quinton had also been a director of Duha Printers for ten years, and was one of the three directors who signed the directors' resolution of February 8, 1984, authorizing the subscription by Marr's of the 2000 Class C shares, authorizing the corporation to enter the unanimous shareholders' agreement, and authorizing the purchase of Outdoor Leisureland's shares. This is sufficient for me to conclude that Paul Quinton was effectively a nominee of the Duha family, and for me to conclude . . . that an election of any combination of these directors assured that control by the Duha family over their family business would not be lost.[136]

Furthermore, he continued,

I cannot see how the matter may be viewed otherwise. Successful, family-owned businesses do not cede control for the mere price of $2,000. Duha Printers was worth almost $600,000. No reasonable person on the street would believe that a share transfer [for] $2,000 would actually give away real control of a $600,000 company. Neither is it coincidental that the three Duha family nominees were in fact elected as directors. Marr's did not even elect as a director its own majority shareholder. This is not a normal commercial result.[137]

In addition, he explained,

Duha Printers was to issue no new voting shares without unanimous shareholder consent. Marr's shares, therefore, could not be diluted. If Marr's had control, Duha Printers could not get it back. This makes it even more difficult to believe that real legal control was given to Marr's. . . . The terms of the unanimous shareholders' agreement, furthermore, could only be changed with unanimous shareholder consent. Marr's, therefore, could not change his restricted ability to vote directors using its majority share position. Finally, by virtue of the agreement, Marr's could not dissent from a corporate transaction and apply to a Court for the redemption of its shares.[138]

135 Ibid. at para. 71.
136 Ibid.
137 Ibid. at para. 72.
138 Ibid. at para. 74.

On these grounds, Justice Linden held, '[i]n these circumstances, Marr's did not control Duha Printers.'[139] On the contrary, he emphasized,

> In the present instance, the taxpayer has used the technicalities of revenue law and company law to conjure a legal remedy for restrictions to which it would otherwise be subject. They did not succeed. The intentions of the parties that Marr's would never really control Duha Printers are demonstrated in the legal obligations actually created by the parties. These obligations are such that, to quote the words of the Tax Court judge, 'in reality, the Duha family shareholders did not relinquish control.'[140]

As a result, he concluded, since Duha Printers and Outdoor Leisureland were not related immediately before the share acquisition and Duha Printers did not carry on the business of Outdoor Leisureland for profit or with a reasonable expectation of profit after the amalgamation, the deduction of Outdoor Leisureland's accumulated losses by Duha Printers was prohibited by the Act.[141]

At the Supreme Court of Canada, the taxpayer's appeal was allowed on the basis that Marr's controlled Duha Printers immediately before the latter company acquired the shares of Outdoor Leisureland.[142] Writing for a unanimous panel of the Court, Justice Iacobucci (L'Heureux-Dubé, Gonthier, Major, Bastarache, Binnie JJ., and McLachlin J., as she then was, concurring) devoted considerable attention to the issue of corporate control,[143] and a few concluding paragraphs to the proper approach for interpreting tax statutes.[144]

With respect to corporate control, Justice Iacobucci began by noting that Canadian courts had consistently held that the statutory concept denotes *de jure* control not *de facto* control,[145] generally interpreting this concept to denote 'the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors.'[146] Nonetheless, he continued, since 'this test is really an attempt to ascertain who is in effective control of the affairs and fortunes of the corporation,'[147] it would be inappropriate to apply the test 'formalistically ... without paying appropriate heed to the reason for the test.'[148] For this reason,

139 Ibid.
140 Ibid. at para. 78.
141 Ibid. at para. 79.
142 *Duha Printers*, supra note 1.
143 Ibid. at paras. 35–85.
144 Ibid. at paras. 86–8.
145 Ibid. at para. 35.
146 *Buckerfield's*, supra note 62 at para. 10.
147 *Duha Printers*, supra note 1 at para. 36, citing *British American Tobacco Co. v. Inland Revenue Commissioners* (1942), [1943] 1 All E.R. 13 (H.L) at 15, *per* Viscount Simon, L.C.
148 *Duha Printers*, supra note 1 at para. 37.

he explained, Canadian courts have been prepared to 'look beyond the share register' when 'something unusual' alters the *de jure* control that would otherwise result from owning a majority of the company's voting shares.[149] At the same time, he suggested, 'The case law seems to point only to . . . a narrow range of documents that may be considered';[150] specifically, the corporation's articles of incorporation and trust instruments governing the manner in which trustees are required to vote the shares that they hold.[151] Furthermore, he emphasized,

> [T]axpayers rely heavily on whatever certainty and predictability can be gleaned from the *Income Tax Act*. As such, a simple test such as that which has been followed . . . is most desirable. If the distinction between *de jure* and *de facto* control is to be eliminated at this time, this should be left to Parliament.[152]

As a result, he concluded, while 'the share register should be read in light of the relevant corporate law legislation . . . and the constating documents of the corporation,'[153] external agreements affecting voting rights are generally 'not to be taken into account as determinants of *de jure* control.'[154]

Although Justice Iacobucci proceeded to hold that a USA should be 'considered a constating document for the purposes of determining *de jure* control of a corporation,'[155] and that the agreement among the shareholders of Duha Printers was a 'unanimous shareholders agreement' within the meaning of the Manitoba Corporations Act,[156] he nonetheless concluded that this agreement did not deprive Marr's of the control that it otherwise obtained from holding a majority of the voting shares of Duha Printers immediately before Duha Printers acquired the shares of Outdoor Leisureland. With respect to Justice Linden's conclusion that Paul Quinton was a nominee of the Duha family, Justice Iacobucci responded that

> [w]hile it is true that Marr's could only elect one direct nominee of its own, it would have been possible, as the trial judge found, for it to elect its own

149 Ibid. at para. 42.
150 Ibid. at para. 40.
151 Ibid. at paras. 41–6, 48–50, reviewing *Dworkin Furs*, supra note 62; *Donald Applicators*, supra note 62; *Imperial General Properties*, supra note 59; *M.N.R. v. Consolidated Holding Co.*, [1972] C.T.C. 18, 72 D.T.C. 6007 (S.C.C.); and *The Queen v. Lusita Holdings Ltd.*, [1984] C.T.C. 335, 84 D.T.C. 6346 (F.C.A.).
152 *Duha Printers*, supra note 1 at para. 52.
153 Ibid. at para. 55.
154 Ibid. at para. 51.
155 Ibid. at para. 60. According to Justice Iacobucci (ibid. at para. 61): '[t]he argument for treating a U.S.A. as part of the corporate constitution, along with and equivalent to the articles of incorporation and the by-laws, is strong, given the role of such an agreement in the overall context of corporate governance.'
156 R.S.M. 1987, c. C225.

nominee, one Duha nominee, and Paul Quinton, who could not be said to be a nominee of either party. While Mr. Quinton was a longtime friend of the Duha family and a director of [Duha Printers], he was also a friend of William Marr and no actual evidence was adduced to suggest that his loyalties lay with the Duhas. If anything, this assessment must have come down to a question of credibility, and with respect, it was not open to Linden J.A. to interfere with such a finding of the trial judge in the absence of palpable and overriding error. In any event, however, the major concern of the *de jure* test is to ascertain which shareholder or shareholders have the voting power to elect a majority of the directors. The test neither requires nor permits an inquiry into whether a given director is the nominee of any shareholder, or any relationship or allegiance between the directors and the shareholders.[157]

With respect to Justice Linden's further conclusion that other limitations in the shareholders' agreement also deprived Marr's of *de jure* control, Justice Iacobucci stated that

[i]n my view, the provisions in the Agreement at issue in this case did not in fact result in the loss of *de jure* control by Marr's. The inability to issue new shares without unanimous shareholder approval, while surely a restriction on the powers of the directors to manage the business and affairs of [Duha Printers], was not so severe a restriction that Marr's can be said to have lost the ability to exercise effective control over the affairs and fortunes of the company through its majority shareholdings.[158]

As a result, he concluded, Marr's had *de jure* control over Duha Printers immediately before it acquired the shares of Outdoor Leisureland by virtue of its ability to elect a majority of its board of directors, notwithstanding the terms of the unanimous shareholder agreement.[159] Accordingly, it followed, Duha Printers and Outdoor Leisureland were related at this time, and Duha Printers was not prevented from deducting Outdoor Leisureland's tax losses in computing its income for its 1985 taxation year.

In light of this conclusion, Justice Iacobucci concluded that it was not necessary to consider whether the Federal Court of Appeal had 'erred in considering the object and spirit of the *Income Tax Act* provisions, the intentions of the parties, and the commercial reality of the transactions, given that the relevant provisions of the Act are clear and unambiguous.'[160] Since the taxpayer's counsel had apparently suggested that Justice Linden would have denied it the benefit of the relevant provisions 'simply because the transaction was motivated solely for tax planning

157 *Duha Printers*, supra note 1 at para. 54.
158 Ibid. at para. 83.
159 Ibid. at para. 84.
160 Ibid. at para. 86.

purposes,'[161] however, Justice Iacobucci considered it necessary to repeat the well-established principle of Anglo-Canadian tax law that 'a taxpayer is entitled to take advantage of the Act even where a transaction is motivated solely by the minimization of tax,'[162] and the statement in *Antosko* that attention to the purpose of a statutory provision and to the economic and commercial reality of a transaction '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.'[163] As a result, Justice Iacobucci emphasized,

> It was entirely open to the parties to use what Linden J.A. referred to as 'technicalities of revenue law' to achieve their desired end: to transfer *de jure* control of [Duha Printers] to Marr's while preventing Marr's from exercising actual or *de facto* control over the business of the corporation. Indeed, this is what they accomplished, and nothing in the 'object and spirit' of any of the various provisions can serve to displace this result. That is, while the general purpose of [the relevant statutory provision] may be to prevent the transfer of non-capital losses from one corporation to another, the parties successfully excepted themselves from the general rule by bringing the two companies under common control prior to their amalgamation.[164]

In contrast to the Supreme Court of Canada decisions in *Stubart*[165] and *Bronfman Trust*,[166] therefore, this passage suggested that taxpayers could rely on the 'formal validity' of a transaction and the 'juristic classification of form' to obtain a tax benefit, notwithstanding that the 'object and spirit' of the benefit or allowance provision was 'defeated by . . . procedures blatantly adopted by the taxpayer to synthesize a loss . . . or other tax saving device'[167] or by 'the taxpayer's sophistication at manipulating a sequence of events to achieve a patina of compliance with the apparent prerequisites for a tax deduction.'[168]

C LUDMER

Like the transactions in *Duha Printers*, the transactions in *Ludmer* were also clearly tax-motivated.[169] Between September 1977 and June 1979, the four taxpayers (a private company called Ludco Enterprises Ltd. and the three children of the company's president and sole shareholder – a businessman and real estate developer named Irving Ludmer) borrowed

161 Ibid.
162 Ibid. at para. 87.
163 *Duha Printers*, supra note 1 at para. 88, citing *Antosko*, supra note 1 at para. 29; see text accompanying note 107.
164 Ibid.
165 Supra note 39.
166 Supra note 65.
167 *Stubart*, supra note 39 at para. 65; see text accompanying note 49.
168 *Bronfman Trust*, supra note 65 at para. 40; see text accompanying note 80.
169 For a concise summary of these transactions, see *Ludmer*, supra note 1 at paras. 4–20.

approximately $6.5 million in Canada, which they used to acquire shares in two offshore companies that were carefully structured to avoid existing Canadian taxes on passive foreign investments.[170] The companies provided further tax advantages to their shareholders by investing in Canadian and US securities that were exempt from non-resident withholding tax and adhering to a declared policy to reinvest most of its income rather than distributing it to shareholders in the form of dividends, since investors could realize returns primarily in the form of partly taxable capital gains that would not be taxable until they disposed of their shares rather than of dividends that would be fully taxable in the year in which they were received.

In 1985, the taxpayers disposed of their shares, realizing capital gains of $9.24 million,[171] half of which was included in computing their incomes and subject to tax.[172] From 1977 to 1985, the taxpayers incurred approximately $6 million in interest expenses and received dividends of roughly $600,000.[173] In computing their incomes during these years, the taxpayers included the dividends that they received and deducted the interest expenses under subparagraph 20(1)(c)(i) of the Income Tax Act,[174] which allows a deduction for interest on borrowed money 'used for the purpose of earning income from a business or property.' This resulted in substantial excess deductions that they used to shelter other income from tax. In 1986 and 1987, the minister of national revenue reassessed the taxpayers in respect of their 1981 to 1985 taxation years, disallowing the deduction of interest expenses incurred during these years on the basis that the borrowed funds were used not to earn income from a business or property but to defer taxes and convert fully taxable income into partly taxable capital gains.[175]

Relying on the emphasis that the Supreme Court of Canada had placed on the taxpayer's '*bona fide* purpose' in *Bronfman Trust*,[176] a majority of the Federal Court of Appeal dismissed the taxpayers' appeals.[177]

170 See *ITA*, supra note 29, ss. 91–5; these rules look through offshore companies to tax Canadian shareholders on the passive 'foreign accrual property income' (FAPI) of a 'controlled foreign affiliate.' Until 1984, these rules applied only to shareholders owning at least 10 per cent of the corporation's shares. Each of the taxpayers held 9.9 per cent of the shares of the offshore companies.

171 *Ludmer*, supra note 1 at para. 18.

172 At the time (as is the case today), *ITA*, supra note 29, s. 38, limited the 'taxable' amount of a capital gain to half the amount of the gain.

173 Ibid.

174 Supra note 29.

175 *Ludmer*, supra note 1 at para. 19.

176 Supra note 65 at para. 52; see text accompanying note 72.

177 *Ludmer v. M.N.R.*, [1999] 3 C.T.C. 601, 99 D.T.C. 5153 (F.C.A.).

According to Justice Marceau, the 'true' purpose for which the borrowed funds were used was not to earn income from a business or property but 'to transform into non-taxable capital gains half of the taxable income that the investments made with their money might generate.'[178] Concurring, Justice Desjardins held that 'the evidence establishes beyond a reasonable doubt that the real purpose the appellants had in mind when they borrowed the money was to acquire property . . . that would produce a capital gain.'[179] As the relevant statutory provision allows a deduction only for borrowed money that is used fully to earn taxable income from a business or property, not borrowed money used to generate a partly taxable capital gain, it followed on this basis that the taxpayers had not satisfied the statutory requirement for an interest deduction under the relevant statutory provision.

In a unanimous decision, Justice Iacobucci (Gonthier, Major, Bastarache, Binnie, Arbour and LeBel JJ., concurring) allowed the taxpayers' appeals on the basis that the borrowed funds had, indeed, been used for the purpose of earning income from a business or property within the meaning of the Act.[180] While the decision depended mostly on the Court's specific interpretations of the income-earning purpose requirement and the concept of income in the statutory provision governing the deduction of interest expenses,[181] it also turned on its more general approach to the interpretation of tax statutes.

With respect to statutory interpretation, Justice Iacobucci began by reaffirming the 'modern rule' that the Supreme Court of Canada had first adopted in *Stubart*,[182] 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.'[183] At the same time, he explained, '[W]hen interpreting the *Income Tax Act* courts must be mindful of their role as distinct from that of Parliament.'[184] For this reason, he continued, 'In the absence of clear statutory language, judicial innovation is undesirable. . . .

178 Ibid. at para. 23 of Marceau J.A.'s decision.

179 Ibid. at para. 7 of Desjardins J.A.'s decision.

180 *Ludmer*, supra note 1. As explained supra note 4, Justice LeBel wrote a concurring decision, agreeing with the Court's disposition of the appeal but dissenting from the Court's general approach to the interpretation of tax statutes.

181 Ibid. at para. 41: 'the appeal at bar raises two novel issues related to the concepts of "purpose" and "income" contained within s. 20(1)(c)(i)'; see also ibid. at para. 46: 'in the present appeal, the Court is asked for the first time to explicate the law on two of the central concepts in s. 20(1)(c)(i): "purpose" and "income."'

182 Supra note 39; see text accompanying note 42.

183 *Ludmer*, supra note 1 at para. 36, citing Driedger, *Construction of Statutes*, supra note 42.

184 *Ludmer*, supra note 1 at para. 38.

Rather, the promulgation of new rules of tax law must be left to Parliament.'[185] Most importantly, he emphasized,

> [G]iven that the *Income Tax Act* has many specific anti-avoidance provisions and rules, it follows that courts should not be quick to embellish the provisions of the Act in response to concerns about tax avoidance when it is open to Parliament to be precise and specific with respect to any mischief to be prevented. . . . To do otherwise would be to fail to give appropriate weight to the well-established principle that, absent a provision to the contrary, taxpayers are entitled to arrange their affairs for the sole purpose of achieving a favourable position regarding taxation.. . .[186]

As a result, it followed, even if a specific statutory provision might be interpreted to discourage or prevent tax avoidance, courts should eschew such an interpretation on the grounds that taxpayers are entitled to arrange their affairs solely to minimize taxes, absent a precise and specific statutory anti-avoidance provision to the contrary. In contrast to the Supreme Court of Canada decisions in *Stubart*[187] and *Bronfman Trust*,[188] therefore, in which the Court assumed at least some responsibility for limiting tax avoidance,[189] this passage suggested that tax avoidance was properly a matter for the legislature, not the courts.

Turning to the interest deduction itself, Justice Iacobucci began by rejecting the *bona fide* purpose test that the Supreme Court of Canada had adopted in *Bronfman Trust*.[190] First, he stated, Chief Justice Dickson's reference to a '*bona fide* purpose' was 'made as a passing comment and did not result from an analysis of the text of the provision.'[191] For this reason, he concluded, 'Dickson C.J.'s comments fall short of elevating the *bona fide* purpose test to a rule of law.'[192]

185 Ibid.
186 Ibid. at para. 39.
187 Supra note 39.
188 Supra note 65.
189 See *Stubart*, supra note 39 at para. 66 (suggesting that an interpretive approach emphasizing the 'object and spirit' of taxing provisions would 'reduce the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction'); and *Bronfman Trust*, supra note 65 at para. 49 (stating that '[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'). These passages are quoted in the text accompanying notes 52, 80.
190 Supra note 65 at para. 52; see text accompanying note 72.
191 Ibid. at para. 49; see also ibid. at para. 47, characterizing Chief Justice Dickson's words as *obiter dicta*.
192 Ibid.

Moreover, he continued, a *bona fide* purpose test was not supported by the 'plain meaning' of subparagraph 20(1)(c)(i),[193] nor by the principles of statutory interpretation affirmed by the Court.[194] On the contrary, he declared,

> With respect to the plain meaning of s. 20(1)(c)(i), the only express requirement related to 'purpose' is that borrowed money must have been 'used for the purpose of earning income.' Apart from the use of the definite article 'the,' which on closer analysis is hardly conclusive of the issue before us, nothing in the text of the provision indicates that the requisite purpose must be the exclusive, primary or dominant purpose, or that multiple purposes are to be somehow ranked in importance in order to determine the taxpayer's 'real' purpose.
>
> Reading such tests into s. 20(1)(c)(i) would require rewriting of the provision to introduce a concept of degree, exclusivity, or primary in the taxpayer's purposes. Presumably, a court would take such an approach in response to concerns over tax avoidance. However, this Court has repeatedly stated that in matters of tax law, a court should always be reluctant to engage in judicial innovation and rule making.[195]

Indeed, he added, a *bona fide* purpose test would compel courts to consider the 'economic realities' of the investments at issue, causing them 'to stray from the express terms of s. 20(1)(c)(i) and supplement the provision with extraneous policy concerns that are said to form part of its purpose.'[196] Furthermore, he suggested, the application of such a test would be 'impractical in the context of investments in securities' and 'would open the door to many reassessments and in each case impose on taxpayers a tremendous burden to justify that their real or dominant purpose was to earn income.'[197]

In contrast to a *bona fide*, primary, or dominant purpose test, Justice Iacobucci proposed that 'it is perfectly consistent with the language of s. 20(1)(c)(i) that a taxpayer who uses borrowed money to make an investment for more than one purpose may be entitled to deduct interest charges provided that one of those purposes is to earn income.'[198] Indeed, he emphasized that

> Absent a sham or window dressing or other vitiating circumstances, a taxpayer's ancillary purpose may be nonetheless a *bona fide*, actual, real and true objective of his or her investment, equally capable of providing the requisite purpose for interest

193 Ibid. at para. 50.
194 Ibid. at para. 49.
195 Ibid. at paras. 50, 53.
196 Ibid. at para. 64.
197 Ibid. at para. 53.
198 Ibid. at para. 50.

deductibility in comparison with any more important or significant primary purpose.[199]

As a result, he concluded, the appropriate test to determine whether borrowed funds are 'used for the purpose of earning income' within the meaning of the relevant statutory provision is 'whether, considering all the circumstances, the taxpayer had a reasonable expectation of income at the time the investment is made.'[200]

In order to address this question, it was necessary to consider not only the facts of the relevant transactions but the meaning of the word 'income' within the context of subparagraph 20(1)(c)(i) of the ITA.[201] If it were interpreted as net income or profit after deducting expenses, the deduction might still be disallowed, since the expected and actual interest expenses on the borrowed funds that the taxpayers used to acquire shares in the offshore companies greatly exceeded the expected and actual dividends that they received from the shares. If interpreted as gross income or revenue, on the other hand, the deduction would be allowed, since the taxpayers reasonably expected to and did receive some dividends from the shares notwithstanding the much greater expected and actual interest expenses.

Explaining that the ITA does not specifically define the word 'income,' Justice Iacobucci advanced several reasons why it should be understood as gross income rather than net income in the context of subparagraph 20(1)(c)(i). First, he suggested, the 'plain meaning' of the statutory provision did not support an interpretation of the word as 'net income' or 'profit': 'Nowhere in the language of the provision is a quantitative test suggested. Nor is there any support in the text of the Act for an interpretation of '"income" that involves a judicial assessment of the sufficiency of income.'[202] On the contrary, he observed, the explicit exclusion in the statutory provision for interest on borrowed money used 'to acquire property the income from which would be exempt' indicates that '"income" in s. 20(1)(c)(i) refers to income generally, that is an amount that would come into income for taxation purposes, not just net income.'[203] In addition, he continued, reading

199 Ibid. at para. 51.

200 Ibid. at para. 54; see also ibid. at para. 55: 'Reasonable expectation accords with the language of purpose in the section and provides an objective standard, apart from the taxpayer's subjective intention, which by itself is relevant but not conclusive. It also avoids many of the pitfalls of the other tests advanced and furthers the policy objective of the interest deductibility provision aimed at capital accumulation and investment.. . .'

201 Supra note 29.

202 Ibid. at para. 59.

203 Ibid. at para. 61.

income in subparagraph 20(1)(c)(i) as gross income rather than net income would be 'more consistent with the objective the interest deductibility provision' recognized by the Supreme court of Canada in *Bronfman Trust*,[204] namely 'to create an incentive to accumulate ... income producing capital ... [that] creates wealth and increases the income tax base.'[205] Indeed, since legislative amendments that would have limited interest deductions to circumstances in which the borrowed funds were used to earn net income were proposed but never enacted in 1981 and 1991, he added, this interpretation was 'bolstered' by 'other evidence of Parliamentary intention.'[206] Finally, he emphasized, to require courts to determine whether taxpayers had used borrowed funds to earn net income or profit would be 'too subjective' and contrary to the pursuit of certainty which 'is to be preferred in the area of tax law.'[207] As a result, Justice Iacobucci concluded, 'where a taxpayer uses borrowed money for a purpose yielding a reasonable expectation of [gross] income from business or property, ... the interest charges incurred will fall within the ambit of s. 20(1)(c)(i) and are deductible.'[208] Consequently, it followed, the taxpayers could deduct the interest expenses that they had incurred on the borrowed funds.

D STEWART

The last of the tax cases in which Justice Iacobucci participated at the Supreme Court of Canada is the Court's judgments in *Stewart* and *Walls*,[209] which were co-authored with Justice Bastarache and released on 23 May 2002. Of these decisions, the most important is *Stewart*.

In *Stewart*, the taxpayer was 'an experienced real estate investor' who acquired four condominium rental units in 1986 at prices ranging from $58,990 to $74,990, all of which were part of a syndicated real estate development promoted by a corporate developer that also offered to arrange financing for the investment and management of the properties.[210] As the taxpayer paid only $1,000 cash for each unit and borrowed the

204 Supra note 65; see text accompanying note 68.

205 Ibid. at para. 63, adding that '[i]t is clearly sufficient for the purpose of the provision that an investor have a reasonable expectation of gross income ... when investing borrowed money. In contrast, the incentive would be much less effective if the investor bore the additional burden of establishing a reasonable expectation of net income or profit.'

206 Ibid. at para. 62, adding that '[i]f Parliament had intended interest to be deductible only in circumstances where borrowed money was used for the purpose of earning "net income," it could have expressly said so.'

207 Ibid. at para. 59.

208 Ibid. at para. 65.

209 Supra note 1.

210 *Stewart*, supra note 1 at paras. 7–9.

remainder of the purchase price, interest expenses were substantial and projected to exceed rental income for ten years.[211] In practice, rental income was worse than projected, and the taxpayer incurred rental losses that were larger than anticipated.[212] When the taxpayer sought to deduct these rental losses against income from other sources, the minister disallowed the deduction under the authority of the Supreme Court of Canada decision in *Moldowan*,[213] on the basis that the condominium units were not a 'source of income' within the meaning of the ITA,[214] since the taxpayer did not have a 'reasonable expectation of profit' during the years at issue.[215]

At the Federal Court of Appeal, the taxpayer's appeal was dismissed on the basis that the taxpayer's 'expectation from the acquisition and holding of the property was a capital gain from its disposition at the end of the projected holding period and not profit from the rental of the property.'[216] Writing for a unanimous panel of the Court, Justice Rothstein, as he then was (Desjardins and Sharlow JJ.A., concurring) explained that

> Where a loss from a business or property is claimed, it is necessary to question whether there is a business or property that is a source of income. When someone owns real property that yields some rent but never a profit over an intended holding period, the question arises as to whether the property was acquired or is being held for some objective other than profit. The objective may be found to be personal use in some form or another, but it might be anything other than to derive a profit. In such a case the losses cannot be deducted because the property is not a source of income.[217]

Since the taxpayer 'understood the developer's projections that there would be no profit over the intended holding period and ... did not have a realistic plan to produce a profit,'[218] it followed, according to the Supreme Court of Canada decision in *Moldowan*,[219] that the condominium units were not a 'source of income' within the meaning of the ITA[220] and that the rental losses were not deductible against other sources of income.[221]

211 Ibid. at para. 9.
212 Ibid.
213 Supra note 29.
214 Supra note 29.
215 *Stewart*, supra note 1 at para. 11. The reference in *Moldowan*, supra note 28, to a 'reasonable expectation of profit' appears in the text accompanying note 31.
216 *Stewart v. The Queen*, [2000] 2 C.T.C. 244, 2000 D.T.C. 6163 (F.C.A.) at para. 10.
217 Ibid. at para. 8.
218 Ibid. at para. 11.
219 Supra note 28.
220 Supra note 29.
221 Ibid. at para. 12.

In a unanimous judgment co-authored by Justices Iacobucci and Bastarache (McLachlin C.J.C., L'Heureux-Dubé, Gonthier, Major, Binnie, Arbour and LeBel JJ., concurring), the Supreme Court of Canada allowed the taxpayer's appeal on the basis that the condominium units were a source of income within the meaning of the ITA.[222] Noting that the Act does not define the term 'source of income,'[223] Justices Iacobucci and Bastarache reviewed numerous judicial decisions in which the reasonable expectation of profit (REOP) test had been developed and applied,[224] following which they rejected this test as a general requirement for a source of income,[225] proposed an alternative test for determining a source of income,[226] and applied this alternative test to the facts of the case.[227]

With respect to the REOP test itself, Justices Iacobucci and Bastarache advanced several reasons why this requirement should not be affirmed as a general test for the existence of a source of income. First, they suggested, since Justice Dickson's reference to a reasonable expectation of profit had cited as authority an earlier decision in which the concept of a reasonable expectation of profit was employed to extend the concept of a source to a circumstance in which there was no net income,[228] the test should properly be understood as a sufficient condition for a source of income, not a necessary requirement for a source of income.[229] Furthermore, they explained, '[E]quating the term "business" with the phrase, "reasonable expectation of profit" does not accord with the traditional common law definition of business, which is that "anything which occupies the time and attention and labour of a man for the purpose of profit is a business."'[230]

More importantly, they emphasized, because the limited statutory references to the phrase 'reasonable expectation of profit' do not

222 Supra note 29.
223 *Stewart*, supra note 1 at para. 21.
224 Ibid. at paras. 21–34.
225 Ibid. at paras. 35–47.
226 Ibid. at paras. 48–60.
227 Ibid. at paras. 61–9.
228 *Dorfman v. M.N.R.* [1972] C.T.C. 151 (F.C.T.D.).
229 *Stewart*, supra note 1 at paras. 36–7, citing Brian S. Nichols, 'Chants and Ritual Incantations: Rethinking the Reasonable Expectation of Profit Test,' in *Report of the Proceedings of the Forty-Eighth Tax Conference*, 1996 Conference Report, vol. 28 (Toronto: Canadian Tax Foundation, 1997) 1 at 4–5; and Silver, 'Great Expectations: Are They Reasonable?' Corporate Management Tax Conference 1995, *Real Estate Transactions: Tax Planning for the Second Half of the 1990s*, vol. 6 (Toronto: Canadian Tax Foundation, 1996) 1 at 6–7.
230 *Stewart*, supra note 1 at para. 38, citing *Smith v. Anderson* (1880), 15 Ch. 247 (C.A.) at 258; and *Terminal Dock and Warehouse Co. v. M.N.R.*, [1968] 2 Ex. C.R. 78, aff'd 68 D.T.C. 53116 (S.C.C.).

support 'its use as a stand-alone source test,'[231] it followed that 'the only way to accept "reasonable expectation of profit" as the test to determine whether a taxpayer has a source of income is to adopt an interpretive rule of law which is independent of the provisions of the Act'[232] – an approach that would cross the line between legitimate 'judicial interpretation and inappropriate judicial rule-making' and contradict the Court's express opinion that 'in matters of tax law, a court should always be reluctant to engage in judicial innovation and rule making.'[233] Finally, they added, 'even if one were to accept the use of the REOP test as a legitimate source of income standard, there are numerous practical difficulties which arise in its application that suggest that the test is ill-suited for the purpose'[234] – such as uncertainty as to what the test means by 'profit,'[235] a tendency for the test to encourage retrospective application,[236] and significant variation in the application of the test according to the manner in which a venture is capitalized.[237] For all these reasons, they concluded, the REOP test 'should not be accepted as the test to determine whether a taxpayer's activities constitute a source of income.'[238]

Having rejected the requirement of a reasonable expectation of profit as a general test for a source of income, Justices Iacobucci and Bastarache turned to the development of an alternative approach, emphasizing at the outset of this analysis that the characterization of a source of income 'must be grounded in the words and scheme of the Act.'[239] Noting that s.s. 9(1) of the Act defines a taxpayer's income from a business or property as the taxpayer's 'profit' from these sources,[240] and that business income is generally distinguished from property income on the basis that a business involves increased activity by the taxpayer,[241] they explained that it was 'logical to conclude that an activity undertaken in pursuit of profit,

231 *Stewart*, supra note 1 at para. 41.
232 Ibid. at para. 42.
233 Ibid., citing *Ludmer*, supra note 1 at para. 53. This statement is quoted in the text accompanying note 192.
234 *Stewart*, supra note 1 at para. 43.
235 Ibid. at para. 44, questioning 'whether the capacity for profit should be determined after taking into account depreciation and, if so, whether capital cost allowance or accounting depreciation should be used,' as well as 'how much expected profit [is] required, in what time frame, and whether the amount of expected profit should vary with the risk of the venture.'
236 Ibid. at para. 45.
237 Ibid. at para. 46.
238 Ibid. at para. 47.
239 Ibid. at para. 48.
240 Ibid. at para. 49.
241 Ibid. at para. 51, citing Vern Krishna, *The Fundamentals of Canadian Income Tax*, 6th ed. (Scarborough: Carswell, 2000) at 240.

regardless of the level of taxpayer activity, will be either a business or property source of income.'[242] More importantly, they emphasized,

> [T]his 'pursuit of profit' source test will only require analysis in situations where there is some personal or hobby element to the activity in question. . . . Where the nature of an activity is clearly commercial, there is no need to analyze the taxpayer's business decisions. Such endeavours necessarily involve the pursuit of profit. As such, a source of income, by definition, exists, and there is no need to take the inquiry any further.[243]

Thus, they concluded, 'the issue of whether or not a taxpayer has a source of income is to be determined by looking at the commerciality of the activity in question.'[244]

Returning to the facts of the case, the Court had no difficulty concluding that the taxpayer was engaged in a commercial activity, as a result of which it necessarily followed that the rental units were a source of income. According to Justices Iacobucci and Bastarache, 'In our view, a property rental activity which lacks any element of personal use or benefit to the taxpayer is clearly a commercial activity. . . . As a result, the appellant satisfies the test for a source of income.'[245]

Nor did it matter that the taxpayer's investment was deliberately structured to generate rental losses that he could deduct against other sources of income in the expectation of an eventual capital gain at the end of the projected holding period, they explained, since 'a tax motivation does not affect the validity of transactions for tax purposes' and did not 'detract from the commercial nature of his rental operation or its characterization as a source of income.'[246] Indeed, they added, '[T]he motivation of capital gains accords with the ordinary business person's understanding of "pursuit of profit," and may be taken into account in determining whether the taxpayer's activity is commercial in nature.'[247] As a result, the Court concluded, the taxpayer could deduct the rental losses for each of the taxation years at issue.[248]

E SUMMARY

As the cases examined in this part of the paper demonstrate, Justice Iacobucci's approach to tax statutes was dramatically different from the

242 *Stewart*, supra note 1 at para. 51.
243 Ibid. at para. 53; see also ibid. at para. 60: '[w]here the activity contains no personal element and is clearly commercial, no further inquiry is necessary.'
244 Ibid. at para. 60.
245 Ibid. at para. 62.
246 Ibid. at para. 65.
247 Ibid, at para. 68.
248 Ibid. at para. 69.

approach that the Supreme Court of Canada had adopted from the 1970s to the early 1990s.

With respect to statutory interpretation, the Court's earlier tax jurisprudence emphasized the 'object and spirit' or purpose of the relevant statutory provision,[249] considered tax fairness to be a relevant consideration in statutory interpretation,[250] and formulated new legal tests in accordance with its purposive approach.[251] In contrast, Justice Iacobucci looked mainly to the text of the ITA,[252] insisted that purposive considerations could not alter the meaning of a statutory provision where 'the words of the statute are clear and plain,'[253] held that 'a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts,'[254] and rejected 'judicial innovation and rule making.'[255]

With respect to the characterization of transactions for the purpose of applying statutory provisions, Supreme Court of Canada decisions in the 1980s and early 1990s looked to 'the economic and commercial reality of the taxpayer's actions';[256] for example, by extending the concept of

249 See, *e.g.*, *Stubart*, supra note 39 at paras. 56, 65; *Bronfman Trust*, supra note 65 at para. 51; and *McClurg*, supra note 81 at para. 46; see text accompanying notes 48–9, 68, 83.

250 See, *e.g.*, *Bronfman Trust*, supra note 65 at para. 38, explaining that it would be unfair to allow wealthy taxpayers to deduct interest on borrowed funds used indirectly to preserve income-producing assets, when less wealthy taxpayers with no income-earning assets 'would not be able to deduct interest payments on loans used in the identical fashion'; and ibid. at para. 49, suggesting that '[a]ssessment of taxpayer's transactions with an eye to commercial and economic realities, rather than juristic classifications of form' could help to avoid the 'inequity' of sophisticated tax avoidance transactions. These statements are quoted in the text accompanying notes 69, 80.

251 See, *e.g.*, *Moldowan*, supra note 28, in which then Justice Dickson formulated the concept of a 'reasonable expectation of profit' as a test to determine whether a taxpayer has a source of income; *Imperial General Properties*, supra note 59, in which Justice Estey suggested that the concept of corporate control should be understood 'in the real sense of the term'; and *Bronfman Trust*, supra note 65, in which the Court interpreted the income-earning purpose requirement in subpara. 20(1)(c)(i) of the Act to require a '*bona fide* purpose.'

252 Supra note 29.

253 *Antosko*, supra note 1 at para. 29; see text accompanying note 107; also *Ludmer*, supra note 1 at para. 50, referring to 'the plain meaning of s. 20(1)(c)(i)'; and text accompanying note 195.

254 *Antosko*, supra note 1 at para. 38; see text accompanying note 108.

255 *Ludmer*, supra note 1 at para. 53; see text accompanying note 192; also ibid. at para. 38; and *Stewart*, supra note 1 at para. 42; see text accompanying notes 185, 233.

256 *McClurg*, supra note 81 at para. 46; see text accompanying note 83; also *Johns-Manville*, supra note 56 at para. 42, emphasizing a 'commonsense appreciation' of transactions rather than 'the juristic classification of legal rights'; and *Bronfman Trust*, supra note 65 at para. 49, advocating '[a]ssessment of taxpayers' transactions with an eye to commercial and economic realities, rather than juristic classifications of form....'; see text accompanying notes 57–8, 80.

corporate control in *Imperial General Properties* beyond 'a highly technical and narrow interpretation of the legal rights attached to the shares of a corporation' to include control 'in the real sense of the term.'[257] In contrast, Justice Iacobucci emphasized the 'legal and practical effect' of the transactions at issue,[258] for example, by limiting the concept of corporate control in *Duha Printers* to 'the constating documents of the corporation,' notwithstanding most external agreements affecting voting rights and restrictions on eligible directors.[259]

Finally, while the Supreme Court of Canada's earlier decisions were prepared not only to interpret statutory provisions broadly in order to discourage tax avoidance[260] but also to disregard at least some tax-motivated transactions that could be shown to contradict the object and spirit of a particular statutory provision,[261] Justice Iacobucci consistently affirmed the traditional Anglo-Canadian principle that taxpayers can arrange their affairs solely to minimize tax,[262] suggesting that legal responsibility to limit or prevent tax avoidance rested with the legislature, not the courts.[263]

The next part of the paper evaluates the merits of this transformation in Canadian tax jurisprudence, examining the reasons why Justice Iacobucci adopted this approach to tax statutes and its connection to a particular conception of the rule of law.

257 *Imperial General Properties*, supra note 59 at paras. 14, 11; see text accompanying notes 61, 64.

258 *Antosko*, supra note 1 at para. 29; see text accompanying note 107.

259 *Duha Printers*, supra note 1 at paras. 55, 51, 54; see text accompanying notes 153–4, 157.

260 See, *e.g.*, *Imperial General Properties*, supra note 59, in which a majority of the Court adopted a broad concept of corporate control in order to prevent what Justice Estey described (ibid. at para. 14) as a 'tax plan' to effectively double its small business deduction; and *Bronfman Trust*, supra note 65, in which Chief Justice Dickson interpreted the income-earning purpose requirement in subpara. 20(1)(c)(i) to require a '*bona fide* purpose.'

261 See, *e.g.*, *Stubart*, supra note 39 at para. 65; see text accompanying note 49; see also *Bronfman Trust*, supra note 65 at para. 53, in which Chief Justice Dickson suggested that a hypothetical transaction in which a taxpayer sold assets in order to finance a non-income-earning expenditure and then used borrowed money to reacquire the assets might be regarded as 'as formality or sham designed to conceal the essence of the transaction'; see text accompanying note 75.

262 See, *e.g.*, *Duha Printers*, supra note 1 at para. 87; and *Ludmer*, supra note 1 at para. 39; see text accompanying notes 162, 186.

263 *Ludmer*, supra note 1 at para. 39, explaining that 'the *Income Tax Act* has many specific anti-avoidance provisions and rules,' and therefore that 'courts should not be quick to embellish the provisions of the Act in response to concerns about tax avoidance when it is open to Parliament to be precise and specific with respect to any mischief to be prevented' (see text accompanying note 186.).

IV *Evaluation*

Based on his tax judgments, Justice Iacobucci's approach to tax statutes appears to have been motivated by three related values or principles. First, as he suggested in *Ludmer* and *Antosko*, courts should be 'mindful of their role as distinct from Parliament'[264] – recognizing that 'the promulgation of new rules of tax law' is properly a legislative function[265] and that 'a normative assessment of the consequences of the application of a given provision is within the ambit of the legislature, not the courts.'[266] Second, as he explained in *Duha Printers*, because taxpayers rely on established tax rules when they plan their personal and business affairs, simple, certain, and predictable rules are 'most desirable' in this area of law.[267] Third, as he also stated in *Duha Printers*, taxpayers are 'entitled to take advantage of the [ITA] even where a transaction is motivated solely by the minimization of tax.'[268] The first of these rationales reflects a principle of judicial restraint, which is generally associated with the constitutional principle of legislative supremacy. The second and third rationales reflect principles of legal certainty and individual liberty, which are closely connected with liberal conceptions of the rule of law.[269]

A JUDICIAL RESTRAINT AND LEGISLATIVE SUPREMACY

Beginning with the principles of judicial restraint and legislative supremacy, Justice Iacobucci was surely right to emphasize that the role of courts as interpreters of existing laws should be distinguished from that of legislatures as promulgators of new laws. While this distinction necessarily applies to any area of law that is based on a statutory text, it is particularly appropriate to the field of tax law, which would not exist but for the legislation that creates the tax. Since legislative authority is

264 Ibid. at para. 38; see text accompanying note 184.

265 Ibid; see text accompanying note 185.

266 *Antosko*, supra note 1 at para. 38; see text accompanying note 108.

267 *Duha Printers*, supra note 1 at para. 52; see text accompanying note 152; see also *Ludmer*, supra note 1 at para. 59, emphasizing that 'certainty is to be preferred in the area of tax law.' This passage is quoted in the text accompanying note 207.

268 *Duha Printers*, supra note 1 at para. 87; see text accompanying note 162; see also *Ludmer*, supra note 1 at para. 39, stating that 'absent a provision to the contrary, taxpayers are entitled to arrange their affairs for the sole purpose of achieving a favourable position regarding taxation' (see text accompanying note 186).

269 See, *e.g.*, Lon Fuller, *The Morality of Law*, rev. ed. (New Haven, CT: Yale University Press, 1969) at 33–94, identifying eight elements of the rule of law: generality, notice or publicity, non-retroactivity, clarity or intelligibility, non-contradiction, conformability, stability, and congruence between declared rules and official action; and Joseph Raz, 'The Rule of Law and its Virtue'(1977), 93 Law Quar.Rev. 195 [Raz, 'Rule'], emphasizing, in addition to other principles, prospectivity, publicity, clarity, and stability.

ultimately expressed through the statutory text, Justice Iacobucci was also undoubtedly right to focus on the text of the ITA as the most important element in its interpretation.[270] For the same reason, as Justice Iacobucci emphasized, it also follows that the promulgation of new tax rules and the consequential assessment of these rules is generally within 'the ambit of the legislature, not the courts.'[271]

Notwithstanding these general principles, however, it is also important to recognize the necessary role that courts fulfil as interpreters of legislation that is not always drafted in precise and unambiguous language and cannot reasonably be expected anticipate every possible circumstance to which it might apply. To the extent that the ITA uses undefined terms like 'control' or 'income' or 'source of income,' for example, courts are necessarily called upon to formulate 'rules of tax law' to interpret their meanings. And so long as taxpayers continue to engage in novel transactions and continue to devise and implement transactions that are intended to minimize taxes that would otherwise be payable, courts are also inevitably required to determine whether the particular transactions at issue are, indeed, the kinds of transactions that are contemplated by the statutory provisions in question. While courts may and clearly do adopt different approaches to the interpretation of statutory provisions and the characterization of transactions, there is little doubt that these tasks are quintessentially judicial, not legislative. As a result, the question is not whether courts should fulfil this responsibility but how they should they should do so.

While the principle of legislative supremacy demands that judicial interpretations should be based on the statutory text,[272] it also suggests that they should be attentive to legislative intentions and to the 'object and spirit' or purpose of the relevant legislation.[273] As well, since

270 See David G. Duff, 'Interpreting the *Income Tax Act*: Part 2 – Toward a Pragmatic Approach' (1999), 47 Can.Tax J. 741 at 795, arguing that textual considerations should have priority in statutory interpretation.

271 *Antosko*, supra note 1 at para. 38; see text accompanying note 107.

272 See, *e.g.*, William N. Eskridge, Jr., & Philip P. Frickey, 'Statutory Interpretation as Practical Reasoning' (1990), 42 Stan.L.Rev. 321 at 354, explaining that a preference for textual elements in statutory interpretation reflects values associated with legislative supremacy: '[f]ormally, all that is enacted into law is the statutory text, and at the very least legislative supremacy means that an interpreter must be attentive to the text.'

273 See, *e.g.*, John Willis, 'Statute Interpretation in a Nutshell' (1938), 16 Can.Bar Rev. 1 at 14 [Willis, 'Statute'], arguing that purposive interpretation, in contrast to strict and literal interpretation, better accords with the principle legislative supremacy; see also James M. Landis, 'A Note on Statutory Interpretation' (1930), 43 Harv. L. Rev. 886 at 886, noting that an emphasis on legislative intent in statutory interpretation derives from the 'Anglo-American scheme of government [which] conceives of lawgivers apart from and at times paramount over courts'; J.A. Corry, 'Administrative

it is unreasonable to expect legislatures to anticipate every possible circumstance to which a statute might apply, legislative supremacy may also be compatible with a more activist judicial approach that would, as Ruth Sullivan suggests, 'adjust . . . the application of fixed rules to individual cases in order to avoid absurd or unjust results.'[274] For both reasons, courts might reasonably adopt a more substantive approach to the characterization of transactions that, in Chief Justice Dickson's words, 'achieve a patina of compliance with the apparent prerequisites for a tax deduction.'[275]

On the basis of a more purposive approach to statutory interpretation, a court might reasonably have adopted a broader concept of corporate control in *Duha Printers*,[276] in order to prevent a tax-motivated transaction clearly at odds with the purpose of the relevant statutory provisions governing the transfer of corporate tax losses. Attending to the purpose of the deduction in subparagraph 20(14)(b) and to the unanticipated effects of the transactions carried out by the taxpayers, a court might have disallowed the deduction for accrued interest in *Antosko*,[277] on the basis that the provision could not reasonably have been intended to allow taxpayers to obtain substantial tax-free compensation through the acquisition of a debt obligation for nominal consideration. According greater weight to purposive and consequential considerations, a court might also have decided against the taxpayers in *Ludmer* and *Stewart*,[278] disallowing deductions that the transactions were deliberately arranged to generate in order that the taxpayers could shelter other sources of income from tax, by adopting more substantive interpretations of the income-earning purpose requirement in subparagraph 20(1)(c)(i) and

Law and the Interpretation of Statutes' (1936), 1 U.T.L.J. 286 at 289, emphasizing the importance of 'intelligent judicial co-operation' in a parliamentary democracy in 'the fulfilment of the aims and objects of parliament'; and John M. Kernochan, 'Statutory Interpretation: An Outline of Method' (1976–7), 3 Dalhousie L.J. 331 at 347–8, suggesting that the concepts of legislative intent and statutory purpose demand 'an interpretive attitude that acknowledges the role of the legislature.'

274 Ruth Sullivan, *Driedger on the Construction of Statutes*, 3d ed. (Toronto: Butterworths, 1994) at 155, adding that '[t]his flexibility does not undermine the authority of the legislature, but complements it.' See also Cass R. Sunstein, 'Interpreting Statutes in the Regulatory State' (1989), 103 Harv. L. Rev. 407 at 482 [Sunstein, 'Interpreting'], suggesting that comparative institutional competence in these circumstances rests with courts, not legislatures, '[b]ecause courts are able to focus upon the concrete and often unforeseeable effects of general statutory provisions,. . . they are in a much better position [than legislatures] to judge whether a particular provision produces peculiar consequences in a particular setting.'

275 *Bronfman Trust*, supra note 65 at para. 49; see text accompanying note 80.

276 Supra note 1.

277 Supra note 1.

278 Supra note 1.

of the concept of a 'source of income.'[279] Indeed, the Federal Court of Appeal reached precisely these conclusions in each of these cases, relying on the purposive and substantive approach that the Supreme Court of Canada favoured from the later 1970s to the early 1990s.

That Justice Iacobucci arrived at different conclusions in these cases, therefore, based on an approach to tax statutes that emphasized the text of the relevant statutory provisions and the legal form of the transactions at issue, therefore, suggests that the principle of judicial restraint on which this approach depended turned less on the notion of parliamentary supremacy than it did on the values of legal certainty and individual liberty. In *Duha Printers*, in fact, Justice Iacobucci explicitly linked the principles of judicial restraint and legal certainty, suggesting that any change to the traditional *de jure* concept of corporate control 'should be left to Parliament' because 'taxpayers rely heavily on whatever certainty and predictability can be gleaned from the *Income Tax Act*.'[280] Similarly in *Ludmer*, Justice Iacobucci emphasized that 'courts should not be quick to embellish the provisions of the [ITA] in response to concerns about tax avoidance' because 'it is open to Parliament to be precise and specific with respect to any mischief to be prevented' and '[t]o do otherwise would . . . fail to give appropriate weight to the well-established principle that, absent a provision to the contrary, taxpayers are entitled to arrange their affairs for the sole purpose of achieving a favourable position regarding taxation.'[281] It is thus to these principles of legal certainty and individual liberty that one must ultimately look to assess Justice Iacobucci's approach to tax statutes.

B LEGAL CERTAINTY, INDIVIDUAL LIBERTY, AND THE RULE OF LAW

As explained at the beginning of this section, principles of legal certainty and individual liberty are closely connected with liberal conceptions of the rule of law. To quote F.A. Hayek's notable formulation, the rule of law 'means that government in all its actions is bound by rules fixed and announced beforehand – rules which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one's individual affairs on the basis of this knowledge.'[282]

279 For a more detailed evaluation of the Supreme Court of Canada decisions in these cases, see David G. Duff, 'Interest Deductibility, the Reasonable Expectation of Profit Test, and the Supreme Court of Canada: From *Bronfman Trust* and *Moldowan* to *Singleton, Ludmer, Stewart,* and *Walls*' in David W. Chodikoff & James L. Horvath, *Advocacy and Taxation in Canada* (Toronto: Irwin Law, 2004) 399 [Duff, 'Interest'], arguing, among other things, that more substantive interpretations of the relevant provisions are, indeed, based on the text and scheme of the ITA as well as on the purposes of the relevant provisions.

280 *Duha Printers*, supra note 1 at para. 52; see text accompanying note 152.

281 *Ludmer*, supra note 1 at para. 39; see text accompanying note 186.

282 F.A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1994) at 80 [Hayek, *Road*].

To the extent that laws are uncertain, unpredictable, unintelligible, unknowable, or unstable, it is impossible to make meaningful life plans, since these can be disrupted by consequences that could not have been foreseen when the plans were made. Since individual freedom is, as Joseph Raz observes, in one sense 'identified with an effective ability to choose between as many options as possible,' legal certainty and predictability are – together with other constituents of the rule of law – important conditions for individual freedom.[283]

More importantly, Raz explains, rule-of-law principles like legal certainty and predictability are essential if the legal system is to respect human dignity: 'Respecting human dignity entails treating humans as persons capable of planning and plotting their future. Thus, respecting people's dignity includes respecting their autonomy, their right to control their future.'[284]

Where a legal system adheres to the rule of law, it respects human dignity by treating people as rational and autonomous beings, attempting to 'guide their behaviour through affecting the circumstances of their actions.'[285] Where laws are uncertain or unpredictable or otherwise violate the rule of law, on the other hand, human dignity is devalued by making it impossible for persons to plan their futures or decide on their actions 'on the basis of a rationale assessment of their outcome.'[286]

While certainty and predictability are central to the rule of law, however, it is important to appreciate what these principles do and do not entail. Hayek's formulation, for example, uses the words 'fair certainty,'[287] thereby acknowledging that a degree of uncertainty exists in the application of any general law to specific circumstances. Similarly, Raz suggests that the rule of law requires 'relatively stable' laws,[288] implicitly recognizing that legal innovation does not contradict the rule of law, provided that laws are not changed 'too often,' that they are 'open and adequately publicized,' and that their application is generally not retroactive.[289] Understanding the rule of law as 'rule in accordance with principles of legality,' David Dyzenhaus goes further, to suggest that decisions by delegated authorities that are based on reasonable

283 Raz, 'Rule,' supra note 269 at 204.
284 Ibid. at 204.
285 Ibid. at 205.
286 Ibid.
287 Hayek, *Road*, supra note 282 at 80; see text accompanying note 282.
288 Raz, 'Rule,' supra note 269 at 199.
289 Ibid. at 198–9. With respect to retroactivity, Raz suggests (ibid. at 198): '[s]ometimes it is known for certain that a retroactive law will be enacted. When this happens retroactivity does not conflict with the rule of law (though it may be objected to on other grounds).'

interpretations of the substantive law of the relevant legal regime do not compromise the rule of law.[290]

While Justice Iacobucci was undoubtedly right to emphasize the values of certainty and predictability in tax law, therefore, it is not obvious that these principles required such a singular focus on the text of the ITA and such a strong aversion to judicial innovation when interpreting statutory provisions. On the contrary, to the extent that the purpose of a statutory provision is reasonably determinable, rule-of-law principles of legal certainty and predictability are not violated by interpreting the provision in accordance with its purpose or precluding its application to circumstances for which it was clearly not intended. While judicial innovation poses the admittedly more troubling issue of retroactivity, it is difficult to conclude that a revised interpretation that accords more closely with the purpose of a statutory provision, while doing no violence to its text, contradicts the rule-of-law ideal that laws should be reasonably stable and predictable. Indeed, since the traditional Anglo-Canadian approach to the interpretation of tax statutes often resulted in narrow interpretations of statutory concepts and provisions, it is not surprising that a more purposive approach such as that adopted by the Supreme Court of Canada from the late 1970s to the early 1990s might yield novel interpretations, such as the concept of a source of income adopted by Justice Dickson in *Moldowan*,[291] the broader concept of corporate control 'in the real sense of the term' that Justice Estey affirmed in *Imperial General Properties*,[292] or the '*bona fide* purpose' test for the deduction of interest expenses that Chief Justice Dickson suggested in *Bronfman Trust*.[293] So long as these interpretations were consistent with the text and purposes of the relevant statutory provisions – as they certainly were in *Duha Printers* and arguably were in *Ludmer* and *Stewart*[294] – one might reasonably question a reluctance to embrace them on the grounds of legal stability.

Turning to the traditional principle that taxpayers may, absent a provision to the contrary, arrange their affairs solely to minimize tax, it is also not obvious that such a right is required by rule-of-law principles of certainty and predictability nor by the values of individual freedom and human dignity that these principles advance. On the contrary, where taxpayers engage in transactions that are deliberately designed

290 David Dyzenhaus, 'The Legitimacy of the Rule of Law' (Paper presented at New York University Colloquium in Legal, Political and Social Philosophy, Reading #10, 10 November 2005) at 15.

291 Supra note 28 at para. 13; see text accompanying note 31.

292 Supra note 59 at para. 14; see text accompanying note 61.

293 Supra note 65 at para. 52; see text accompanying note 72.

294 See Duff, 'Interest,' supra note 279.

and carried out in order to defeat the object and spirit or purpose of the relevant legislation, the certainty and predictability on which they rely is not that of the law itself (assuming that its object and spirit or purpose is reasonably determinable), but of an alleged principle that they are entitled to arrange their affairs solely to minimize the taxes that they would otherwise be required to pay. Indeed, if the rule of law is to recognize human dignity by treating people as rational and autonomous beings whose behaviour may be influenced by law, it would seem that the rule of law is itself undermined if a legal system sanctions conduct that is deliberately intended to defeat the law.[295] Given the substantial costs of tax avoidance in terms of lost revenue, socially unproductive resources devoted to tax avoidance arrangements, and diminished respect for the integrity of the tax system and the legal system more generally, moreover, one might rightly wonder why such a principle should be recognized at all.

Historically, of course, the answer to this question turns on the early antipathy exhibited by English and Canadian courts toward taxes, which were regarded as encroachments on private property.[296] On this basis, as John Willis observed in 1938, these courts 'leaned against taxing acts'[297] – concluding in cases like the *Duke of Westminster* that it was 'not only legal but moral to dodge the Inland Revenue.'[298] By the time that the Supreme Court of Canada affirmed a different view of tax statutes in *Stubart*[299] – acknowledging 'the state interest in revenue, equity in the raising of revenue, and economic planning'[300] and recognizing that the income tax was 'no longer a simple device to raise revenue' but also an important instrument 'to attain selected economic policy objectives'[301] – the assumption that taxpayers are entitled to arrange their affairs solely to avoid tax was well-established in Anglo-Canadian tax jurisprudence. While Justice Estey was prepared to place some judicial limits on this principle – suggesting that transactions could be ignored where 'the 'object and spirit' of [an] allowance or benefit provision is defeated by . . . procedures blatantly adopted by [a] taxpayer to synthesize

295 This argument, of course, depends on the assumption that the content of the law includes its object and spirit or purpose – an assumption that presumably depends on the premise that this object and spirit or purpose is reasonably determinable.

296 Sherbaniuk, 'Tax Avoidance,' supra note 22 at 436; see, *e.g.*, *Canadian Northern Railway*, supra note 13 at 275: '[a] law imposing taxation should always be construed strictly against the taxing authorities since it restricts the public in the enjoyment of its property.'

297 Willis, 'Statute,' supra note 273 at 25.

298 Ibid. at 26.

299 Supra note 39.

300 Ibid. at para. 53; see text accompanying note 45.

301 Ibid. at para. 55; see text accompanying note 40.

a loss, delay or other tax saving device'[302] – Justice Wilson favoured a different approach, concluding that the *Duke of Westminster* principle was 'far too deeply entrenched in our tax law for the courts to reject it in the absence of clear statutory authority.'[303]

Although the enactment of the GAAR four years later created this statutory authority,[304] introducing a broadly worded 'provision to the contrary' that displaces the *Duke of Westminster* principle whenever it applies,[305] the GAAR did not apply to the transactions at issue in *Antosko*, *Duha Printers*, *Ludmer*, and *Stewart*, all of which preceded the GAAR's effective date of 13 September 1988. For this reason, it seems, Justice Iacobucci considered it appropriate to reaffirm the *Duke of Westminster* principle in these judgments, notwithstanding that it had been qualified in *Stubart* and questioned in other Supreme Court of Canada decisions and legislatively reversed. Here too, therefore, an emphasis on rule-of-law principles of stability and predictability appears to have shaped Justice Iacobucci's approach. As the GAAR established a statutory test to limit tax avoidance, it appears that Justice Iacobucci was of the view that it was this provision, rather than judicial innovation, that should be relied upon to prevent any unacceptable tax avoidance.

C STATUTORY INTERPRETATION, TAX AVOIDANCE, AND INSTITUTIONAL COMPETENCE

Since the *Duke of Westminster* principle governs only the characterization of transactions for tax purposes, not the interpretation of statutory provisions, however, it does not clearly follow from the continued affirmation of this principle that statutory provisions should not be interpreted broadly to achieve anti-avoidance objectives. According to Justice Iacobucci, however, courts should not interpret statutory provisions in this manner, since 'it is open to Parliament to be precise and specific with respect to any mischief to be prevented.'[306] While this conclusion reflects rule-of-law concerns about the certainty and predictability of tax rules, it is also based on an explicit presumption that institutional competence to address tax avoidance rests with the legislature, not the courts.

The argument that courts should not interpret statutory provisions broadly to prevent tax avoidance is a variant of the more general argument considered earlier that courts should not interpret statutory

302 Ibid. at para. 65; see text accompanying note 49.
303 Ibid. at para. 72; see note 47.
304 *ITA*, supra note 29, s. 245; see notes 53–4 and accompanying text.
305 *Canada Trustco*, supra note 55 at para. 13.
306 *Ludmer*, supra note 1 at para. 39; see text accompanying note 186.

provisions in accordance with their purposes. To the extent that the income tax endeavours to allocate tax burdens in a fair and reasonable manner, it follows that transactions that are deliberately designed to defeat the specific provisions that define these tax burdens necessarily contradict the object and spirit or purpose of these provisions. To interpret a provision broadly in order to foreclose the opportunity to avoid tax, therefore, is to interpret the provision in accordance with its purpose. So long as the purposes of the relevant provisions are reasonably determinable, therefore, interpretation along these lines does not contradict rule-of-law principles of certainty and predictability. Of course, this conclusion depends on the important assumption that the purposes of the relevant provisions are 'reasonably determinable' – both by taxpayers who are subject to the tax rules at issue and by courts which are responsible for their interpretation.

Given the detailed and complicated provisions of the ITA, it is impossible not to sympathize with Justice Iacobucci's conclusion that 'courts should not be quick to embellish the provisions of the Act in response to concerns about tax avoidance.'[307] On the contrary, to the extent that the purposes of these provisions are doubtful or obscure, it seems reasonable to conclude that courts should look to the text of the ITA to determine its meaning, and taxpayers should be able to rely on these textual interpretations. It is also easy to sympathize with Justice Iacobucci's conclusion that tax avoidance is best addressed by 'precise and specific' statutory rules promulgated by Parliament. Although judicial interpretations based on reasonably determinable understandings of statutory purposes may not violate the rule of law, they are not as certain and predictable as precise and specific statutory rules. For this reason, therefore, one might conclude that courts should interpret all statutory provisions narrowly, leaving the task of limiting or preventing tax avoidance to Parliament.

As the history of the income tax suggests, however, Parliament is not always able to craft 'precise and specific' rules 'with respect to any mischief to be prevented.'[308] On the contrary, as the transactions in *Antosko*, *Duha Printers*, *Ludmer*, and *Stewart* illustrate, the ingenuity of taxpayers and their advisors makes it impossible for Parliament to foresee every possible 'mischief' that may be devised. Although Parliament may subsequently amend the ITA to in order to prevent future tax avoidance of a particular kind, rule-of-law principles suggest that these amendments are almost never retroactive, allowing those who act quickly to profit from these transactions. Once enacted, moreover, these amendments invariably increase the complexity of the ITA, creating what Douglas Sherbaniuk appropriately described as a 'hopelessly complex,

307 Ibid.
308 Ibid.

unmanageable labyrinth'[309] that is incomprehensible to the vast majority of taxpayers who are subject to its rules.[310] Even more troubling is the very real possibility that Parliament may not respond, constrained by limited resources or political calculations that have little or nothing to with sound public policy.

In contrast, as Cass Sunstein explains, courts possess two important institutional characteristics that can justify a more 'aggressive' approach to statutory interpretation in certain circumstances, such as those involving unanticipated tax avoidance:

> First, the focus on the particular circumstances enables judges to deal with applications that no legislature, no matter how farsighted, could reasonably have foreseen. . . . Second, because of their independence and their deliberative capacities, courts have significant advantages over a legislature that may be influenced by parochial interests and is frequently responsive to momentary demand.[311]

For these reasons, therefore, it is often the case that courts, rather than legislatures, have a comparative institutional advantage when it comes to preventing unacceptable tax avoidance. Indeed, Parliament itself recognized this comparative institutional advantage when it enacted the GAAR in 1988.

That Justice Iacobucci did not recognize this comparative institutional advantage may, in part, reflect the characteristic humility for which he is so well known. It may also reflect a more optimistic assessment regarding the institutional abilities of the legislative and executive branches of the federal government. Above all, though, I expect that it reflected his deep conviction in a conception of the rule of law that emphasized judicial restraint, legal certainty, and individual liberty. Ultimately, his understanding of his proper role as a judge required him to reject 'the incertain and crooked cord of discretion' and apply 'the golden and straight metwand of the law.'

V *Conclusion*

Although one might disagree with Justice Iacobucci's approach to tax statutes and the conception of the rule of law on which it was based, it is impossible not to admire the conviction with which he held this view about tax law, the consistency with which he applied this view in his tax judgments, and the clarity with he expressed this view in his reasons. One must also admire his ability to persuade his fellow members of the

309 Sherbaniuk, 'Tax Avoidance,' supra note 22 at 439.

310 Stephen W. Bowman, 'Interpretation of Tax Legislation: The Evolution of Purposive Analysis' (1995) 43 Can.Tax J. 1167 at 1184.

311 Sunstein, 'Interpreting,' supra note 274 at 439–40.

Court to adopt his views about tax statutes – an ability that clearly attests to the strength of his convictions and to the consistency and clarity with which they were expressed. As this paper has demonstrated, the tax decisions that Justice Iacobucci authored during his years at the Supreme Court of Canada transformed Canadian tax jurisprudence. It was a remarkable achievement.

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