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ASSESSMENT AND COLLECTION OF CORPORATE INCOME TAX IN QUEBEC, ONTARIO AND ALBERTA - THE PROBLEMS OF AN INDEPENDENT APPROACH IN A FEDERAL JURISDICTION

by

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ABSTRACT

Seven provinces in Canada have entered tax collection agreements with the federal government whereby that government collects corporate income tax on their behalf. Quebec, Ontario and Alberta have not entered such agreements and levy and collect corporate income tax pursuant to their own legislation and within their own administrative systems.

This thesis will examine the problems resulting from the independent approaches taken by Quebec, Ontario and Alberta, as they affect the corporate taxpayer. The problems fall into three categories. First, provincial adoption of the Income Tax Act (Canada), while assuring some similarity between the federal and provincial systems, can have adverse consequences for the corporate taxpayer. Secondly, differences between the legislation of Canada, Quebec, Ontario and Alberta create inconsistencies that present difficulties for the corporate taxpayer. Thirdly, differences in the administrative systems of the three provinces and the federal government increase the cost to the corporate taxpayer and create compliance problems for it.

The thesis concludes that the future of the Canadian corporate income tax system will involve even more provincial independence and, therefore, measures to alleviate some of the problems are discussed. These include a new approach to co-operative federalism, an examination of the efficacy of more provincial autonomy and tax harmonization. This analysis shows that the corporate taxpayer would benefit from more co-operation between the federal and provincial governments together with a degree of harmonization of the tax bases.

TABLE OF CONTENTS

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CHAPTER I

OVERVIEW OF CORPORATE INCOME TAX IN CANADA

A. Introduction

Two indisputable facts emerge when the system of levying and collecting corporate income tax in Canada is examined. First, corporate income tax is an indispensable form of revenue for all governments. It is the second largest source of tax revenue for the federal government and the fourth largest for the provinces.[1] Secondly, over 75 per cent of corporate taxable income earned in Canada is earned in the three provinces that do not subscribe to a common system of corporate income taxation.[2] The question is what effect do these facts have on a corporate taxpayer in a federal jurisdiction that includes eight other participants?

Fiscal federalism in Canada has become a popular topic for comment by both economists and political scientists.[3] Its popularity is evidenced by the appointment in 1981 of a Parliamentary Task Force to report on Federal-Provincial Fiscal Relations in Canada.[4] That Task Force was charged with examining:

> [T]he programs authorized by the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, focusing, in particular, on fiscal equalization, the tax collection agreements, the Canada Assistance Plan, and Established Programs Financing.[5]

While the Task Force rather daringly likened its report to that of the Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois Commission),[6] there is no doubt that it was not so extensive in its examination of nor so novel in its solution to the problems. Nevertheless its. recommendations were timely, if somewhat predictable. In the income tax area, it recommended a continuation of the present distribution of taxing powers and a continuation of the tax collection agreements with emphasis on fiscal harmonization achieved through consultation with all governments.

Inevitably, any report that examines the tax collection agreements also examines the arrangements of those jurisdictions that have not entered the federal-provincial tax collection agreements. In this regard, the Task Force is of the opinion that there has been, of late, a movement towards more provincial autonomy in the corporate income tax field.[7] The tax collection agreements are viewed by the provinces as a fetter on this provincial autonomy. The Task Force stated:

> Increasingly, however, provinces view the restrictions arising out of these arrangements as constraints on their ability to implement social or economic policies through selective tax measures.[8]

The report, however, is a political document tabled in the House of Commons and as such takes a political approach to the problems.

The purpose of this thesis is to examine one component of fiscal federalism, namely the corporate income tax system. That examination will be made from a legal perspective rather than an economic or political one. It will concentrate on the problems faced by the corporate taxpayer and will be restricted to the problems presented by the legislation of the three provinces which do not permit Ottawa to administer their corporate income tax systems. The different tax bases and tax systems will be analysed. Specifically, this analysis will focus on three main issues. First, a look will be taken at the problems arising from the provincial adoption by Ontario and Alberta, and to a lesser extent by Quebec, of the Income Tax Act (Canada). Secondly, the problems resulting from differences between those three provinces' legislation and the federal legislation will be analysed. Thirdly, administrative difficulties that occur when a corporate taxpayer has to comply with the administrative requirements of more than one system will be highlighted. Finally, three potential courses open to the federal and provincial governments to improve the system and thereby the lot of the corporate taxpayer will be examined.

As mentioned, the approach will be one of analysis of the legislation and legal difficulties posed by that legislation. Despite this, it must not be forgotten that there are many other factors that affect the direction and content of Canada's corporate income tax system. They are, most notably, factors of a political, economic and social nature that are not easy to grasp let alone change with a view to overall improvement of the system. This thesis will ignore virtually all those other factors and restrict itself to a legal interpretation of the problems and solutions.

B. Historical background

It is somewhat fitting that Quebec was the first province after Confederation and enactment of the British North America Act[9] 1867, to levy a tax on corporations. As will be seen Quebec has, with the exception of a short period in the early 1940s, consistently pursued its own independent course in the taxation of the corporation. The passage, in 1875, of An Act to compel Assurers to take out a Licence[10] involved a novel form of taxation. Despite its name, that Act imposed a tax based on corporate income. An assurer was bound to purchase a licence to sell assurance and the price of that licence was a percentage of the premiums received by the corporation from sales of assurance policies. The life of that Act was, however, short. It was held ultra vires the province of Quebec by the Privy Council in Attorney-General for Quebec v. Queen Insurance Company[11] on the basis that it was a Stamp Act because the fee was paid by fixing postage stamps to the policies in the required amounts. As such it was an indirect tax and thus not within provincial powers under subsection 92(2) of the B.N.A. Act, 1867.

Undeterred by this decision Quebec, in 1882, enacted An Act to impose certain direct taxes on certain commercial corporations.[12] That legislation imposed a tax on the income of banks and insurance companies carrying on business in Quebec and was held valid by the Privy Council in Bank of Toronto v. Lambe.[13]

The distinction of imposing the first valid tax on corporations belongs to British Columbia. In 1876 the province enacted The Assessment Act[14] which imposed a tax of "one-half of one per cent on the income of every person of $1,500 and over".[15] Today in Canada every province imposes a corporate income tax and five provinces impose a tax on corporation capital.[16] It is important to be aware of the progression over the years towards this state of affairs because those events help to explain the disparate approaches taken to corporate taxation today by the federal government and the provinces, especially Quebec, Ontario and Alberta.

By the early 1900s three provinces were levying corporate income tax.[17] They were soon followed in 1916 by the federal government which imposed, effective January 1, 1915, a business profits war tax.[18] The tax was a 25 per cent tax on the profits of incorporated businesses to the extent that those profits exceed 7 per cent of the capital of the business. It marked a departure from custom for the federal government for until this Act was passed, the Canadian war effort had been supported by revenues raised from bonds and taxes on consumer items. This tax lasted until 1920[19] but it was not the only tax that was the product of World War I. In 1917 the federal parliament passed the Income War Tax Act,[20] the forerunner to today's federal Income Tax Act and the foundation on which income tax law in Canada has been built and expanded upon over the years. The Act specifically included corporations and a 4 per cent tax was levied on corporate profits.[21] At the time of introduction of this Act the Minister of Finance said:

> I may say that the adoption of such a measure is a distinct innovation in federal fiscal legislation. Hitherto we have relied upon duties of custom and of excise, postal rates and other miscellaneous sources of revenue.[22]

An innovation it was, but one that despite its temporary sounding title has been around ever since.

By 1939 all nine provinces[23] were levying taxes on corporate profits in amounts ranging from 1 per cent on the first $1,000 in British Columbia[24] to a top rate of 10 per cent in Manitoba.[25] The federal government levied a 15 per cent tax on corporate profits. The result was chaos. In 1937 the federal government had attempted to alleviate this choas when it appointed the Royal Commission on Dominion Provincial Relations (the Rowell-Sirois Commission) to determine, among other matters, "whether taxation as at present allocated and imposed is as equitable and as efficient as can be devised".[26] That Commission illustrated the problems that the existing federal and provincial corporate tax regimes presented when it said in its report issued in 1941:

> There are, in addition, taxes levied by one or more governments, on various bases such as capital stock, number of business places, gross revenue, physical volume of output, period of operation, mileage of track or wire, mileage operated, note circulation, insurance premiums, investments, volume of deposits. These taxes apply on different terms to banks, chain stores, electric power companies, fire insurance companies, accident and guarantee companies, and 'miscellaneous' companies. They have grown up in a completely unplanned and unco-ordinated way, and violate every canon of sound taxation.[27]

The Commission's recommendation was that the provinces should only tax a corporation in respect of its business in the same way that an individual was taxed, that is taxation based on income. The federal government should increase its taxation of corporations to compensate for the overall loss of revenue incurred as a result of withdrawal of the provinces from the other forms of corporate taxation. It is interesting to note that despite the unhappy fate of these recommendations at the time they were made, today's Canadian corporate tax system is not dissimilar in structure to this recommendation.[28] However, in 1941 Canada required immediate revenues to finance its war effort and thus the Minister of Finance did not wait for provincial agreement on the recommendations. The government went one step further than the Commission had suggested and persuaded all nine provinces to enter Wartime Tax Agreements whereby the provinces vacated the field of personal and corporate income tax and other corporate taxes in return for payments from the federal government.[29] Thus from September 1, 1941 to August 31, 1947 Canada had, for the first and last time in its history, a uniform corporate tax on income and excess profits payable to only one government. Unfortunately for Canadian corporations once the wartime tax agreements expired things were never this simple again.

On the expiry of the agreements both Quebec and Ontario chose to go their own ways in the taxation of the corporation. While all other provinces, including Newfoundland in 1949, entered tax agreements with the federal government whereby the federal government collected a 5 per cent tax on corporate incomes for those provinces,[30] Ontario and Quebec imposed their own corporate income tax.[31] Both taxed corporate income at 7.5 per cent and imposed miscellaneous taxes of 1.5 per cent.

The pattern for the future was established and continued with minor variations until January 1, 1981 when Alberta began to administer its own corporate tax system.[32] During the intervening years Ontario had briefly re-entered the federal fold when it permitted the federal government to collect all income taxes on its behalf from 1952 to 1956. When new tax agreements were entered into between the federal government and all provinces except Quebec in 1957, Ontario returned to its own system of corporate taxation. The variations that have occurred over the years mainly centre on the federal government's system of abatement of a percentage of federal tax in lieu of provincial tax payable. That system was introduced in 1957[33] and applied to tax paid by corporations to both agreeing and non-agreeing provinces. At that time the federal abatement was 9 per cent and Quebec corporate taxpayers were paying tax at the rate of 11 per cent.

New federal-provincial taxation agreements were entered into in 1961,[34] 1967,[35] 1972[36] and 1977[37] and today Ottawa collects corporate income taxes for 7 provinces while Quebec , Ontario and Alberta levy and collect their own corporate income tax.[38] Those seven provinces all have the same tax base but their rates vary.[39]

Why did Quebec, Ontario and Alberta opt out, at different times, from a corporate income tax system administered by the federal government? As will be seen, each province gave different reasons for its decision. Both Quebec and Ontario refused to enter the tax agreements of 1945 that were negotiated at the Federal-Provincial Conference on Reconstruction.

Quebec went to that conference armed with a document entitled a Memorandum Submitted to the Dominion-Provincial Conference. That document made it clear that Quebec objected strenuously to the federal proposals. In it M. Duplessis, Prime Minister of Quebec, said:

> The Financial proposals of the Dominion Government tend to replace the system of fiscal autonomy of the Provinces, in the field of taxation, by a system of grants that would allow the Dominion Government to exercise over them a financial tutelage control. Such a system is incompatible with their sovereignity. Moreover, these proposals exclude the Provinces from the most important field of direct taxation and to that extent deprive them of the exercise of the powers assigned to them by the constitution.[40]

Yet, encroachment on the fiscal autonomy of Quebec was not that province's only concern. In subsequent statements made in the Quebec Legislature, the Treasurer indicated that Quebec felt that the proposed tax rental system struck at the heart of Confederation by favouring certain provinces over others. He added that Quebec, under the federal proposal, would receive less money per person from the federal government than any other province.[41] This was probably the key issue. Quebec felt that financially it could do better on its own and thus went its own way in both the corporate and personal income tax fields.

Ontario expressed its dissatisfaction with the proposed fiscal arrangements at the 1945 meeting by countering with its own set of proposals. In the corporate tax field Ontario agreed that the federal government should be the collection agent for the provinces. The difference of opinion with the federal government arose over the allocation formula. Premier Drew of Ontario requested an allocation formula based on sales alone and not on gross incomes together with salaries and wages.[42] Ontario's alternative proposals were rejected by both the federal government and several of the provinces who no doubt felt that an allocation formula based on sales alone would favour the well populated provinces at the expense of the less populated provinces. However, the main cause of concern to Ontario seems to have been the belief that the amounts to be paid by the federal government to rent the provincial income tax fields were not sufficient nor certain enough. Premier Drew said:

> I can only say that the rigid position of the Dominion government, the fact that it says, 'Here is what you are going to get although we may possibly make certain adjustments within that amount', makes agreement impossible.
>
> From the very first time we came here I have said that an agreement is absolutely essential. There will be only one reason why this conference breaks down and we do not get an agreement, namely, that rigidity which says, 'Here is the total amount: you sit around the table and divide it up'.[43]

In light of this rhetoric it is little wonder that no agreement was reached and in 1947 Ontario enacted its own Corporations Tax Act.

Alberta's progression towards independent control of its corporate tax system was very different from the events in Ontario and Quebec. Alberta entered all the federal-provincial tax collection agreements up until 1981. Effective January 1, 1981 the tax collection agreement between Alberta and the federal government was amended to exclude corporate income tax and Alberta enacted the Alberta Corporate Income Tax Act. There had been no obvious public disagreement at federal-provincial fiscal conferences between Alberta and the federal government although Alberta had expressed its concern over the federal government's White Paper on tax reform issued in 1970. On April 2, 1974 Premier Lougheed announced in the Alberta Legislature that Alberta was giving notice to the federal government of its withdrawal from the tax collection agreement in respect of corporate income tax.[44] He continued that Alberta would pursue its own course in that field. Basically, Premier Lougheed argued that the national corporate tax structure was not sensitive to the needs or objectives of Alberta. He summed up Alberta's view of the current arrangements this way:

> There is insufficient scope for a provincial government to develop a different definition of the tax base in order to meet particular and unique circumstances. There is no scope to redefine income, provide incentives or to levy differential rates of provincial taxation.[45]

After this announcement in 1974 there were meetings between representatives of the Alberta and federal governments to ascertain whether Alberta's move could be headed off. Despite some federal concessions, including permitting provincial rebates and credits where their calculation followed the federal determination of taxable income, the last straw seems to have been the federal government's refusal to administer the Alberta rental investment credit.[46] Thus, in 1981 Alberta began levying and collecting provincial corporate income tax.

C. Constitutional framework

No historical view of corporate income taxation would be complete without a brief examination of the constitutional framework within which federal and provincial taxation powers are exercised. The federal government's taxing power is exercised pursuant to subsection 91(3) of the Constitution Act, 1867.[47] That subsection grants the federal parliament powers with respect to "the raising of Money by any Mode or System of Taxation". The provincial Legislatures derive their taxing powers from subsection 92(2) of the Constitution Act, 1867 which allows them to make laws in relation to "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes". It is clear that the levying of corporate income tax comes within the scope of both these powers.[48]

With respect to the provincial powers in this area, it should be noted that the tax has to be direct. There is no question about the directness of income tax. It fits squarely within the definitive description of a direct tax given by J. S. Mill. He said:

> Taxes are either direct or indirect. A direct tax is one which is demanded from the very person who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another; such are excise and customs.[49]

This description has formed the cornerstone on which all judicial deliberation on the directness or indirectness of a provincial tax has been founded.[50] It was first raised in Attorney-General of Quebec v. Reed[51] and, although not an integral part of that decision, it was adopted in Bank of Toronto v. Lambe[52] and applied to hold "an act to impose certain direct taxes on certain commercial corporations" valid. Since that decision provincial corporate income tax has been recognized as a valid provincial tax provided that it meets the other requirements of subsection 92(2).

Taxation within the province has been held to include direct taxation of property, transactions or benefits acquired even though the taxpayer may reside outside the province.[53] This principle was upheld in Alworth v. Minister of Finance[54] where a logging tax imposed by British Columbia was held not to be restricted to persons residing in the province but to be payable in respect of income derived from logging activity in the province. Therefore provincial corporate income tax legislation that taxes on the basis of permanent establishment is valid.

Any constitutional examination of taxation powers in Canada is inevitably coloured by the operation of the taxation agreements. These agreements place taxation in a unique position since they contemplate a division of the fiscal powers that is independent of the written constitution. They are not entered into pursuant to any specific power in the Constitution Act, 1867 and have been said to be no more than a "gentleman's agreement".[55]

The fact that these agreements are not enforceable pursuant to any principles of constitutional law is evidenced by the resolution of a dispute that arose in 1944 between the federal government and the government of Saskatchewan over a seed grain debt. The federal government refused to pay to the province money promised under the Wartime Tax Agreement Act because a debt owing by Saskatchewan in respect of seed grain had not been paid. The Arbitration Board appointed to hear the dispute held by a majority that there was nothing illegal in the federal government's action.[56] They held that the federal government could set off the seed grain debt owing against the payments due and, inter alia, that the agreement was not legally enforceable against the federal government in respect of this issue. Even though the decision turned on the plea of setoff, it does illustrate the tenuous nature of taxation agreements. Their enforcement is dependent on the rules of contract law and not on any inherent constitutional right.

Yet despite their lack of any constitutional basis, taxation agreements are an integral part of the taxation system in Canada. Their negotiation and operation has dominated Canadian taxation since the 1940s and they play a major role in the taxation of corporations.

Finally, because the taxation powers of the provinces and parliament under the Constitution Act, 1867 are interdependent of each other there is no constitutional objection to double taxation. Thus a corporation may be required to pay tax to both the federal and provincial governments. In Forbes v. Attorney-General of Manitoba[57] Lord MacMillan, when considering federal and provincial income tax legislation, put it this way:

> Both income taxes may co-exist and be enforced without clashing. The Dominion reaps part of the field of the Manitoba citizen's income. The Province reaps another part of it.[58]

D. Provincial corporate income tax

Examination of provincial corporate income tax legislation in Canada reveals that three different approaches to the levying and collection of corporate income tax have been taken by the provinces. One approach is that taken by Ontario and Alberta. These provinces incorporate sections of the

Income Tax Act (Canada) in their provincial corporate income tax legislation. Quebec, on the other hand, takes a different approach. It has enacted a corporate income tax statute that makes no reference at all to the federal legislation. The final approach is that taken by the other seven provinces. They levy a corporate income tax based on taxable income as calculated under the Income Tax Act (Canada). A brief look at the form and content of the provincial legislation used in these disparate approaches is necessary before taking a critical look at the ramifications of and problems presented by Quebec, Ontario and Alberta's corporate income tax legislation.

(i) Ontario and Alberta

Both Ontario and Alberta have enacted legislation that is based on the Income Tax Act (Canada).[59] The framework of the corporate income tax system in both those jurisdictions is provided by the Income Tax Act (Canada). That framework is then supplemented and tailored to meet specific provincial needs by the provincial legislation. Thus, the provincial legislation is read in concert with the federal legislation. The reasons for taking this approach and the problems associated with it will be discussed later. At this stage, however, an analysis of the technique used by Ontario and Alberta to adopt the Income Tax Act (Canada) and combine it with their own legislation is useful.

Both Ontario and Alberta open their corporate income tax legislation with a series of application rules designed to ensure incorporation of the federal provisions with no resulting ambiguity or uncertainty. Thus, most of the interpretations contained in Part XVII of the Income Tax Act (Canada) are adopted without change and made applicable for the purposes of the provincial legislation.[60] The most critical rules are those that deal with the applicability of sections of the Income Tax Act (Canada) that are not specifically incorporated in the provincial legislation but that are referred to in provisions of the federal legislation that are incorporated. These ground rules are crucial to the successful operation of a statute that relies on another statute for the majority of its substantive provisions. Basically, both Ontario and Alberta provide that where a reference is made in an adopted section of the Income Tax Act (Canada) to an unadopted section of that Act, then unless there is a provincial provision equivalent to or enacted in lieu of the unadopted section the adopted federal section is to be read as though the reference to the unadopted section were deleted.[61]

Some of the other basic interpretive rules deem acts done pursuant to the federal legislation to also be acts done for the purposes of the provincial legislation. For example, references in the Income Tax Act (Canada) to returns or assessments required or made under that Act are deemed to be references to returns or assessments under the provincial legislation.[62]

Ontario and Alberta differ in their treatment of regulations made under the Income Tax Act (Canada). Alberta makes all regulations made pursuant to the Income Tax Act (Canada) applicable for provincial purposes.[63] Therefore as soon as a regulation is enacted and published in the Canada Gazette it automatically applies to Alberta's corporate income tax system. There are two exceptions to this rule. Adoption is automatic unless Alberta provides by its own regulation that it is not applicable or unless the federal regulation is inconsistent with an existing regulation made under The Alberta Corporate Income Tax Act. Ontario takes the opposite approach in that rather than automatically adopting all federal regulations, it provides a mechanism to adopt only those federal regulations that the province requires.[64] The technique is different but the result is the same. Both jurisdictions use federal regulations made under the Income Tax Act (Canada) in the administration of their corporate income tax systems.

Both Ontario and Alberta base the computation of income for the purposes of calculating corporate income tax payable on the federal Act. Ontario makes sections 3 and 4 of the Income Tax Act (Canada) applicable to its Act.[65] Therefore it adopts, with only minor editorial changes, the federal rules respecting calculation of income and income or loss from a source. Alberta also uses the federal rules although it does not adopt the federal sections but rather reiterates them in the text of its legisation.[66] Both provinces then proceed to make Division B of Part I of the Income Tax Act (Canada) applicable to their own legislation and thus incorporate many of the other federal rules respecting computation of income. They also, in different ways, make Division C of Part I of the Income Tax Act (Canada) respecting computation of taxable income applicable to their legislation.[67]

It is when income tax payable is computed that both Ontario and Alberta depart from the federal legislation. Both provinces impose a corporate income tax on a percentage of the "amount taxable" in the province.[68] In Ontario that is taxable income earned in Ontario less the deduction in respect of election contributions.[69] In Alberta amount taxable is taxable income earned in Alberta less the royalty tax deduction.[70] The income tax payable is then reduced by a series of deductions offered by each province. This is where both systems acquire their uniquely provincial characteristics. The incentives to business are provided by these sections and the desire to provide these incentives is one of the reasons often given by the two provinces for the decision to administer their own corporate income tax systems.[71]

Finally, both provinces set up their own administrative schemes for the collection of corporate income tax.[72] While these systems are similar to each other and to the federal administration they are administered by the respective provinces and therefore are not dependent on the federal administation or legislation for their operation. It is worth noting that despite the independent administrative systems some federal-provincial and interprovincial co-operation is anticipated. Both Ontario and Alberta's legislation permits communication between the province and the federal government or the government of another province in respect of information obtained under the respective provincial Acts.[73]

(ii) Quebec

1972 was an historic year in the history of Canadian taxation. That was the year that a new income tax system was implemented. It must not be forgotten that 1972 was also an historic year in the history of Quebec taxation. That year saw the enactment of The Taxation Act,[74] a statute that embodied a new income tax system for Quebec. Certainly, it was no coincidence that the Quebec tax reform took place at the same time as the federal tax reform. In fact the Quebec Minister of Finance, Raymond Garneau, announced in late 1971 in the National Assembly that one of the objectives of the Quebec tax reform was to bring Quebec tax law more into line with the federal system.[75] Thus, The Taxation Act, while not referring directly to the federal legislation as its predecessor legislation had,[76] paralleled the federal legislation in many ways.[77] The similarities between the two statutes and lack of direct reference to the Income Tax Act (Canada) was explained this way by Andre Gauvin, Deputy Minister in the Quebec Department of Revenue:

> You may wonder why Quebec wanted to have a separate Act, as complete as the federal Act. Would it not have been enough that Quebec, like the other provinces, pass a law which reproduced only the points on which it wanted to be different from the federal? Could it not have adopted the federal provisions either by referring to them mutatis mutandis or by reproducing textually in its own Act the provisions of the federal Act? We have asked ourselves these questions too.
>
> To begin with, several objectives had to be reconciled, some immediate and some long-term. Among immediate objectives, we wanted a statute which came as close as possible to the federal law, in order to meet the requirements and priorities of the government of our province.
>
> We also wanted a statute that would be as autonomous as possible, thus avoiding references to the federal Act. The law had to be drafted and structured so as to conform with the whole provincial legislation.[78]

Those two objectives could have proved rather difficult to achieve together since they tend to be in conflict with each other. Nevertheless, if one accepts provincial autonomy in the field as merely meaning the omission of references to the federal Act, then autonomy was achieved. The references to the federal Act appear in the regulations made under The Taxation Act and not in the body of the Act itself - a rather subtle distinction. This procedure enables Quebec to change the law based on the federal Act without resorting to legislative approval. An Order in Council signed by the Quebec Prime Minister and Lieutenant Governor is sufficient.

If one associates a greater degree of independence with provincial autonomy then the 1972 legislation would not meet that requirement. The wording may have been different, the structure of the Act was different[79] but the basic elements of the system were the same. The system in 1972 paralleled that of the federal government. Evidence of this was that at the time of enactment of the Quebec legislation 842 of the 922 provisions in The Taxation Act were to be found in one form or another in the Income Tax Act (Canada).[80] The definition of income in the Quebec legislation was the same as that contained in the federal Act and the inclusions, exclusions and deductions with respect to computation of income and taxable income were very similar to the federal ones.

Nevertheless, events since 1972 have resulted in the Quebec corporate income tax system becoming more provincial in nature. The 1977 Quebec Budget proposed changes to the system that prompted one commentator to note that "It is obvious from the last budget and the ministerial declaration that Quebec intends to reaffirm its autonomous right in direct taxation and intends to be less influenced by federal policies".[81] The changes proposed in 1977 included a redefinition of "taxable Quebec property" and changes in the calculation of Canadian exploration and development expenses by the resource industry.[82] Since that time there have been other changes that confirm the trend towards a more independent approach by Quebec towards corporate income taxation. In 1979 the meaning of "establishment", the basis on which corporate income tax is levied, was extended.[83] The 1981 Budget brought changes to the rules respecting non capital losses that put these rules at variance with the federal rules. A tax credit in lieu of the use of the losses is now available to corporations for the year in which the losses were incurred.[84]

Therefore Quebec appears to be slowly edging away from its past attachment to federal corporate income tax policy. The new approach seems to be less harmonization with the federal system and a more uniquely Quebec system. As we shall see, the further Quebec diverges from the federal system, the more problems that arise for the corporate taxpayer.

(iii) The seven other provinces

The third approach to corporate income taxation is that taken by British Columbia, Saskatchewan, Manitoba, Prince Edward Island, New Brunswick, Nova Scotia and Newfoundland. These seven "agreeing" provinces have entered tax collection agreements with the federal government and their corporate income tax is collected under those agreements by the federal government.[85] The tax collection agreements are entered into pursuant to the Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977[86] and the Income Tax Acts of the respective provinces. The agreements, due to expire in 1982, provide that the corporate income tax levied by the provinces shall be "expressed as a percentage of the taxable income of a corporation earned in the Province in the year".[87] Thus, all seven provinces have the same tax base although the rates vary.[88] The system appears to be a harmonious and uniform one. Yet appearances can be deceptive. While all seven provinces do express the tax payable by a corporation as a percentage of the taxable income, the federal government has been persuaded to administer various tax credits on behalf of some of the provinces.[89]

In 1974 the federal Finance Minister acknowledged this movement by the agreeing provinces away from a uniform corporate income tax system. John Turner said:

> I have come to the conclusion that where it is possible to permit provincial income tax systems to depart from strict conformity with the criteria we have previously insisted upon without distorting and damaging the over-all national system. I would be prepared to do so. This does not mean that I no longer consider the essential harmony of the federal and provincial tax systems as necessary. I certainly do. It simply means that we can now begin to consider relaxing the earlier conditions we insisted on in the tax collection agreement provided, in doing so, we do not jeopardize the main features of our tax system or overstrain the tolerance of taxpayers or the capacity of the tax collecting apparatus.[90]

An illustration of the lack of harmony between an agreeing province and the federal government in the corporate income tax area can be found in an examination of corporate income tax in British Columbia. Section 5(3) and (4) of The Income Tax Act[91] provides for a foreign tax credit in respect of foreign investment income. Section 7 provides for a small business tax rate of 8%. There is nothing too unusual about these two items as every other agreeing province grants a foreign tax credit and all agreeing provinces, except Prince Edward Island, provide a lower rate of tax for small businesses. However, British Columbia then goes on to provide three other "provincial" deductions. They are a deduction from tax payable in respect of logging taxes payable or paid,[92] a deduction in respect of political contributions[93] and royalty rebates for gas producers, oil producers and mining corporations.[94]

Not surprisingly, these types of provincial initiatives in an area administered for them by the federal government have led to some adverse comments by federal representatives. The Minister of Finance, Allan MacEachen criticized the provinces for their initiatives when he said:

> [T]he proliferation of special provincial income tax credits and other measures has complicated calculations for taxpayers and tax administration for Revenue Canada, thereby eroding the simplicity of the system.[95]

He concludes that special provincial incentive measures in the corporate income tax system lead directly to inter-provincial tax competition. This, in his opinion, is an extremely undersirable state of affairs.

Therefore all indications are that the federal government will not be so willing in the future to allow those provinces with which it has entered tax collection agreements to diverge from a certain degree of uniformity in the tax base. However the federal government has to measure its moves very carefully in this area. If it restricts the power of the provinces to individualize their own corporate income tax systems by the use of regional incentives, then the result may well be withdrawal from the tax collection agreements by the provinces. Certainly Alberta's recent withdrawal from the agreement in the corporate income tax area appears to be directly attributable to federal restrictions.[96] We are also seeing indications that the federal government will have to deal with a similar situation in British Columbia. In 1980 the British Columbia government asked the federal government to administer a dividend tax credit for British Columbia residents investing in British Columbia based corporations. The federal government refused to administer such a program. This led the British Columbia Minister of Finance to comment that British Columbia would "if absolutely necessary"[97] collect its own personal and corporate income taxes.

Thus there are three different approaches in Canada to the levying and collection of corporate income tax. This thesis is concerned mainly with the two different approaches taken by Quebec and both Ontario and Alberta. As a point of interest, these three provinces together account for over 75% of corporate taxable income earned in Canada.[98] Yet they are the three provinces that do not participate in the tax collection agreement system in respect of corporate income tax. This would suggest that any belief that the federal government may have that the Canadian corporate income tax system is well-coordinated and in harmony provincially is an illusion. The desire that "fiscal arrangements should seek to provide machinery for harmonizing the policies and priorities of the federal and provincial governments"[99] is commendable but, as will be seen, clearly not a fact of life in the present Canadian corporate tax system.

CHAPTER I - FOOTNOTES

1 R. W. Boadway and H. M. Kitchen, Canadian Tax Policy, Canadian Tax Paper No. 63, Canadian Tax Foundation (1980) at 98.

2 These provinces are Quebec, Ontario and Alberta. See Federal-Provincial Fiscal Arrangements in the Eighties, A Submission to the Parliamentary Task Force on the Federal-Provincial Fiscal Arrangements (1981) at 55-56.

3 Numerous articles have been written discussing fiscal federalism in Canada in the 1970s. For an economic view see, for example, Boadway and Kitchen, supra, note 1; R. M. Bird, Fiscal Dimensions of Canadian Federalism, Canadian Tax Foundation (1980). For a political scientist's point of view see Canadian Federalism: Myth or Reality (2nd ed.) ed. J. P. Meekison and Canadian Federalism: Myth or Reality (3rd ed.) ed. J. P. Meekison.

4 The Task Force was established on February 5, 1981 and submitted its report in August, 1981.

5 Fiscal Federalism in Canada, Report of the Parliamentary Task Force on Federal-Provincial Fiscal Relations (1981) at 1.

6 Ibid, 3.

7 Ibid, 41-42.

8 Ibid, 177.

9 30 & 31 Vict., c. 3 (Imp.).

10 S.Q. 1875, c. 7 (39 Vict.).

11 (1877-78) A.C. 1090.

12 S.Q. 1882, c. 22 (45 Vict.).

13 (1887) 12 A.C. 575.

14 S.B.C. 1876, c. 8 (38 Vict.).

15 Section 9(3) of The Assessment Act. It should be noted that "person" included a body corporate by virtue of section 8(13) of The Interpretation Act.

16 These provinces are Quebec, Ontario, Manitoba, Saskatchewan and British Columbia.

17 These were Quebec, British Columbia and Prince Edward Island. Prince Edward Island introduced its corporate income tax in 1894.

18 The Business Profits War Tax Act, 6-7 Geo. V, c. 11.

19 It was repealed effective December 31, 1920 by S.C. 1924, c. 10.

20 7-8 Geo. V, c. 28.

21 Section 4 of the Income War Tax Act.

22 Sir Thomas White, Canadian House of Commons Debates, July 25, 1917, 3760.

23 Newfoundland did not enter Confederation until 1949.

24 Section 21 of The Income Tax Act R.S.B.C. 1936, c. 280, as amended by S.B.C. 1938, c. 57.

25 The Corporations Taxation Act, R.S.M. 1924, c. 191, as amended by S.M. 1932, c. 49.

26 Royal Commission on Dominion-Provincial Relations Report (Rowell-Sirois Commission) Book I, 13.

27 Royal Commission on Dominion-Provincial Relations Report (Rowell-Sirois Commission) Book II, 113.

28 The obvious exception is the levying of a corporation's capital tax by five provinces.

29 For an in depth analysis of the tax rental agreements, see also R. M. Burns, The Acceptable Mean; The Tax Rental Agreements, 1941-1962, Financing Canadian Federation 3, (Canadian Tax Foundation, 1980).

30 These agreements were entered into under the authority of the Dominion-Provincial Tax Rental Agreement Act, S.C. 1947, c. 58.

31 An Act to amend The Corporations Tax Act, 1939 S.O. 1947, c. 19; The Corporation Tax Act, S.Q. 1947, c. 38.

32 The Alberta Corporate Income Tax Act R.S.A. 1980, c. A-17.

33 The Federal-Provincial Tax Sharing Agreements Act, S.C. 1956, c. 29.

34 The Federal-Provincial Fiscal Arrangements Act, 1961, S.C. 1960-1961, c. 58.

35 The Federal-Provincial Arrangements Act, 1967, S.C. 1966-1967, c. 89.

36 The Federal-Provincial Fiscal Arrangements Act, 1972, S.C. 1972, c. 8.

37 The Federal-Provincial Fiscal Arrangements and Established Programs Financing Act, 1977, S.C. 1976-1977, c. 10.

38 The federal government collects corporate income tax on behalf of Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, Manitoba, Saskatchewan and British Columbia.

39 The rates vary from a low of 10 per cent (excluding the small business deduction) in Prince Edward Island to a high of 16 per cent in British Columbia.

40 Dominion and Provincial Submissions and Plenary Conference Discussions, Dominion-Provincial Conference (1945) 353 at 362.

41 Hon. Onesime Gagnon, Treasurer of Quebec, Budget Speech, March 25, 1947.

42 Supra, note 40, at 242.

43 Supra, note 40, at 599.

44 Alberta Hansard, April 2, 1974, 888.

45 Alberta Hansard, April 2, 1974, 889.

46 Hon L. Hyndman, Provincial Treasurer, advised the Alberta Legislature that the federal government has refused to administer the Alberta MURB program and that this was a reason for withdrawing from the federal system, Alberta Hansard, May 13, 1980, 943.

47 This was formerly subsection 91(3) of the British North America Act, 1867, 30 & 31 Vict., c. 3 (Imp.).

48 See generally, G. V. LaForest, The Allocation of Taxing Powers under the Canadian Constitution, Canadian Tax Paper No. 65 (2nd ed. 1981).

49 J. S. Mill, Principles of Political Economy, Book V, (1848), at 418.

50 Mills' definition has appeared with unfailing regularity in all decisions of the Privy Council and the Supreme Court of Canada on the issue of direct and indirect taxation. See, for example, Attorney-General of Quebec v. Reed (1884) 10 A.C. 141; Atlantic Smoke Shops v. Conlon [1943] A.C. 550; Simpson-Sears Ltd. v. Provincial Secretary of New Brunswick 20 N.B.R. (2d.) 478 and Canadian Industrial Gas and Oil Ltd. v. Government of Saskatchewan [1977] 6 W.W.R. 607.

51 (1884) 10 A.C. 141.

52 (1887) 12 A.C. 575.

53 R v. Lovitt [1912] A.C. 212; Alleyn v. Barthe [1922] 1 A.C. 215; International Harvester Co. v. Provincial Tax Commission [1949] A.C. 36.

54 [1978] 1 S.C.R. 447.

55 F. R. Scott, The Constitutional Background of Taxation Agreements (1955) 2 McGill L.J. 1.

56 In re Taxation Agreement between Government of Saskatchewan and Government of Canada 1946 1 W.W.R. 257.

57 [1937] A.C. 260.

58 Ibid, 274.

59 The Corporations Tax Act, R.S.O. 1980, c. 97; The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17.

60 The Corporations Tax Act, R.S.O. 1980, c. 97 s. 1(1); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 1(1).

61 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 1(2)(d); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17 s. 2(1), (2) and (3).

62 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 1(2)(c); The Alberta Corporate Income Tax Act; R.S.A. 1980, c. A-17, s. 2(5).

63 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 56(2).

64 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 1(3).

65 The Corporations Tax Act, R.S.O. 1980, c. 97, ss. 9 and 10.

66 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, ss. 6 and 7.

67 The difference is that Ontario adopts Division C of Part I of the Income Tax Act (Canada) with only minor changes and then expands its operation by adding its own provisions dealing with the deductibility of election contributions. Alberta does not adopt Division C of Part I in whole but does make sections 110, 111, 112 and 113 applicable and expands their operation with the inclusion of the royalty tax deduction as a factor in determining the amount taxable in Alberta.

68 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 30; The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 21.

69 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 30.

70 The Alberta Corporate Income Tax Act, R.S.A. 1980 c. A-17, s. 20(2).

71 See, Premier Lougheed of Alberta, Ministerial Statement to the Alberta Legislature, April 2, 1974 reported in Alberta Hansard, April 2 1974, 888 when he outlined the special needs of Alberta corporations for their own incentives in tax legislation.

72 The Corporations Tax Act, R.S.O. 1980, c. 97, Part V; The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, Part 8.

73 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 91(3); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 77(4).

74 S.Q. 1972, c. 23.

75 See, Guy Dube, A New Phase in Quebec: Tax Evolution (1978) 26 Can. Tax J. 123.

76 The Corporation Tax Act, R.S.Q. 1964, c. 67; The Logging Tax Act, R.S.Q. 1964, c. 68; The Provincial Income Tax Act, R.S.Q. 1964, c. 69.

77 See also, for an analysis of the similarities and differences between the two statutes in 1972, Jacques Raymond, Quebec Tax Developments, Report of Proceedings of the Twenty-Fifth Tax Conference (1973), Canadian Tax Foundation, 528.

78 *Ibid* at 539-540.

79 *Supra,* note 77.

80 Robert Bertrand, Understanding Quebec Tax Laws, 1973 Meredith Mem. Lect., 8.

81 *Supra,* note 75, at 131.

82 An Act to amend the Taxation Act, S.Q. 1977, c. 26.

83 An Act to amend the Taxation Act, S.Q. 1979, c. 18.

84 Tax Highlights of the 1981 Budget, Quebec Tax Reporter, Vol. 2, 11641.

85 The two territories have also entered tax collection agreements with the federal government. The Northwest Territories entered an agreement in 1978 and the Yukon Territory entered an agreement in 1980.

86 S.C. 1976-77, c. 10, s. 7.

87 This phrase is contained in all the tax collection agreements entered into between the federal government and the provinces.

88 The corporate income tax rates, as of June 1982, are as follows:

	Corporate rate	Small Business rate
Newfoundland	15%	12%
Prince Edward Island	10%	-
Nova Scotia	13%	10%
New Brunswick	14%	9%

Manitoba	15%	11%
Saskatchewan	14%	10%
British Columbia	16%	8%

89 See, Fiscal Federalism in Canada, Report of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements, August 1981, at 41.

90 Hon. John Turner, Minister of Finance, Federal-Provincial Meeting of Ministers of Finance and Provincial Treasurers, January 1974, quoted in Federal-Provincial Fiscal Arrangements in the Eighties, A Submission to the Parliamentary Task Force on the Federal-Provincial Fiscal Arrangements, (1981) at 53.

91 R.S.B.C. 1979, c. 10.

92 Ibid, s. 6.

93 Ibid, s. 8.1.

94 Ibid, s. 8.

95 Supra, note 2, at 53.

96 Supra, note 71.

97 Hon. Hugh M. Curtis, British Columbia Budget, March 1981, at 31.

98 Supra, note 2, at 55-56.

99 Hon. Mitchell Sharp, Minister of Finance, Federal-Provincial Tax Structure Committee (Ottawa: Queen's Printer, 1966).

CHAPTER II

PROBLEMS PRESENTED BY PROVINCIAL ADOPTION OF THE INCOME TAX ACT (CANADA)

Both Ontario and Alberta directly incorporate certain provisions of the Income Tax Act (Canada) into their corporate income tax statutes. Quebec incorporates certain provisions of the federal Act into its regulations made under the Taxation Act.[1] It has long been acknowledged that referential legislation, that is legislation that adopts and, in some instances, adapts statutory provisions of another jurisdiction, is valid legislation.[2] In fact, the technique of adopting legislative provisions by reference has been traced back to the thirteenth century when the Statute of Westminster, 1285 adopted terms from the Statute of Malborough, 1267.[3]

A. Referential Legislation

Concern over referential legislation is not based on the legal validity of such legislation. Rather, the concern arises over more prosaic matters. A statute that adopts provisions of another statute is meaningless when read on its own unless the reader is familiar with the text of the adopted statute. Conversely, without referential legislation our statute books would be considerably thicker than they are at present. The draftsman's argument in favour of referential legislation is that the text of an adopted provision may have an established meaning that is automatically extended to the adopting legislation when the provision is referred to. The tax practitioner could well argue in reply that repetition of the words of the provision would not affect the established meaning and would certainly make the statute easier to read.

Obviously, the final decision as to whether or not referential legislation will be enacted is made by the politicians. In the corporate income tax field both Ontario and Alberta chose to enact referential legislation while Quebec deliberately chose to restrict the use of references to federal legislation to its regulations.[4] One reason the politician would favourably consider referential legislation would be to restrict the time spent debating and enacting legislation that had already been debated and enacted, albeit in another forum or another context. There is no doubt that legislation by reference is a particularly expedient method of enacting tax legislation. In an area that is so technical and exacting resort to references to existing principles and concepts tends to be welcomed by both the draftsmen and the politicians.

A more cynical view of referential legislation would be that the true ramifications of such legislation are well hidden when other legislative provisions are incorporated but not repeated word for word. There tends to be no debate of, nor publicity attached to, provisions of another jurisdiction's legislation adopted by reference. Certainly this is a valid complaint in respect of legislation of a controversial nature. Whether tax legislation is controversial or just merely unpopular is a matter of opinion.

The one legal issue that does arise when considering referential legislation is a question that touches on the area of delegation. If the adopting legislation refers to other legislation as it reads at the time of adoption and as it may read in the future then is that a delegation of authority by one jurisdiction to another and ultra vires the jurisdiction that incorporates the legislation? Before pursuing this issue, the difference between referential legislation and delegatory legislation should be examined. It has been described this way:

> In the case of referential legislation each legislature acts independently in the exercise of its own legislative authority; in the case of delegation, the authority to enact the legislation to be incorporated is derived from the other legislature and cannot stand on its own feet.[5]

The argument can be made that by adopting legislation that is subject to change in the future by another legislative body the adopting jurisdiction has granted the power to amend its legislation to that other legislative body. The authority to enact legislation that will be incorporated no longer lies with the adopting jurisdiction because the amendments of the other jurisdiction will automatically apply to the legislation of the adopting jurisdiction. The adopting jurisdiction does not have the power to amend the legislation referred to and therefore an invalid delegation of power has occurred. This view of anticipatory adoption of legislation has been approved by several writers in the past.[6]

The issue of whether or not anticipatory adoption of legislation is valid arises when considering the corporate income tax legislation of Ontario and Alberta. Both provinces provide in their corporate income tax legislation that all references to the Income Tax Act (Canada) are references to that

Act as amended from time to time.[7] Does this represent a delegation of power to the federal parliament?

The answer appears to be no. Certainly, in the past, there was considerable doubt about the validity of such legislation R v. Fialka[8] the Ontario Court of Appeal held that legislation that adopted other statutory provisions "as amended or re-enacted from time to time" intra vires the province but only in respect of amendments prior to enactment of the adopting statute. The court reserved judgment on the validity of adoption of subsequent amendments. The issue was dealt with squarely in R v. Glibbery [9]where the Ontario Court of Appeal held that federal regulations that incorporated by reference provincial law respecting highways included any future amendments to those laws even though the regulations did not specifically so provide. McGillivray J.A. said:

> Parliament could validly have spelled out in its own regulations the equivalent of relevant sections of the Highway Traffic Act as they existed from time to time but it was more convenient to include them, as has been done, by reference to contemporary legislation in the Province. There should be no objection to delegation of this type made for a valid Federal purpose to save repetition in its own regulations of valid Provincial legislation.[10]

The issue appears to have been well settled.[11]

There is no question that adoption of sections of the Income Tax Act (Canada) by reference is legitimate. On the other hand it is clear that a delegation by the province of its taxing powers to the federal government would be ultra vires the province.[12] Therefore care must be taken to ensure that the adopting legislation is worded in such a way that it is clearly incorporation by reference and not a delegation. This point arose in R v. Zaslavsky[13] when the Saskatchewan Court of Appeal held a purported adoption by reference of the federal Livestock and Livestock Products Act by the Saskatchewan Livestock and Livestock Products Act was in fact not an adoption by reference but was a delegation by Saskatchewan to the federal government of a power that the federal Parliament would not otherwise have had. It has been suggested that the reason for the decision was that "the apparently intended referential section was so clumsily written that the majority could not construe it as being other than an attempt at delegation and struck it down."[14] The same cannot be said of Ontario and Alberta's adoption of the federal sections. It is clear, direct and explicit in its intention and purpose.

B. Application rules - the price to be paid for simplicity?

> To say that one is in favour of tax simplification is tantamount to stating that one is in favour of good as opposed to evil or to stating that one favours equity and neutrality in a tax statute. Everyone favours simplicity and clarity, but the question which must be faced up to is the cost and possibility of obtaining simplicity.[15]

One can certainly make a case for the proposition that adopting legislation by reference contributes to tax simplification. Adopted sections usually come with given and well-understood meanings. This, in the area of tax law, provides certainty for the practitioner and to a certain extent eliminates the complexity normally associated with income tax legislation. Most users of provincial tax legislation are familiar with the adopted provisions of the Income Tax Act (Canada) and therefore do not have to interpret these provisions from scratch. A reference to section 87 of the federal Act immediately conjures up visions of the myriad of rules respecting amalgamation of corporations. Existing knowledge can be used, thus simplifying the interpretive and application processes.

A jurisdiction that wishes to adopt the laws of another jurisdiction has three options. It can incorporate those laws referentially, reproduce them word for word or rewrite those laws in a new manner. Quebec chose to rewrite the federal corporate income tax laws in a new manner and, in the opinion of some, that decision has resulted in a clearer set of rules.[16] Yet, while the law is clear and may be simpler, the certainty of interpretation is lost. A rewritten provision does not carry the guarantee that it will be interpreted in the same manner as the original section.

Word for word reproduction of provisions presents its own problems. Alberta has taken this approach in its adoption of the computation of income rules found in sections 3 and 4 of the Income Tax Act (Canada). Sections 6 and 7 of The Alberta Corporate Income Tax Act reproduce the federal rules. However, the problem arises when the sections reproduced are not reproduced exactly word for word. Alberta, in its reproduction of the federal sections has omitted references to income from office or employment because Alberta's legislation is restricted to corporate income tax. This leaves room for the argument to be made that Alberta's section is not to be interpreted in the same manner as the federal section because it is different. In addition, because Alberta adopts so many other sections of the federal Act, some with change, an argument can be made that in this instance it did not adopt sections 3 and 4 of the Income Tax Act (Canada) because it wished to express something different. The simplicity of the legislation is not enhanced by this kind of uncertainty.

Therefore, adoption by reference has become an acceptable technique. Yet, there is a price to be paid for this approach. What at first glance may appear to result in a straightforward, simple expression of the law can turn into a complicated and somewhat incoherent legislative document. The reason - those rules of application without which all adopted provisions would be meaningless.

Both Ontario and Alberta use two different kinds of application rules. Each province opens their corporate income tax legislation with general rules that determine how the adopted federal provisions are to be applied. Then, scattered throughout both provinces' Acts are specific rules of application that deal only with individual sections of the federal Act. Although Ontario and Alberta's general application rules are not word for word identical, their import is the same. In order to examine the difficulties presented by the operation of these rules a close look at their wording should be taken. Alberta's rules, as contained in section 2 of The Alberta Corporate Income Tax Act read as follows:

> 2(1) Where a section of the federal Act or a regulation made under the federal Act has, by this Act been made applicable for the purposes of this Act and reference is made in that section to another provision of the federal Act and that other provision has been made inapplicable for the purposes of this Act, then that section shall be read as if the reference to the other provision had been struck out.

> (2) Where a section of the federal Act or a regulation made under the federal Act has, by this Act, been made applicable for the purposes of this Act and reference is made in that section to another provision of the federal Act and that other provision does not apply for the purposes of this Act because a provision of this Act applies in lieu of it, then the reference to the other provision shall be deemed to be a reference to the provision of this Act that applies in lieu of it.
>
> (3) Where a section of the federal Act or a regulation made under the federal Act has, by this Act been made applicable for the purposes of this Act and reference is made in that section to another provision of the federal Act and that other provision applies in a different manner for the purposes of the federal Act then it does for the purposes of this Act, then the reference shall be deemed to be a reference to the other provision as it applies for the purposes of this Act.

Interpreting these rules before one even attempts to apply them can be a little complex. Presumably their object is to cover every situation where an adopted provision of the Income Tax Act (Canada) has a reference to another provision of the Income Tax Act (Canada) and that other provision has not been adopted or applies in a different manner for the purposes of the provincial Act. Yet when specific situations are examined problems arise in the interpretation of the rules. For example, Ontario and Alberta's rules differ in one important respect.[17] Ontario's rules operate when a reference is made to a provision of the federal Act that "does not apply" for the purposes of the provincial Act. Alberta's legislation also operates in that particular case, except for the situation described in section 2(1). In that instance a reference to a provision of the federal Act that "has been made inapplicable" for the purposes of the provincial Act is to be read as though the reference was struck out. The difference between the two approaches is a subtle one. Ontario's wording would appear to encompass the wider instance of general non-application of a section for any reason. Alberta's legislation would appear to be more restrictive in operation, only applying where there is a positive statement in the legislation that a section of the federal Act does not apply.[18] It should be easier for the reader to determine whether or not Alberta's rule applies because all he needs is a statement in the legislation that a provision does not apply. The reader of Ontario's legislation has to make a judgment call in respect of whether or not a federal section applies if the Ontario Act is silent on the issue. A minor difference in the wording of the two provinces, but one that can result in major differences in the interpretation to be given to the same federal provision.

Both Ontario and Alberta's application rules apply when a section of the federal Act "has been made applicable" for the purposes of the provincial Act. The question then becomes, when has a section been made applicable for the purposes of the provincial Act? The general wording used by both jurisdictions is to state that a section of the federal Act applies or is applicable. It is clear that this wording would bring the rules of application into play. However, there are variations on this theme and they present problems.

Section 22 of The Alberta Corporate Income Tax Act provides for the small business deduction for Alberta corporate taxpayers carrying on an active business. Section 22(1)(h) provides that "income of the corporation for the year from an active business has the meaning assigned to it by paragraph 125(6)(e) of the federal Act." Has paragraph 125(6)(e) of the Income Tax Act (Canada) been made applicable for the purposes of the provincial Act? Certainly, paragraph 125(6)(e) is being referred to in the provincial Act, thus eliminating the need to repeat the wording of the paragraph. Any jurisprudence attached to the meaning of the phrase "income of the corporation for the year from an active business" is being brought into the provincial Act.

Yet, if paragraph 125(6)(e) has been made applicable for provincial purposes there is a problem when the application rule in section 2(1) is applied. Paragraph 125(6)(e) of the Income Tax Act (Canada) excludes from the definition "income from a source in Canada that is a property (within the meaning assigned by subsection 129(4.1))". Thus income from a specified investment business is excluded from the definition of income of the corporation for the year from an active business. A problem arises because subsection 129(4.1) is not adopted provincially and therefore section 2(1) of The Alberta Corporate Income Tax Act operates to eliminate the reference. This effectively results in specified investment business income being included in the definition of income from an active business because the specific exclusion in the federal Act is struck out by the provincial application rules. It seems unlikely that this would be an intended result because there are more direct methods of achieving that result, if desired.

An indication that perhaps paragraph 125(6)(e) has not been made applicable for the purposes of the provincial legislation can be found in section 22(1)(c) of The Alberta Corporate Income Tax Act. That section provides that "'business limit' has the meaning assigned to be by subsection 125(2) of the federal Act, as modified by subsections 125(3) and (4) of that Act and as adopted by this Act". Normally the rule of application in section 2(3) would apply to ensure that any changes made to subsections 125(3) and (4) by the provincial Act would apply if the definition of 'business limit' had been adopted.

The rule respecting the application of a federal section that refers to a section that does not apply because a provincial section applies in lieu also presents problems. How does the reader know whether or not a provincial section applies in lieu of a federal section? Ontario enacts this rule in section 1(2)(d) of The Corporations Tax Act. Yet, none of the sections of that statute expressly provide that they are in lieu of a federal section. The reader is left to determine that issue unaided. For example, it is clear that the foreign tax deduction provided by section 32 is in lieu of the federal foreign tax deduction provided in section 126 of the Income Tax Act (Canada). Therefore the reference to section 126 of the federal Act in subsection 138(8) of the federal Act, a section adopted by Ontario, should read as a reference to the provincial foreign tax deduction. Other examples are not so obvious.

Section 125 of the Income Tax Act (Canada) provides for the federal small business deduction. That section is not adopted by Ontario's corporate income tax legislation. Therefore any reference to it in another federal provision that is adopted by Ontario should read as a reference to an Ontario section in lieu of section 125. Section 15.1 of the federal Act is adopted by Ontario.[19] That section refers in paragraph (2)(c) to subsection 125(1). Therefore, any provincial provision that applies in lieu of subsection 125(1) should be substituted. The question is which section applies in lieu? Ontario does not provide for a small business deduction that is identical to the federal one. Instead, there are three separate deductions. Section 33 provides for a deduction from tax otherwise payable of an amount calculated with reference to section 125 under the heading "small business incentives". Section 34 provides a deduction from tax otherwise payable of an amount calculated with reference to section 125 under the heading of "tax credit for eligible profits". Section 35 provides a deduction from tax otherwise payable by a corporation entitled to a deduction under section 125 in respect of the cost of depreciable property. To further complicate matters sections 33, 34 and 35 of The Corporations Tax Act refer to subsection 125(1) of the federal Act, although they do not adopt it.

Another type of application rule that has become a standard feature of income tax legislation is the transitional section. This section provides the rules that are to apply during the change from one set of rules to another. Because taxation years do not take heed of legislative change and do not end and restart on enactment of new legislation there is a need for a mechanism to ensure continuity. The transitional rule is that mechanism and is especially important in legislation that is based on an existing system and that purports to incorporate part, but not all, of that existing system into a new system.

Perusal of both Ontario and Alberta's corporate income tax legislation indicates that two kinds of transitional rule are used. The first includes rules of a general nature that apply to the whole provincial Act.[20] The second kind of transitional rule is that restricted to specific situations.[21]

The only significant issue that arises in respect of the transitional section is whether or not the general type of section is sufficiently broad enough to encompass all possible events. Alberta soon discovered after enactment of its corporate income tax legislation that it had not foreseen all possible events. That province enacted a new subsection to provide that amounts calculated, deducted or deductible under the federal Act for previous taxation years are to be deemed to have been calculated, deducted or deductible under the new legislation for that previous taxation year.[22] This would presumably encompass losses calculated under the federal Act that are to carry forward and be deductible under Alberta's legislation.

As can be seen, the application rules, with perhaps the exception of those of a transitional nature, leave many unanswered questions. They are a required tool of interpretation of adopted sections but a tool that sometimes seems to raise as many problems as it solves. They should be a simple rule of construction but invariably result in all manner of complexities when put to use.

C. Amendment of the Federal Income Tax Act - its effect on provincial corporate income tax legislation.

One of the ironies in the approach taken to corporate income taxation by Quebec, Ontario and Alberta is that while those provinces profess their autonomy in the area an amendment by the federal government to the Income Tax Act (Canada) often amends the provincial corporate income tax legislation. This is especially true in Ontario and Alberta where so much of the federal Act is incorporated into the provincial tax statutes. It is also true, though to a lesser extent, in Quebec where some provisions of the Income Tax Act (Canada) are made applicable for the purposes of the Taxation Act by a Regulation Respecting the Taxation Act.[23] The result is that any illusions of independence from the federal system must be tempered by the reality of the consequences of adoption of legislation by reference.

Quebec

In 1972 Quebec rewrote its Taxation Act and eliminated all references to the Income Tax Act (Canada) from its Act. Nevertheless, the definition of tax base and computation of taxable income are similar to those of the federal government. Therefore any change to the federal legislation has an effect on Quebec's corporate income tax structure. This effect occurs in one of two ways. If a section of the federal Act is made applicable by Quebec's Regulation Respecting the Taxation Act and that section is amended, obviously that amendment will automatically apply in Quebec by virtue of the adoption of the original section. What is more interesting is the other effect of federal amendments on the Taxation Act. If a federal section is not adopted but rather is rewritten in the Quebec Act without any reference to its origins, then any federal amendment will not alter the federal provision. However, if Quebec wishes to keep in harmony with the federal system it must make a corresponding amendment to its legislation. Thus, a conscious decision must be made on whether or not to follow the federal government's policy changes.

This presents an interesting situation. On the one hand we have the political rhetoric that espouses autonomy and independence for the Quebec corporate income tax system. On the other hand we have the convenience and expediency of following in the federal government's footsteps and thereby preserving some elements of harmony between the two systems. Perhaps this dilemma was best expressed in 1965 in the Quebec Report of the Royal Commission on Taxation. That Commission recommended that "unless there are special reasons, Quebec and federal legislation governing taxes shared jointly by both sectors of government should be in agreement".[24] The Report then continued by qualifying the recommendation in this way:

> This recommendation should not be interpreted to mean that the Quebec Government must slavishly and blindly follow federal legislation. On the contrary, Quebec should even break new ground if need be and have its viewpoint admitted by the other governments as it has done in other fields. In addition, it should not hesitate to legislate differently from other governments if required to do so by economic or social circumstances.[25]

As has been indicated earlier,[26] Quebec has legislated some uniquely Quebec touches in the corporate income tax field. Yet, generally it can be said Quebec has amended its legislation to conform with the federal amendments. In fact since 1977 the Minister of Revenue for Quebec has each year made a "ministerial declaration" to the Quebec National Assembly outlining the amendments to be made to the Taxation Act as a result of federal amendments to the Income Tax Act (Canada). These declarations have been made in respect of amendments "to harmonize the taxation systems of Ottawa and Quebec."[27] That language must surely be of comfort to corporate taxpayers and federal officials alike.

Thus Quebec has maintained some degree of harmony between its Taxation Act and the Income Tax Act (Canada) by amending its Act to incorporate changes made to the federal Act. Nevertheless, because such incorporation is not automatic it would be very easy for Quebec to diverge from federal policies. All that would be required would be no action on the part of Quebec after the federal law is changed. The situation is a tenuous one to say the least.

Ontario and Alberta

Both Ontario and Alberta incorporate all future federal amendments to the Income Tax Act (Canada) automatically.[28] Certainly the justifications for this approach are many and varied. Because their systems are so close to the federal one it seems reasonable and expedient that any change to the federal system become a change to the provincial one. The corporate taxpayer is only faced with digesting one set of changes to the law. The work of the respective provincial officials is lessened since they do not have to plan and propose the amendments. Any double taxation that might arise if the amendments were not incorporated does not arise. But, for every advantage there is a disadvantage.

From a provincial point of view, the most obvious disadvantage is their non-participation in the policy discussions and decisions that lead up to the changes. Proposed changes to the Income Tax Act (Canada) are traditionally announced in the federal Budget and provincial participation in the processes leading up to the Budget is limited. The rationale was explained this way in respect of the period between 1972 and 1976:

> First, the concept of Budget secrecy demanded that there be no consultation with respect to most issues. Second, even if consultation could take place, it would have been impossible to obtain a consensus on all changes.[29]

Nothing appears to have changed since that date. Federal-provincial co-operation has been limited to rather strained formal discussions at the political level. What is really needed is more co-operation at a less exalted level. Federal and provincial officials should be in a position to discuss and plan together changes that affect both jurisdictions and are of mutual concern. The Tax Legislative Process Committee of the Canadian Tax Foundation has recommended more federal-provincial communication in this area. In its report submitted to the federal Minister of Finance in 1977 it stated that "in the federal-provincial context, the present procedures inhibit co-ordination of the taxing policies of the respective authorities".[30]

Therefore, in practice, the federal government directly affects Ontario and Alberta's corporate income tax policy and legislation. It is not merely influence but takes the more substantive form of amendment to the provincial legislation. If Ontario or Alberta do not wish to follow the federal initiatives they have to amend their legislation. That in itself is a time-consuming, costly exercise that also involves political and public debate. Therefore, both provinces have tended to accept the federal amendments. Any changes they have made to their legislation have been in the form of the addition of new provincial incentives and programs.

Automatic adoption of federal amendments to the Income Tax Act (Canada) also presents problems for the corporate taxpayer. Obviously, when consulting the provincial legislation the taxpayer must be aware of any recent changes to the federal legislation that has been adopted provincially. However, of more serious concern to the taxpayer is the retrospective nature of the federal amendments. Two issues arise here. First, because there is usually a lengthy gap in time between announcement in the federal Budget of the proposed changes and enactment of those changes, the taxpayer is left in an uncertain position as to the status of the changes. Then when and if they are enacted it is done retroactively to the date of their announcement. Second, the retroactive nature of the federal amendments is adopted provincially. There is no legal barrier to retroactive legislation.[31] The objections to such legislation are based on a distaste for the imposition on a taxpayer of legal requirements or consequences for a period of time when the taxpayer was not aware of those requirements or consequences. Automatic adoption of amendments to the Income Tax Act (Canada) means automatic adoption of the retrospective aspects of that legislation.[32]

Automatic adoption of federal amendments to the Income Tax Act (Canada) raises an issue that strikes at the foundation of Quebec, Ontario and Alberta's corporate income tax systems. All three provinces claim control over their own systems. When Alberta's new corporate tax legislation received second reading in the Alberta Legislature on May 13, 1980, the Provincial Treasurer asserted that Alberta

> [W]ould in effect acquire control over our own provincial corporate destiny. We would be able to have as one of the basic levers for economic diversification this very crucial tool of control over our own corporate tax act.[33]

Quebec and Ontario have both expressed similar sentiments about their corporate income tax systems. The question is does enactment of legislation that is either altered directly or, in the case of Quebec indirectly, by the federal government really give the three provinces the control over their systems that they so vociferously claim they want? The answer has to be no. The appearance of independence is there but the mechanics of it are not. What is there are all the problems associated with legislation based on one system and tailored to fit another without breaking all ties with the original system. The only consolation for the corporate taxpayer is that this is more to his advantage than a total departure from the federal system.

CHAPTER II - FOOTNOTES

1 Regulation respecting the Taxtion Act, O.C. 1981-80, Quebec Gazette.

2 See generally, E.A. Driedger, The Composition of Legislation (1976) at 124-126; G.V. LaForest, Delegation of Legislative Power in Canada (1975) 21 McGill L.J. 131, at 138; E.A. Driedger, The Interaction of Federal and Provincial Laws (1976) 54 Can. B. Rev. 695, at 708.

3 Horace Read, Is Referential Legislation Worth While? (1940) 18 Can. B. Rev. 413, at 416.

4 See, Jacques Raymond, Quebec Tax Developments. Report of the Proceedings of the Twenty-fifth Tax Conference (1973), Canadian Tax Foundation, 539-540.

5 E.A. Driedger, The Composition of Legislation (1976) at 126.

6 K. Lysyk, Constitutional Law - The Inter-Delegation Doctrine: A Constitutional Paper Tiger (1969) 47 Can. B. Rev. 271 at 175; see LaForest, supra, note 2, at 138; see Read, supra, note 3, at 444.

7 The Corporations Tax Act, R.S.O. 1980, c.97, s. 1(6); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17 s. 1(1)(e).

8 (1953) 4 D.L.R. 440.

9 (1963) 1 O.R. 232.

10 Ibid at 236.

11 R v. Glibbery was approved by the Supreme Court of Canada in Attorney-General for Ontario v. Scott (1956) 1 D.L.R. (2d) 433 and Coughlin v. Ontario Highway Transport Board et al (1968) S.C.R. 569.

12 See Attorney-General for Nova Scotia v. Attorney-General for Canada (1951) S.C.R. 31 where a scheme of inter-delegation between the federal government and the government of Nova Scotia was held invalid.

13 (1935) 2 W.W.R. 34.

14 E.A. Driedger, the Interaction of Federal and Provincial Laws (1976) 54 Can. B. Rev. 695, at 713.

15 M.A. Cohen, Tax Simplification - A Government Perspective, Report of Proceedings of the Twenty-Seventh Tax Conference, (1975), Canadian Tax Foundation, 7.

16 Heward Stikeman, Tax Simplification, Report of Proceedings of the Twenty-Seventh Tax Conference, (1975), Canadian Tax Foundation, 26-28.

17 For Ontario's rules of application, see The Corporations Tax Act R.S.O. 1980, c.97, s.1(2)(d).

18 See, for example, The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s 13(2).

19 The Corporations Tax Act, R.S.O. 1980, c.97, s.12.

20 See, for example, The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 85(1), (2), (3), (4) and (4.1). Ontario does not contain any general transitional provisions because it has been in force so long and they have been removed on successive revisions of the Ontario statutes.

21 See, for example, The Corporations Tax Act, R.S.O. 1980, c.97, ss. 33(4) and 35(5) for specific transitional provisions respecting small businesses.

22 An Act to amend The Alberta Corporate Income Tax Act, S.A. 1981, c.34.

23 Supra, note 1.

24 Report of the Royal Commission on Taxation, (Government of Quebec, 1965) at 85.

25 Ibid

26 See, pages 20-21.

27 J. Parizeau, Ministerial Declaration concerning the concordance of Federal and Provincial Taxation Systems and the adoption of certain fiscal measures, December 21, 1978.

28 The Corporations Tax Act, R.S.O. 1980, c.97, s. 1(6); The Alberta Corporate Income Tax Act, R.S.A. 1981, c. A-17 s.1(1)(e).

29 A. Drache, Introduction to Income Tax Policy Formulation: Canada 1973-76 (1978) 16 Osgoode Hall L.J. 1, at 7.

30 The Tax Legislative Process (1978) 26 Can. Tax J.157 at 162. It would appear that nothing has changed since that report was issued in 1977. The Committee on the Budget Process, Canadian Tax Foundation, commented that "since the submission of the Committee's report (in 1977), little has been done to cure the deficiencies outlined." See, On Opening Up the Budget Process: A Report to the Hon. Allen J. MacEachen, Minister of Finance (1982) 30 Can. Tax J. 161.

31 E.A. Driedger, Retroactive, retrospective reflections (1978) 56 Can. B. Rev.264.

32 See, for examples of specific items affected adversely by the retroactivity of federal legislation, D.R. Huggett, The Budget Process and Income Tax Changes, Report of the Proceedings of the Twenty-Ninth Tax Conference,(1977), Canadian Tax Foundation, 32-33.

33 Hon. L. Hyndman, Provincial Treasurer,Alberta Hansard,May 13, 1980, at 942.

CHAPTER III

PROBLEMS PRESENTED BY DIFFERENCES BETWEEN FEDERAL AND PROVINCIAL LEGISLATION

A. Introduction

The problems presented by provincial adoption of the provisions of the Income Tax Act (Canada) have been examined. This chapter looks at the other side of the coin. It analyses the issues and problems that arise from the decision of Quebec, Ontario and Alberta to diverage from the federal policies and legislation in the levying and collection of corporate income tax. The problems are more obvious than those associated with the adoption of federal legislation. Double taxation of the corporation is a legal reality in Canada. The taxing province may also suffer because of the difference between its legislation and that of other provinces and the federal government. The corporate taxpayer may be able to use these differences to its advantage resulting in tax avoidance and less revenue for the province. The problem has been described as one of "multiple taxation, excessive taxation and undertaxation."[1]

It can be said that a critic of both provincial adoption of the federal income tax legislation and provincial divergence from the federal legislation will never be satisfied with any provincial corporate income tax system because these two approaches are the only ones open to the provinces. This is not so. There is a third alternative open to the provinces and that is a combination of the two approaches. Unfortunately, the combination enacted by the non-agreeing provinces encompasses the worst and not the best of each approach.

Provincial adherence to a system that is either totally based on the federal legislation or totally provincial in character would, obviously, be a more consistent approach. The agreeing provinces have taken the former position levying corporate income tax as a percentage of taxable income under the federal Act. The non-agreeing provinces have not taken the latter position. Instead, they have fallen somewhere between two stools and have made no more than a rather feeble attempt to establish their own corporate income tax systems. The result is that all the disadvantages of an independent course are there and yet, in reality, independence from the federal system has not been achieved.

This chapter will examine the results of provincial divergence from the Income Tax Act (Canada) under four headings. They are based on Divisions a to e of Part 1 of the Income Tax Act (Canada) and are liability for income tax, computation of income, computation of taxable income and computation of tax payable.

B. Liability for Income Tax

The Income Tax Act (Canada) imposes corporate income tax on the taxable income of every corporation resident in Canada.[2] Ontario and Alberta levy corporate income tax on the basis of permanent establishment[3] and Quebec levies it on the basis of establishment.[4] These basic charging sections are supplemented by provisions dealing with non-resident corporations. There is no doubt that it is in the area of taxation of non-resident corporations that the legislation of the agreeing provinces differs most substantially from that of the federal government. In addition, each of the agreeing provinces treats non-resident corporations in a different manner from the other agreeing provinces. Before examining the different definitions of permanent establishment and establishment, a description of the statutory provisions respecting non-resident corporations is in order.

Alberta has not changed the scope of its liability for income tax provisions since its days as an agreeing province. Therefore, it still does not tax non-resident corporations unless they have a permanent establishment in Alberta. The seven agreeing provinces also do not tax non-resident corporations unless they have a permanent establishment. The Income Tax Act (Canada) imposes an income tax on non-resident corporations which carry on business in Canada or which dispose of taxable Canadian property.[5] This imposition is, however, directly affected by the tax treaties that Canada enters with other jurisidictions and therefore not all non-resident corporations are taxed in Canada.[6]

Quebec levies corporate income tax on non-resident corporations that have an establishment in Quebec and on those non-resident corporations that do not have an establishment but that do dispose of taxable Quebec property.[7] An example of the former would be a corporation deemed under section 3 of The Taxation Act to have an establishment in Quebec because it carries on business through an employee or agent. The corporation could be a non-resident and still caught by the extended establishment rules. As with taxation by the federal government, treaty provisions provide an exception to these rules. Quebec does not tax a non-resident corporation that is exempt from tax pursuant to a treaty entered into with the federal government. The problems that the corporate taxpayer incurs in Quebec revolve around Quebec's extended definition of establishment. If a non-resident corporation has a permanent establishment in an agreeing province and is also caught by Quebec's extended definition then the federal government may well not grant that corporation the federal abatement in respect of the tax paid to Quebec on the basis that it does not recognise the extended definition of establishment. This issue will be examined in more detail when a close look is taken at the provincial definitions of permanent establishment and establishment.

Ontario takes the broadest approach provincially to taxation of non-resident corporations. It taxes corporations incorporated in a jurisidiction outside Canada with which Canada does not have a tax treaty if the corporation has a permanent establishment in Ontario, received income from the sale or rental of real property, timber resource property or a timber limit in Ontario or disposed of taxable Canadian property.[8] Much more interesting, however, is the treatment afforded non-resident corporations from a jurisdiction with which Canada does not have a treaty.[9] They receive rather harsh treatment from Ontario. Until recent amendments a non-resident corporation from a treaty jurisidiction that disposed of taxable Canadian property was liable for Ontario tax. That provision was repealed as part of Ontario's 1981 budget.[10] Nevertheless, two types of non-resident but treaty jurisidiction corporations are still taxed by Ontario. They are the corporation with a permanent establishment in Ontario and the corporation that receives income from the rental of real property, timber resource property or timber limit or from a royalty or timber royalty on that property and that has elected to file an income tax return with the federal government. The tax on these corporations is levied in accordance with the rules provided by section 115 of the Income Tax Act (Canada) respecting a non-resident taxable income in Canada.[11] Non-resident corporations with a permanent establishment in Ontario or receiving rent or royalties may well have an argument that they are being treated rather shabbily by Ontario because, pursuant to the tax treaties, they are not taxable in any other province or by the federal government.

Because all three non-agreeing provinces base their taxation of corporations on permanent establishment or establishment, it would be useful for the corporate taxpayer if the terms had the same meaning in each jurisidiction. Unfortunately, this is not so. There are three different versions of permanent establishment or establishment. Alberta and the agreeing provinces have adopted the federal definition of permanent establishment. In Alberta's case the definition is repeated in the Alberta legislation.[12] Quebec and Ontario have both followed a different path and each jurisdiction has expanded the definition so that it is significantly different from the federal definition.[13] The expanded definitions increase the tax burden for both non-resident and resident corporations by bringing them into the net of Ontario and Quebec taxation.

As far as non-resident corporation is concerned, section 5(8) of Ontario's legislation catches non-resident corporations that

> [P] roduced, grew, mined, created, manufactured, fabricated, improved, packed, preserved or constructed in whole or in part anything in Canada, whether or not the corporation exported

> that thing without selling it prior to exportation.

Quebec's legislation provides a variation on this theme as it encompasses non-resident corporations that operate a mine, produce, process, preserve, pack or build goods or products in whole or in part, or produce or present a publication.[14]

These provisions can have an adverse effect on the corporate taxpayer. Take the example of a non-resident corporation that packs goods in Ontario for sale elsewhere and that is a resident of a non-treaty jurisdiction. That corporation will be denied the federal abatement in respect of provincial tax paid and therefore be subject to double taxation. It works this way. The corporation will pay tax federally as a non-resident corporation from a non-treaty jurisdiction but Ontario will also levy corporate income tax on the basis of its expanded definition of permanent establishment. Meanwhile, the federal government will not recognise the expanded definition and therefore will not grant the abatement in respect of provincial tax paid. If the corporation packed its goods in any province other than Ontario or Quebec it would not pay a provincial corporate income tax and the problem would not arise. The corporation that is caught by the expanded definition and subject to double taxation has one option, other than relocating to another province, left open to it. It can apply to the federal government for a remission order in respect of the denied federal abatement. Those orders issued by the Governor in Council, on the recommendation of the Treasury Board, under the Financial Administration Act have, in the past, returned taxes paid to individuals subject to double taxation in this kind of situation. Whether or not such an order would be issued in respect of a corporation is another question that can only be answered by Revenue Canada.[15]

The Canadian resident corporation also faces difficulties because of discrepancies in the provincial allocation rules. Ontario is the only province that extends its definition of permanent establishment to include the province in which the head office, as designated in the corporation's charter or by-laws is situated.[16] Until a recent amendment, this provision presented problems in the allocation of taxable income.[17] A corporation that had a head office in Ontario by virtue of section 5(11) and yet carried on all its day to day operations in another province would be taxable in both Ontario and the other province. Yet, once again the federal government presumably would not grant an abatement in respect of the Ontario tax paid and the other province would expect all the taxable income of the corporation to be allocated to it. In 1981 Ontario made a major change to section 5(11) when it restricted its operation to the instance where the corporation does not have any other permanent establishment in Canada.[18] This severely limits the operation of the subsection since one would not expect to find many corporations without a permanent establishment in Canada under the federal rules but with a head office in Ontario. Perhaps this move by Ontario is an indication of changing times and attitudes towards inter-provincial and federal-provincial co-operation in the difficult area of what should constitute a permanent establishment.

There has been another recent significant event that may well have heralded improved inter-provincial relations in the administration of, but not the content of, provincial corporate income tax legislation. On June 18, 1979 Quebec and Ontario entered several agreements respecting exchanges of information in the tax area between the two provinces.[19] These agreements refer directly to issues raised by the definitions of permanent establishment and establishment. While they do not dwell on the differences in the definitions they do clarify how certain parts of the definitions should be interpreted. For example, Ontario and Quebec had encountered difficulty in agreeing on what was an "office" for the purposes of the definition. The agreement resolves this issue by stating that the two provinces will adopt the federal interpretation contained in Interpretation Bulletin IT-177R.

As far as the corporate taxpayer is concerned, this kind of inter-provincial co-operation in the administration of corporate income tax legislation is welcome. Nevertheless, it does not go far enough. As can be seen from the problems with the definitions of permanent establishment, all the co-operation in the world on administrative matters does not help if the content of the legislation varies from province to province. Until there is more uniformity in the legislation and especially the calculation of taxable income, double taxation and the non-availability of the federal abatement will continue to be a hardship endured by the corporate taxpayer.

C. Computation of Income

The first factor in the calculation of tax payable, both federally and provincially, is the computation of income of a corporation. Alberta's computation of income provisions parallel those of the Income Tax Act (Canada). The only difference of any note is the adaptation of subsections 87(2) and 88(1) of the Income Tax Act (Canada) respecting amalgamation and winding up of a corporation to the calculation of the Alberta royalty tax deduction account.[20] It is when examining Quebec and especially Ontario's method of computing income that a distinct departure from the federal legislation is visible. Quebec's legislation differs from the Income Tax Act (Canada) in only two respects in this area. They involve the calculation of a business investment loss on the sale of shares of a controlled corporation and certain deductions for the resource industry.[21] On the other hand, Ontario has enacted major changes in the computation of income and its legislation operates in a rather different manner from that of the federal government and the seven agreeing provinces and Alberta.

Ontario adopts by reference subdivisions a and b[22] of Division B of Part 1 of the Income Tax Act (Canada). It is interesting to note that neither Alberta nor Quebec adopt by reference or otherwise subdivision a of Division B of Part 1 in respect of corporations. Subdivision a deals with income or loss from an office or employment. Alberta does not adopt the subdivision at all and Quebec rewrites it to refer to income or loss to an individual. The question becomes, can a corporation have an income or loss from an office or employment? Presumably, Ontario would answer that question positively while Quebec and Alberta would answer in the negative. Subdivision a itself appears to contemplate a positive answer since it refers to income or loss of a "taxpayer" and corporations.[23] It may be that Ontario takes the view that a corporation can be an employee and is attempting to bring into the ambit of its legislation those personal service corporations that receive some of the benefits outlined in section 6 of the Income Tax Act (Canada) in their capacity as employees. While this issue would only affect a small number of one man corporations it could result in a significant provincial tax burden to those corporations that operate in Ontario. It certainly is a major difference in treatment of those corporations from that afforded by all other provinces.

Ontario also includes in income several items that are not included in income federally or by any other province. These include local items such as payments received under the Ontario Beef Calf Stabilization Program.[24] A minor variation of the federal provisions require a corporation to include in income imputed interest on loans made by it to non-residents, whether or not tax has been paid under Part XIII of the Income Tax Act (Canada).[25] An inclusion in income of a more important nature is to be found in section 12(6) of The Corporations Tax Act. That subsection requires that five-fourteenths of certain payments made to non-residents with whom the payer is not dealing at arms length be included in the income of the payer corporation. These payments include:

(a) a management or administration fee or charge;

(b) a rent, royalty or a similar payment;

(c) a right in or to the use of motion picture film or films or video tapes for use in connection with television that have been or are to be reproduced in Canada.[26]

The inclusion in income is only to be made if federal withholding tax is exigible under section 212 of the Income Tax Act (Canada).[27] Once again, Ontario is legislating in an area previously the sole domain of the federal government, that is taxation affecting non-resident corporations.

On the deduction side of computation of income, Ontario again differs from the federal law in several respects. Slight changes are made to the rules pertaining to deductions in respect of capital cost of property[28] and in the resource area. Mining corporations are ineligible for a resource allowance deduction based on resource profits.[29] A benefit to the corporate taxpayer is to be found in section 12(7)(c) which expands a federal deduction to permit a corporation to deduct property taxes and interest expenses in respect of land held in inventory for resale and development.[30] In an age of high interest rates, such a deduction is of considerable value to a corporation. However, Ontario's legislation also denies the corporate taxpayer a provincial deduction in respect of certain items deductible federally and in the agreeing provinces. Section 12(8) operates to prohibit a corporation from deducting a reserve under paragraph 20(1)(n) of the Income Tax Act (Canada) for provincial purposes if the corporation has "sold, pledged, assigned or in any way disposed of any security received by it"[31] as payment for the property sold and for which a reserve was previously claimed.

The purpose of listing these differences between the federal computation of income rules and those of Ontario is to show that while the differences may not appear individually to be of any great import, taken as a whole they do present the corporate taxpayer with problems. They represent a marked departure from the familiar federal provisions applied to provincial tax in all other provinces. In addition, while the number of corporations affected by the differences may not be many, once the differences do apply to a corporation their effect can make a considerable difference in the amount of income attributable to that corporation for a taxation year.

There is one item in the computation of income that is treated in differing ways by Canada, Ontario and Quebec. That item is the calculation of capital cost allowances. Alberta, by virtue of adopting all the regulations made under the Income Tax Act (Canada) incorporates Part XI of the federal regulations. That Part provides the method of calculating the capital cost allowance in respect of the different classes of property for the purposes of a deduction under paragraph 20(1)(a) of the Income Tax Act (Canada). Quebec and Ontario have taken a different approach. While both provinces have enacted legislation that follows the general principles of the federal legislation, the details are different.

Ontario acknowledges those differences in Information Bulletin No. 10-78R which says:

> Both Ontario and the federal authorities use the same classes of assets and capital cost allowance rates, except for Ontario grain storage facilities. The amount of C.C.A. deducted in Ontario may differ from that at the federal level.[32]

That difference was first permitted by Ontario Regulation 504/77, filed on July 14, 1977. That regulation allowed corporations to claim a different amount or different proportion of capital cost allowance for Ontario purposes than for federal purposes. The corporations to benefit from this are those that do not wish to claim the full allowance at the federal level for a taxation year because it is not to their advantage to do so but that do wish to claim the full amount at the Ontario level. Meanwhile in Quebec, corporate taxpayers have never been required to claim the same amount of capital cost allowance in Quebec that they claim federally.[33]

There is no doubt that a corporation can use the differences in the federal rules and those of Ontario and Quebec to its advantage. The claimable amount can be larger in Ontario and Quebec and this in itself may persuade certain corporations to relocate to one of the non-agreeing provinces. Those provinces can use the capital cost allowance rules to encourage certain types of corporations to move to the province. Because the technical rules are legislated by regulations and not statute they can be changed quickly and with no political debate. Yet the substantive differences between the federal rules and those of Ontario and Quebec presented both those provinces with a problem. While immigrating corporations from the agreeing provinces were carrying over the undepreciated capital cost of their capital property, as calculated for federal purposes, into Ontario and Quebec corporations that moved between

Ontario and Quebec were not. They were claiming the full historical cost of their depreciable property rather than the undepreciated capital cost.

The state of affairs led to both Ontario and Quebec enacting legislation to stop corporations moving between the two provinces from claiming the full historical value of their assets for capital cost allowance purposes.[34] The legislation deemed the immigrating corporation to have claimed for provincial purposes the capital cost allowance it claimed under the Income Tax Act (Canada) prior to its immigration into the province. Yet, this did not solve all the problems associated with a corporation moving from Ontario to Quebec or vice-versa and the calculation of its capital cost allowance. An excellent example of the problems incurred in such a situation is given by Richardson in his article.[35] He illustrates how the corporation could lose potentially claimable capital cost that would, but for the move, have been used to reduce income in the original province of residence. In addition there can be recapture problems for the corporation that sells the depreciable property before taking any further capital cost allowance in the new province. As Richardson comments, such results can be extremely costly to corporations and careful planning must be done before such a move is executed.[36]

Therefore, in conclusion, three points should be made. First, corporations in Quebec and Ontario have a distinct advantage over their counterparts in the agreeing provinces because they can claim a different amount of capital cost allowance provincially than federally. Secondly, those corporations are not encouraged to leave Ontario or Quebec because on departure their base for claiming capital cost allowance in their new province of residence reverts to the federal base. Thirdly, there may well be a tax disadvantage to a corporation that moves its permanent establishment from Ontario to Quebec or vice versa.

D. Computation of Taxable Income

Computation of taxable income is a calculation that is made in a different manner in each of the three non-agreeing provinces. Alberta adopts section 110 to 113 of the Income Tax Act (Canada) unchanged and thereby incorporates the deductions provided by section 110 and those respecting losses and dividends in sections 111 to 113. Ontario and Quebec have used the federal provisions as a framework for computation of taxable income but have reworked the details to provide deductions and rules that are peculiar to those provinces.

An example of Ontario and Quebec's reworking of the federal rules can be seen in the computation of taxable income of the non-resident corporation. Quebec taxes a non-resident corporation that does not have an establishment in Quebec on the disposition of taxable Quebec property.[37] Therefore, it does not include in taxable income all the items listed in section 115 of the Income Tax Act (Canada) although the definition of "taxable Quebec property" is very similar to the definition of "taxable Canadian property".[38]

Ontario meanwhile takes a substantively different approach. That province adopts section 115 of the Income Tax Act (Canada) but expands its operation to include events not brought within the federal Act.[39] Once again Ontario is much more aggressive in its taxation of the non-resident corporation than any other province.

Ontario includes in taxable income earned by a non-resident any income from the sale or rental of real property in Canada. Ontario also, effective 1981 and future tax years, will not tax capital gains realized on the disposition of taxable Canadian property in Ontario if the proceeds were not taxed, because of a tax treaty, by the federal government. Nevertheless, if a non-resident corporation from a jurisdiction with which Canada does not have a tax treaty owns real property in Canada and rents that property out, tax will be eligible in Ontario. Again, on sale of that property, any capital gain will be taxable.

Another area where Ontario has diverged from the federal law is in the deduction from taxable income of election contributions to Ontario political parties and candidates. Section 28(1) of The Corporations Tax Act permits this deduction to be made by a corporation and this is in marked contrast to both the federal and Alberta legislation that gives a tax credit, that is a deduction from tax payable, for political contributions to the respective federal and Alberta parties and candidates.[40] Quebec does not grant either a credit or deduction in respect of political contributions made by a corporation, restricting the deduction from tax payable to individuals.[41]

A recent indication of provincial dissatisfaction with the federal method of computing taxable income is to be found in Quebec's new rules respecting non-capital losses. It was announced in the Quebec Budget speech on March

10, 1981, that a corporation would receive an option with respect to the tax treatment of non-capital losses. It could, for tax years after March 10, 1981, continue to have its losses treated in the normal way as far as the carry forward of the loss is concerned or it could choose to claim a tax credit for the loss. The existing Quebec rules are similar to those found in section 111 of the Income Tax Act (Canada) and provide for a carry forward of non-capital losses for five years and a carry back for one year.[42]

The proposed tax credit if claimed in the year in which the loss is incurred will be the lesser of

> (a) 3% of the loss net of carry backs for the previous year (which represents the ratio between business carried on in Quebec during the taxation year in which the losses were incurred and businesses carried on in Quebec and elsewhere in the same year), and
>
> (b) a corporation's paid-up capital tax for that year.[43]

If the credit is claimed in the five year period immediately preceding the year the losses were incurred, the credit is calculated according to the formula stated above but may not exceed the corporation's total income tax and capital tax payable for that year.

This treatment of non-capital losses is unique in provincial taxation. Losses are normally deductible from a corporation's taxable income and not the subject of a refundable tax credit. Yet, in Quebec, if a corporation so elects it may receive the tax credit.[44] Furthermore, Quebec now links the tax treatment of non-capital losses to the amount of paid-up capital tax paid by the corporation in a year. If the corporations paid-up capital tax is less than 3 per cent of its non-capital losses then the corporation will only receive a refund of the lesser amount of paid-up capital tax. Therefore the corporation that has a higher paid-up capital and thus pays more capital tax will receive the greater economic benefit from the tax credit.

The existence of this tax credit may well influence those corporations that have a high paid-up capital but that anticipate losses to set up an establishment in Quebec so that at least part of those losses are allocable to Quebec for the purposes of obtaining the tax credit. Whether or not a corporation chooses to claim the tax credit or deduction treatment will depend on the amount of its losses in relation to the paid-up capital tax paid by it.

Quebec and Ontario's treatment of non-capital losses differs from the federal treatment in one other important respect. Paragraph 186(1)(c) of the Income Tax Act (Canada) permits a corporation to deduct its non-capital losses from income used to determine Part IV tax payable. While the offsetting of losses against this income is an unusual practice because the rate of tax is less than that payable under Part I, nevertheless losses can be and are utilized in this manner. The provinces do not levy Part IV tax. Therefore both Quebec and Ontario omit from their legislation any reference to the use of losses in this manner. Thus, it would appear that a corporation that uses up its non-capital losses against income on which Part IV tax is payable may still carry forward these losses and use them as a deduction from income provincially or, in Quebec, to obtain a tax credit.

This is an interesting anomaly allowing non-capital losses to be used in a different manner against different kinds of income.

Finally, because the income of a corporation is calculated in a different way by two of the three non-agreeing provinces, the amount of income calculated for provincial purposes can be different from that calculated for federal purposes. Therefore the amount of non-capital losses that a corporation will wish to use against that income will also vary for federal and provincial purposes. The issue has been put this way:

> This could have serious reprecussions if such losses, otherwise available, expire without being fully utilized. Corporations should, however, by planning their other deductions (and adjusting capital cost allowance claims) be able to avoid such results.[45]

The differences in computation of taxable income outlined in this chapter are yet another example of the lack of harmony between federal and provincial income tax treatment of corporations. The reason that they can be considered more crucial than those differences at the computation of income level is that they are that bit closer to tax payable. The amount of tax payable is the bottom line for every corporation. A reduction or increase in taxable income due to disparities in federal and provincial legislation reflects itself more directly in the tax payable than a reduction or increase in income.

E. Computation of Income Tax Payable

It is when income tax payable is calculated that governments are able to offer tax programs of the most stimulating economic nature. Any diminution of tax payable is an obvious and easily calculable reduction for the corporate taxpayer. Therefore it is at this stage that jurisdictions introduce the various incentives to industry that are of such value to the corporate taxpayer. These incentives can take the form of tax rebates, tax credits, tax reductions or even different tax rates.[46] "Incentive" is a term used in its broadest sense since the measures contemplated by it range from a tax credit in Alberta to builders of certain multiple unit residential buildings to a special tax rate for small businesses granted by the federal government and all provinces except Prince Edward Island.

Provincial tax incentives clearly contribute to jurisdiction shopping by corporations. This fact was acknowledged by the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements when, in its discussion of the value of incentives, it said:

> No corporation will long remain in a jurisdiction in which the costs in terms of taxation outweigh the benefits received in the form of public goods and services.[47]

These incentives also add an element of tax competition to inter-provincial relationships. Whether this competition is benefical or detrimental to the corporate income tax system depends on whether you view the effect of the incentives as a corporate taxpayer or not.

To the corporate taxpayer the profusion of special incentives offered through a tax system can only be beneficial. In contrast to the problems a corporation encounters with different rules respecting computation of income and taxable income that can result in double or excessive taxation, the incentives offered can only work to lower the tax burden of a corporation. The corporation can organise its affairs in such a manner that it makes the best use of the particular tax advantages offered by the incentive schemes of the particular jurisidictions. The critics of this system, however, attack these incentives on the basis of their regionalism.[48]

They argue that such an approach does nothing to harmonize the Canadian tax system and adversely affects federal-provincial and inter-provincial relations.[49] Perhaps the most realistic view of the issue is that expressed by the Minister of Finance who said:

> [T]he introduction of special measures has altered the progressivity of the combined federal and provincial individual income tax system. It must therefore be assumed that the equity objective which was to be achieved by requiring uniform progressivity now has a lower priority.[50]

While this comment was made in the context of individual income tax, it is equally pertinent when considering corporate income tax. Certainly, justification of the proliferation of provincial incentives as a result of a change in priorities is an easy way to avoid a direct confrontation with the provinces.

An examination of the application of federal and provincial incentives to the corporate taxpayer in the calculation of income tax payable should begin with Alberta. That province determines tax payable in a different manner from Ontario, Quebec and the federal government. Alberta is the only province to calculate amount taxable in the province by making a deduction from taxable income.[51] It then levies a tax of 11 per cent of the amount taxable in Alberta and provides for provincial deductions from that figure.[52] The deduction at the computation of amount taxable stage is in respect of any royalty tax paid by a corporation to the Crown. The royalty tax deduction results in a corporation's amount taxable in Alberta being initially computed with reference to the corporation's total Canadian taxable income for the year and not just the part that is allocated to Alberta. The royalty tax deduction was originally introduced in 1974 and was intended to offset the disallowance by the federal government of the deduction of royalty payments to the Crown from taxable income.[53] The deduction is the amount of a corporation's attributed Canadian royalty income for the year and that income is calculated with reference to royalties paid to the Crown and in respect of which there is no deduction under the Income Tax Act (Canada) or that are included in income under that Act.

The importance of the royalty tax deduction is directly related to Alberta's contention that it is the undisputed owner of at least 85 per cent of all petroleum and natural gas resources in the province.[54] The province enters leases with the producer corporations and collects royalties pursuant to those leases. Those corporations with a permanent establishment in Alberta then receive a tax deduction in respect of the royalties paid. Alberta's royalty tax deduction is a clear example of a province granting tax relief to corporations to fill the vacuum left by the federal reluctance to provide such relief. It is also an example of a provincial deduction unique to one province. No other province has the petroleum and natural gas reserves that Alberta has. Therefore no other province needs to consider the special interests of the producers of those resources.

Deductions from tax otherwise payable in the form of tax credits are popular with corporate taxpayers because they involve an immediate reduction in the amount of tax payable rather than merely a reduction in the amount of one of the components used to calculate tax payable. The Income Tax Act (Canada) provides two different kinds of incentives by way of tax credits to corporations. These are incentives intended to encourage investment in Canadian corporations and incentives of a more general nature that assist the different types of corporations. The former incentives would include the investment tax credit[55] and accelerated capital cost allowances[56] while the latter group includes items such as the employment tax credit,[57] manufacturing and processing deduction,[58] small business deduction,[59] foreign tax deduction[60] and logging tax deduction.[61]

(i) Investment incentives

A comparison of the federal incentive schemes with those of the provinces indicates that the provinces have used tax credits as an incentive to corporations in areas either left untouched by the federal government or areas that the provinces consider not adequately dealt with by the federal government. This has led to obvious differences in the incentives offered by the agreeing provinces and non-agreeing provinces. The agreeing provinces have tended to leave the creation of incentives through taxation to the federal government but Alberta and especially Quebec and Ontario have used the flexibility offered by their own legislation to offer new and varied incentives to corporations.

The federal investment tax credit permits a corporation to reduce its tax payable by an amount ranging from 5 per cent to 50 per cent of the capital cost of certain qualified or certified property. This then reduces the capital cost of property for the purpose of claiming the capital cost allowance. Therefore the credit must be viewed in conjunction with the accelerated write off for depreciable property provided by federal regulations 1100 and 1104. If the investment tax credit is taken then the accelerated write off of the capital cost of the property is only available in respect of that portion of the cost of the property not the subject of the tax credit. If the accelerated capital cost depreciation is taken, then the property may have been written off to such an extent that no investment tax credit is available. As far as the effectiveness of these federal incentives is concerned, it has been said that "Canadian investment incentive policies have had an impact on the level of investment expenditures, but the revenue losses associated with the policies casts a cloud over their efficacy".[62] This view appears to be shared by the provinces who, as we shall see, have adopted certain parts of the federal investment incentive schemes, rejected others and formulated some new ones.

The federal incentives offered to specific kinds of corporations are well known. There is a deduction from tax payable for small business in respect of income from an active business or non-qualifying business. The manufacturing and processing deduction offers a credit to those corporations engaged in that business. When combined with the small business deduction, the tax saving can be substantial. The employment tax credit is a uniquely federal item offered to both corporations and individuals alike. The foreign tax deduction and logging tax deduction are self-explanatory.

As with the federal deductions from tax payable, the credits granted by Quebec, Ontario and Alberta can be divided into two groups. First there are those offered as investment incentives and secondly those designed for particular kinds of corporations. None of the three non-agreeing provinces have adopted the federal investment tax credit. They have chosen instead to provide tax relief to encourage investment by providing for a return of capital invested in fixed assets through the accelerated capital cost allowance. In Quebec, Title VI of The Taxation Act Regulations provides for accelerated write-off in a manner very similar to that found in the Income Tax Act (Canada). Ontario and Alberta both incorporate the federal provisions into their legislation.[63] The result of this is that the option to take the investment tax credit and thereby less accelerated capital cost depreciation of assets is not available in respect of provincial tax payable. The major advantage to a corporation of the investment tax credit as opposed to accelerated write-off is that the tax credit will continue for a longer period of time than the write-off. Accelerated depreciation, as its name implies, is a method to claim a tax deduction in a faster way than usual. It ends once the asset has been fully depreciated. The immediate boost to a corporation's cash flow resulting from the accelerated pace of the deduction is shortlived. Therefore the investment incentive offered provincially is tailored for the corporation that wants a quick return on its investment in the form of lower taxes. It does not encourage a slower or more controlled return on investment.

An incidental result of the non-availability of the investment tax credit provincially is that a corporation may acquire a different undepreciated capital cost in respect of depreciable property for federal purposes than for provincial purposes. The reason is that if a corporation chooses to claim the investment tax credit federally, it probably has assets eligible for the capital cost allowance if it chooses to claim its full capital cost allowance provincially then its undepreciated capital cost will be less for provincial purposes then federal purposes. Some of the problems presented by different undepreciated capital costs have been examined earlier.[64]

Quebec, Ontario and Alberta have each provided new and different incentives to investment. A brief look at one such incentive from each jurisdiction is warranted. As will be seen the three incentives examined represent an expansion and continuation of an old federal incentive and two examples of new provincial incentives.

Alberta has taken a discontinued federal program and redesigned it for use in Alberta. That program was an incentive to encourge investment in multiple unit residential buildings.[65] It has resurfaced in Alberta as the Alberta Rental Investment Tax Credit[66] and the Extended Alberta Rental Investment Tax Credit.[67] There is, however, one significant difference between the old federal program and that offered in Alberta. The federal MURB program provided for a capital cost allowance claim in respect of qualifying MURBs. Alberta's program goes one step further and grants a non-refundable tax credit, generally five per cent of the amount invested in the MURB. Certainly, the MURB program in Alberta is of considerable value to the corporate investor. It has been said that "investors who are able to qualify probably realize the best return on investment of any MURB investors to date".[68] The success of the program is indicated by a recent amendment to The Alberta Corporate Income Tax Act to provide for a new extended MURB program until the end of 1984.[69] It is somewhat ironic that it was the federal government's refusal to administer Alberta's original MURB program that was given as one of the reasons Alberta chose to administer its own corporate income tax system.[70]

Another form of investment incentive is to be found in the venture capital field. Significantly, this is an area that the federal government has chosen not to take any action in.[71] It has been left to others to promote investment in this field and both Ontario and Quebec have been quick to step in where some have been rather hesitant. As long ago as 1975 the Alberta Legislature was presented with a position paper recommending the establishment of Alberta Investment Incentive Corporations and special manufacturing and processing incentives for new corporations.[72] As yet, none of these recommendations have become the subject of legislation, although there are indications that this may occur soon.[73] Meanwhile Ontario and Quebec have vigourously encouraged investment in the venture capital area. In Ontario there is a tax credit in respect of investment in a small business development corporation (SBDC) and in Quebec the credit is for investment in a Societe de developpement de l'enterprise Quebecoise (SODEQ).

Ontario's Small Business Development Corporations Act [74] grants a deduction from tax payable to a corporate investor equal to thirty per cent of money paid for equity shares of a SBDC established under that Act. In addition the SBDC is not liable for capital tax.[75] The Act also provides for a recapture of the tax credit granted if the SBDC is wound-up, dissolved or buys back its own shares.[76] The recapture is imposed on the SBDC itself and not on the investor and takes the form of a tax imposed under The Corporations Tax Act.[77] Investors in a Quebec SODEQ receive a tax credit equal to twenty-five per cent of their investment and, as in Ontario, the SODEQ itself becomes liable to repay the amount of the tax credit on revocation of its registration or cancellation of the shares.[78] The SODEQ may then invest in small or medium sized firms in Quebec.

As noted, these incentives are not provided by the federal government and are only available in Quebec and Ontario. The advantages of provincial rather than federal tax credits in this area has been put this way:

> Where the provinces control the venture capital corporation, they control the areas of stimulus and also provide the required policing over the input of funds to the venture capital corporation and their distribution. The provincial government, presumably being closer to the economic pulse of the province, can move more quickly to alter the direction and quantum of stimulus than the federal government.[79]

One could add to this statement the further point that federal incentives of this nature tend to be so all encompassing and general that they cannot and do not aid specific corporations in specific regions.

On the other hand a purely provincial approach to investment in the venture capital field encourages regionalism and inter-provincial tax competition. This situation is exacerbated by the perennial problem of the less affluent provinces. In order to set up a tax credit scheme to encourage investment, revenues are needed to finance the tax credits and those revenues are recouped in the form of income taxes and other economic benefits to the province from the now presumably successful corporations. Provinces such as Quebec and Ontario with their larger budgets are able to carry the burden over the intervening period of time. The less affluent provinces are not able to do so and are left in a precarious position. They need the investment most but are least able to afford to grant the tax relief that produces such investment. There is also a question, of course, as to whether or not the federal government would administer a tax credit to encourage investment for an agreeing province. The answer is probably no in light of the federal government's more recent tough line on administering provincial programs.[80]

(ii) Other incentives

Quebec, Ontario and Alberta also offer special deductions from tax payable that are designed to assist particular types of corporations. In Alberta, not surprisingly, the emphasis is on the oil and gas industry. The royalty tax deduction has already been discussed. In addition to that deduction, Alberta also grants a royalty tax credit to corporations with a permanent establishment in that province. This tax credit was available to corporations before Alberta chose to administer its own corporate income tax system but recent amendments have increased the value of the credit considerably.[81] This credit has been called the "small explorer's credit"[82] and that description is most apt. The deduction from tax payable is for corporations that have an Alberta crown royalty.[83] Those corporations receive a refundable tax credit of 75 per cent of the royalty for tax years from August 31, 1981 to January 1, 1984 and 50 per cent for tax years commencing after December 31, 1983.[84] There is a maximum allowable credit of $4 million for the former period and $2 million for the latter period. In addition, the royalty tax credit sections also provide for deemed association of corporations by the Provincial Treasurer and sharing of the maximum allowable limits among associated corporations.[85]

What is especially interesting about the Alberta royalty tax credit is that the amount of it has been increased so significantly. Prior to the recent amendments the percentage of royalty available to corporations was 25 per cent with a maximum allowable credit of $1 million.[86] In addition, it is a refundable tax credit payable on an instalment basis and therefore a corporation will receive a refund if the royalty tax credit due to it exceeds the corporation's Alberta taxable income. It is certainly an inducement to resource corporations to explore and recover resources in Alberta. It is not offered by the federal government. As mentioned earlier, the federal government does not even offer a deduction for royalties and this point is highlighted by Alberta when it defines an Alberta crown royalty as being the aggregate of royalties included in income under paragraph 12(1)(o) of the Income Tax Act (Canada) and "any amount in respect of which no deduction is allowed in computing the corporation's income for the year by virture of paragraph 18(1)(m) of the federal Act".[87]

It should also be noted that corporations that are exempt from tax pursuant to section 35(1) of the Alberta Corporate Income Tax Act will be able to claim the royalty tax credit. The reason is that the exemption is from tax payable on taxable income and is not an exemption granted directly to the corporation. Therefore a calculation of taxable income can be made and the refundable royalty tax credit granted on the basis of this calculation to a corporation that would otherwise be exempt from tax.[88] This could involve quite a loss of revenue for Alberta since not only will the province receive no taxes from the exempt corporation, it will have to make a "refund" to it in respect of royalties paid.

Ontario and Quebec emphasize the small business in their tax credit system. Ontario grants a small business tax credit for 4 per cent,[89] a special tax credit of 1 per cent for manufacturing and processing income[90] and a depreciable property credit of 20 per cent of the cost of depreciable property used in Ontario to earn income from a business.[91] Quebec grants a deduction for small businesses by virtue of providing that tax payable on corporate income is equal to the difference between 13 percent of taxable yearly income and 5 per cent of the annual federal tax deduction allowed for small businesses.[92] The 1981 Quebec Budget proposed to extend this small business deduction to an effective amount of 10 per cent for July 1, 1981 to December 31, 1981, 5 per cent for 1982 and 2 per cent thereafter.[93]

The 1981 Budget also provided that "eligible business" became eligible for a 5 per cent tax credit, effective January 1, 1982 and a 7.5 per cent credit effective January 1, 1983. An eligible business includes, among other activities, manufacturing and processing corporations, fishing, farming, mining, professional practices, service businesses, management and professional services and investment activities deriving income from property.

These incentives of both an investment and non-investment nature are the one item that cause most of the bad feeling between the agreeing and non-agreeing provinces. Quebec, Ontario and Alberta, by virtue of administering their own corporate income tax systems, are in a position to offer whatever tax incentives they feel are economically viable. The agreeing provinces, bound by the terms of their agreements with the federal government, cannot do this.[94] Therefore in the competition to attract investment and certain types of corporations to the province the non-agreeing provinces start from a much superior position than that enjoyed by the agreeing provinces. In fact, the major concern of the non-agreeing provinces is just to make sure that they strike the correct balance between attracting investment and corporations to the province and losing tax dollars to over generous incentive schemes. It is little wonder that the agreeing provinces feel at a distinct disadvantage. They face a dilemma. If they wish to continue to enjoy the benefits of Ottawa administering their corporate income tax programs then certain sacrifices have to be made. There is evidence that the agreeing provinces see this dilemma. They have taken the view that sacrificing tax room to the federal government in return for the administration of the system puts the onus on the federal government to ensure that neither the province nor its citizens suffer because of a lack of revenue.[95]

F. Allocation rules

Without doubt, one of the major headaches for the corporate taxpayer is the operation of the allocation rules. These rules, based on gross income together with wages and salaries, allocate a corporation's taxable income among the provinces. The operation of the federal rules contained in Regulations 400 to 413 made under the Income Tax Act (Canada) has been described as follows:

> The first step is to calculate total salaries and wages and then determine the portion of salaries and wages paid to employees at permanent establishments in each province. Gross revenue must then be determined in total and for each province with a permanent establishment. The percentages attributable to each province with a permanent establishment are applied to taxable income.[96]

Because the allocation rules determine the percentage of a corporation's taxable income that will be allocated to and thus subject to tax in each province, a degree of uniformity in the tax legislation is necessary to achieve a fair result for the corporate taxpayer. Differences in the tax rate, calculation of taxable income and the credits and rebates offered provincially all confuse the procedure. As we shall see, uniformity in the allocation rules themselves has been sadly lacking over the years and there are no indications that any improvement is in sight for the corporate taxpayer. In fact, as long ago as 1912, one writer said:

> Each province should tax corporations on the gross income earned within its jurisdiction. The proportion of the total gross earnings of a corporation taxable by each authority can be

> ascertained according to some index, such as mileage in the case of railways, or by co-operation on the part of the several jurisdictions under which the company operates. Such co-operation will make possible, not only the proper division of earnings, but also the devising of methods of ascertaining the total amount of earnings.[97]

That co-operation still does not exist today.

In order to view the effect of the allocation rules on the corporate taxpayer in their true context, a brief historical review of their enactment and operation is of assistance.[98] In 1946, the federal government proposed a reduction of federal corporate income tax by 10 per cent together with a 5 per cent income tax to be levied by the provinces. This necessitated rules to allocate income to the provinces for the purposes of the new provincial tax. Rules were proposed and after much federal-provincial debate were drafted. At that time it was said that they would reduce, if not eliminate, double taxation.[99] As we shall see this was not to be. Those rules were agreed to by all provinces except Quebec and Ontario. Quebec and Ontario drafted their own sets of rules and these conflicted dramatically with the federal rules. Not only did both these provinces levy tax at a 7 per cent rate, rather than 5 per cent, they also based the allocation of income on the location of the head office of a corporation. For example, even if a corporation's income was earned outside Ontario, that income was allocable to Ontario if its head office was located in the province.[100] The problems presented by this were somewhat alleviated during the period from 1952 to 1957 when Ontario briefly re-entered the federal fold and signed a tax rental agreement with the federal government. It therefore abided by the federal allocation rules during this period.

However, relief for the corporate taxpayer was only temporary. In 1957 Ontario again went its own way in the levying and collection of corporate income tax and introduced allocation rules that differed substantively from those it had been applying with the federal government for the past five years. These new rules included a rule that directly conflicted with both the federal and Quebec rules respecting attribution of revenue to the place of shipment of goods to a customer rather than the place of residence of the customer.[101] Over the next ten years, however, Ontario and Quebec slowly began to change their allocation rules to bring them more in line with those of the federal government and that were used by the seven agreeing provinces. In 1961 Quebec adopted the sales and wages formula contained in the federal government's rules and by 1972 and the new Canadian tax system a certain degree of similarity began to appear in the allocation rules of Quebec, Ontario and the federal government. The serious differences of the past no longer existed, but nevertheless there were and are today enough subtle differences to present some rather difficult situations for the corporate taxpayer.

As far as the use to which the allocation rules are put, the most obvious one is to apportion the taxable income of a corporation to the various jurisdictions. Yet the rules play an extremely important role in another area. The amount of taxable income allocated to a province is a key factor in determining the amount of federal equalization payments made to that province. It works like this. The amount allocated to a province is given a weighting of about 50 per cent and as such is a part of the calculation of simulated total income of a province. The simulated total income is used to calculate about 15 per cent of the revenues of a province. Therefore while the corporate taxpayer may complain that the allocation rules operate in a harsh and sometimes illogical manner, it must be remembered that this may in part be attributable to the fact that they are used by a province in the continuing war over equalization payments.

As mentioned, the federal allocation rules are to be found in Regulations 400 to 413 made under the Income Tax Act (Canada). Alberta adopts the federal allocation formula by virtue of section 19(2) of The Alberta Corporate Income Tax Act which provides that "taxable income earned in Alberta" is to be calculated with reference to the federal regulations made under the Income Tax Act (Canada). How long Alberta will continue to operate under the federal rules is another matter. Spokesmen for the province have expressed dissatisfaction with the federal rules on the basis that they do not include a capital factor and therefore create an allocation bias against the capital intensive corporations that exist in Alberta.[102] Quebec's allocation rules are contained in regulations made pursuant to section 771(2) of The Taxation Act.[103] Ontario's rules are to be found in regulations made under section 31 of The Corporations Tax Act.[104]

The federal rules apply where a corporation has a permanent establishment in more than one province and allocate taxable income accordingly. It is at this stage and before one gets into an analysis of the operation of the technical rules that the first problems in the application of the federal rules and those of Quebec and Ontario arise. Regardless of how similar the rules of these three jurisdictions appear to be, because they are predicated on the notion of permanent establishment they can and do operate to produce double taxation.

The problem is the expanded meaning given to permanent establishment and establishment by Ontario and Quebec. As already illustrated[105] a corporation may have its income allocated to more than one jurisdiction by the operation of provincial allocation rules and only receive the federal abatement in respect of one such allocation because of the non-recognition by the federal government of the expanded definition of permanent establishment. About all a corporation can do in this instance is to plead its case with the respective governments and hope for a sympathetic hearing.

Yet there are also legislative differences between the detailed rules that determine the two major components of the rules --- gross revenue and salaries and wages. In Ontario, for example, there are special allocation rules to allocate taxable income earned in Canada by non-residents. These are necessitated by Ontario's taxation of non-resident corporations. Ontario also excludes the proceeds of the disposition of capital property from gross revenue[106] and excludes investment income from gross revenue if the corporation has business income in the taxation year.[107] One of the more significant differences between the federal allocation rules and those of Ontario from the viewpoint of the corporate taxpayer is to be found in section 402(4)(j) of the Ontario regulations. That section provides that gross revenue derived from the sale of land that is non-capital property and constitutes a permanent establishment in the province, is allocated to the province. Therefore if a corporation sells a head office and land it stands on, or other land that comprises a permanent establishment, the proceeds of sale will be allocated to Ontario.

This affects the corporation that moves its operation out of Ontario. It could find itself being required to allocate the proceeds of disposition from the sale of the land to Ontario and to another province in which it also had a permanent establishment at the time of the sale. Under the federal rules the full amount of the sale would be allocated to the other province. Therefore a corporation finding itself in such a situation would do well to make sure that it only has one permanent establishment at the time of the sale.

Quebec's legislation differs from that of both the federal government and Ontario.[108] Perhaps the most obvious difference is that Quebec bases its rules on the carrying on of business in a province rather than on taxable income. This results in a different application of the allocation rules that otherwise bear a great deal of resemblance to those contained in the regulations under the Income Tax Act (Canada). Such an application can result in the allocation of a greater percentage of a corporation's taxable income to Quebec. Taxable income is a narrower starting point than carrying on business. Taxable income, as indicated earlier, is an amount determined after application of credits and deductions to income. Carrying on business, on the other hand, is a more flexible and vague concept that is determined without reference to credits and deductions that would reduce the amount of income derived from it. The result is that the operation of Quebec's allocation rules is more dependent on provincial administration than those of any other jurisdiction. Quebec has given itself much more discretion in the application of its allocation rules.

The treatment of investment income under the federal and provincial allocation rules also presents difficulties for the corporate taxpayer. An investment corporation with a permanent establishment in more than one jurisdiction may well be of the view that there is no need to allocate its income for income tax purposes. This is because the federal allocation rules exclude from gross revenue income derived from interest and dividends and rentals and royalties from property.[109] Yet Ontario includes in its determination of gross revenue investment income if that is the only income of the corporation.[110] Therefore the corporation may well have difficulties deciding how it should pay tax provincially. Ontario's rules will allocate a portion of its income to Ontario while the rules of the other province in which it has a permanent establishment will not operate to make an allocation.

From an administrative standpoint, it has been said that both Ontario and Quebec have been more aggressive in reviewing the corporate taxpayer's allocation of income than the other provinces.[111] This aggressiveness has inevitably resulted in clashes between the two provinces over the application of the rules. In fact these disputes have arisen over

> [W] hat constitutes a sale and what a service when a sale occurs what should be included in gross revenue what should be included in salaries and wages what criteria should be established to determine the permanent establishment to which an employee should be attached and when management fees should be included in salaries and wages.[112]

Faced with a continuing battle over these issues, Ontario and Quebec finally reached agreement in June, 1979 to adopt a uniform basis for deciding these questions. This agreement must be seen by the corporate taxpayer as an encouraging sign. While the agreement is restricted to administration of the rules rather than their content and therefore not a total solution to the problem, it is a definite improvement. Unfortunately there is one dark cloud on the horizon. That is the distinct possibility that Alberta will draft its own rules based on a different formula. If Alberta follows up on this threat, the corporate taxpayer will once again be faced with double taxation because of a provincial inability to agree on the format of these basic rules.

CHAPTER III - FOOTNOTES

1 E.H. Smith, Allocating to Provinces the Taxable Income of Corporations: how the Federal Provincial Allocation Rules Evolved (1976) 24 Can. Tax J. 545 at 568.

2 The Income Tax Act, R.S.C. 1952, c. 148, s. 2(1).

3 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 2(1); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 5(1).

4 The Taxation Act, R.S.Q. 1977, c. I-3, s.22.

5 The Income Tax Act, R.S.C. 1952, c. 148, s. 2(3).

6 See, for example, Canada - U.S. Tax Convention, Articles I, II and VIII; Canada - United Kingdom Income Tax Convention, Articles 7 and 13.

7 The Taxation Act, R.S.Q. 1977, ss. 22 and 27.

8 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 2(2).

9 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 2(3).

10 Section 29(2) of the Corporations Tax Act removes the disposition of taxable Canadian property from the ambit of section 2(3)(b).

11 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 29(1).

12 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 1(1)(g)

13 The Taxation Act, R.S.Q. 1977, c. I-3, ss. 12, 13, 14, 15, 16 and 16.1: The Corporations Tax Act, R.S.O. 1980, c. 97, s. 5.

14 The Taxation Act, R.S.Q. 1977, c. I-3, s. 16.1.

15 See, E. Richardson, Tax Planning for Corporations in Light of Differences in Federal and Provincial Income Tax Legislation, Report of the Proceedings of the Thirty-first Tax Conference (1979), Canadian Tax Foundation, 766 at 775. Mr. Richardson points out in a footnote that relief of this nature had not been granted to a corporation at the time his article was written.

16 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 5(11).

17 An Act to amend The Corporations Tax Act, S.O. 1981, s. 2.

18 Ibid.

19 Richardson, supra, note 15, at 773-774. Mr. Richardson describes the meetings leading up to these agreements and reports that the agreements were described by the Ontario Minister of Revenue as "providing a framework for a province to advise the other of proposed tax assessments which affect the other's revenue or income allocation, to avoid double taxation".

20 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s.14(3.1) and (3.2).

21 The Taxation Act, R.S.Q. 1977, c. I-3, ss. 236.2 and 236.3.

22 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(1).

23 The Income Tax Act, R.S.C. 1952, c. 148, s. 248(1). This section defines "taxpayer" to include a person and under the Interpretation Act, R.S.C. 1970, c. I-23, person includes both individuals and corporations.

24 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(3).

25 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(5).

26 The Corporations Tax Act, R.S.O. 1980, c. 98, s. 12(6).

27 Interpretation Bulletin No. L-6, Ontario August 14, 1978, gives a detailed description of the operation of section 12(6).

28 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(7)(a).

29 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(7)(b).

30 Interpretation Bulletin No. L-5 Ontario, August 14, 1978 gives a detailed description of the operation of section 12(7)(c).

31 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 12(8)(b).

32 Information Bulletin No. 10-78R, September 14, 1981.

33 One reason for this is that in Quebec certain provincial deductions and grants do not reduce the capital cost of property for Quebec tax purposes. See, sections 130 and 130.1 of The Taxation Act and regulation 130 R 56 to 133.2 R 1 of the Regulations respecting the Taxation Act.

34 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 9(3): The Taxation Act, R.S.Q. 1977, c. I-3, s. 31.

35 Supra, note 15, at 793.

36 Supra, note 15, at 794.

37 The Taxation Act, R.S.Q. 1977, c. I-3, s. 27.

38 For the definition of "taxable Canadian property", see, the Income Tax Act, R.S.C. 1952, c. 148, s. 115(1)(b).

39 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 29.

40 The federal tax credit is provided by section 127(3) of the Income Tax Act (Canada) and Alberta's tax credit is found in section 24 of The Alberta Corporate Income Tax Act.

41 The Taxation Act, R.S.Q. 1977, c. I-3, s. 776.

42 The Taxation Act, R.S.Q. 1977, c. I-3, s. 727.

43 Tax Memo No. 65, 1981 Tax Developments (Canadian Tax Foundation, 1981) at 101.

44 The election procedure is to be found in the addition of section 1029.1 to The Taxation Act by an Act to amend certain legislation to give effect to government budget policy for the fiscal period 1981-82, assented to on June 18, 1981, s. 12(1).

45 Supra, note 15, at 788.

46 It has Been calculated that in 1975 tax incentives for investment in Canada cost an estimated $4 billion, an amount equal to 52% of the total corporate taxes levied in that year. R.M. Bird, Tax Incentives for Investment: The State of the Art. Canadian Tax Paper No. 64, at 1.

47 Fiscal Federalism in Canada, Report of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements, August 1981 at 178.

48 See, for example, Wayne Thirsk, Tax Harmonization and its Importance in the Canadian Federation, contained in Fiscal Dimensions of Canadian Federalism, ed. Richard M. Bird, Canadian Tax Foundation, 118 at 132.

49 See, D. V. Smiley, Canada in Question: Federalism in the Seventies (2nd ed.) 142.

50 Hon. Allan J. MacEachen, Federal-Provincial Fiscal Arrangements in the Eighties, A Submission to the Parliamentary Task Force on the Federal-Provincial Fiscal Arrangements, (1981) at 53.

51 Section 20(2) of The Alberta Corporate Income Tax Act reads as follows:

> (2) Subject to subsection (3), "amount taxable in Alberta" means the product obtained when taxable income less the royalty tax deduction is multiplied by the Alberta allocation factor.

52 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, Part 5.

53 L. Landry, Address to the Institute of Chartered Accountants of Alberta, Edmonton, June 12, 1981.

54 See, Hon. M. Leitch, The Constitutional Position of Natural Resources, contained in Canadian Federalism: Myth or Reality (3d. ed.) ed. J. P. Meekison, 170 at 173. The figure of 85% ownership was given by the Minister of Mines and Minerals for Alberta in a speech to the Canadian Council of Resource and Environment Ministers in Victoria on November 21st, 1974. Considering the source of the figure it may be a little optimistic. Nevertheless, it gives a good indication of Alberta's view of the situation.

55 The Income Tax Act, R.S.C. 1952, c. 148, s. 125(5).

56 While not a deduction from tax payable, the accelerated capital cost allowance goes hand in hand with the investment tax credit to provide a double barrelled incentive to investment in Canadian corporations. For an informative analysis of the history of the two incentives, see F. J. Harman and J. A. Johnson, An Examination of Government Tax Incentives for Business Investment in Canada (1978) 26 Can. Tax J. 691.

57 The Income Tax Act, R.S.C. 1952, s. 148, s. 127(13).

58 The Income Tax Act, R.S.C. 1952, c. 148, s. 125.1.

59 The Income Tax Act, R.S.C. 1952, c. 148. s. 125.

60 The Income Tax Act, R.S.C. 1952, c. 148, s. 126.

61 The Income Tax Act, R.S.C. 1952, c. 148, s. 127.

62 Supra, note 56, at 704. For an economic assessment of the value of investment incentives see Robin W. Boadway and Harry M. Kitchen, Canadian Tax Policy, Canadian Tax Paper No. 63, (1980) at 134-136 and Richard M. Bird, Tax Incentives for Investment: The State of the Art, Canadian Tax Paper No. 64. (1980) at 32-45.

63 This is done in Alberta by the general adoption of all federal regulations by section 56(2) of the Alberta Corporate Income Tax Act. In Ontario section 301(1) of the regulations made under The Corporations Tax Act adopts the federal regulations.

64 See page 65.

65 The federal MURB program expired on December 31, 1979.

66 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 25.

67 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26.5.

68 Ross D. Freeman, The Alberta MURB (1981) 30 Can. Tax J. 163 at 170.

69 The Alberta Corporate Income Tax Amendment Act, 1982, S.A. 1982, c. 1.

70 Hon. L. Hyndman, Provincial Treasurer, Alberta Hansard, May 13, 1980, 943.

71 For discussion of the lack of federal action in this area, see also, J. Michael Lavery, A Review of Developments in the Venture Capital Field, Report of the Proceedings of the Thirty-First Tax Conference (1979), Canadian Tax Foundation, 508 at 511-514.

72 Basic Objectives and Terms of Reference for Alberta Business Taxation and Incentives, A Position Paper of the Government of Alberta, January 29, 1975, presented to the Alberta Legislature by the Hon. Gordon Miniely, Provincial Treasurer.

73 Alberta News Release, Hon. L. Hyndman, Provincial Treasurer, March 7, 1980.

74 R.S.O. 1980, c. 475.

75 Ibid, s. 19.

76 Ibid, s. 24.

77 Ibid, s. 25.

78 An Act respecting Corporations for the development of Quebec Business Firms, R.S.Q. 1977, c. S-28; The Taxation Act, R.S.Q. 1977, c. I-3, s. 1163.

79 Supra, note 71, at 521.

80 See, supra note 50, at 54.

81 Supra, note 69, s. 12.

82 Donald H. Watkins, Current Developments in Petroleum Income Taxation (1981) 19 Alta. L. Rev. 62 at 78.

83 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26.1.

84 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26.1(9) and (10).

85 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26.1(7).

86 See, section 26 of The Alberta Corporate Income Tax Act, as repealed by section 12 of The Alberta Corporate Income Tax Amendment Act, 1982, S.A. 1982, c. 1.

87 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26(1)(b).

88 This interpretation has been confirmed by officials with the Alberta Department of the Provincial Treasurer.

89 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 33.

90 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 34.

91 The Corporations Tax Act, R.S.O. 1980, c. 97 s. 36.

92 The Taxation Act, R.S.Q. 1977, c. I-3, s. 771.

93 Supra, note 43, at 100.

94 See page 24 for a description of the federal government's refusal to administer a British Columbia dividend tax credit scheme.

95 See, Attitudes Towards Financial Relations, Nova Scotia's view, contained in Canadian Federalism: Myth or Reality (2nd ed.) ed. J. Peter Meekison, 304-308.

96 Supra, note 15, at 776.

97 S. Vineberg, Provincial and Local Taxes in Canada, (Toronto: Longman Green) 134-135.

98 See, for a full historical review of the evolution of the allocation rules, Smith, supra, note 1.

99 Letter from Dr. W. C. Clark, Deputy Minister of Finance to Department of National Revenue, 1947, quoted in Smith, supra, note 1 at 553.

100 See, J. H. Perry, Taxation in Canada, (1st ed.) (Toronto: University of Toronto Press, 1951) 176-177 for a full description of the differences between the federal allocation rules and those of Ontario and Quebec. This description is particularly informative, probably because Mr. Perry was involved in the drafting of the 1946 allocation rules in his capacity as an official with the Department of Finance.

101 This rule was rescinded in December 1957 and replaced with a rule attributing revenue to the place of destination of goods.

102 As early as 1975 dissatisfaction was expressed by the Provincial Treasurer in Basic Objectives and Terms of Reference for Alberta Business Taxation and Incentives, June 29, 1975. Since that report a Caucus Committee on Business Tax and Tax Incentives has been established and it is understood that once it makes its final report changes will be made to the allocation formula in Alberta, Press Release, Hon. L. Hyndman, March 7, 1980.

103 Regulation respecting The Taxation Act, O.C. 1981-80, Quebec Gazette, ss. 771R1 to 771R38.

104 Regulation made under The Corporations Tax Act, 1972, O. Reg. 350/73, Ontario Gazette, ss.401 to 419.

105 See, page 58.

106 Regulation made under The Corporations Tax Act, 1972, O. Reg. 350/73, Ontario Gazette, s. 402(8)(c)(iv).

107 Regulation made under The Corporations Tax Act, 1972, O. Reg. 350/73, Ontario Gazette, s. 402(8)(c)(iii).

108 See, Richardson, supra, note 15, for a detailed description of four major differences between the allocation rules of Quebec and the federal government.

109 Income Tax Regulations, s. 402(5).

110 Regulation made under The Corporations Tax Act, 1972, O. Reg. 350/73, s. 402(8).

111 Richardson, supra, note 15 at 779.

112 Ibid.

CHAPTER IV

ADMINISTRATIVE PROBLEMS

A. Introduction

A corporation that has a permanent establishment in Ontario, Quebec and Alberta is faced with the prospect of dealing with four different administrative bodies when it comes to payment of its corporate income tax. They are the Ontario Ministry of Revenue, Corporations Tax Division, the Quebec Department of Revenue, Operations Branch, The Alberta Treasury Department, Corporate Income Tax and, of course, the federal Department of National Revenue. Each administration issues its own forms, interpretation bulletins and information circulars. Furthermore, each province requires a separate provincial return to be filed in respect of income earned in the province and each follows its own procedures when it comes to assessing tax, handling appeals and generally enforcing the respective provincial corporate income tax legislation.[1]

The inconvenience or even hardship encountered by corporations dealing with four different administrative bodies is hard to evaluate. This hardship takes two forms. First there is the expense and inconvenience in dealing with two or more different administrations. Secondly, there is the substantive problem of double taxation. Literature on the levying and collection of corporate income tax focuses almost exclusively on the federal system and the problems corporations encounter with that administration. There has been no comprehensive analysis of the operation of the provincial administrations and their relationship to that of the federal government. Perhaps one reason for this is that until recently there had been no new developments in the area. Only Ontario and Quebec administered their own systems. Now that Alberta has joined them and broken ties with the federal government on this issue, the time is ripe to take a look at the administrative side of corporate income tax collection in Canada. This chapter will examine the provincial administrative provisions and attempt to pinpoint areas of potential difficulty for corporations. It will also highlight those areas where inter-provincial or federal-provincial friction could arise because of different administrative rules.

There is no question that Quebec, Ontario and Alberta consider the administration of their own corporate income tax systems to be a purely provincial matter and therefore one that should have no direct federal input. This is evidenced by the fact that while their corporate income tax legislation adopts by reference, in many instances, the federal rules respecting the steps leading up to calculation of tax payable, none of the provinces do this when it comes to the administrative provisions.[2] The administrative provisions are uniquely provincial in nature and each of the three provinces has legislated its own distinctive set of rules without direct incorporation of the federal rules. Certainly they are similar to the federal rules and each other but there are enough substantive differences to allow the provinces to feel that they can call the system their own.

B. Assessment and reassessment

One of the first procedures that divergence between federal and provincial practice can be found in is the assessment and reassessment of tax payable. Section 152 of the Income Tax Act (Canada) provides that the Minister of National Revenue shall assess the tax owing for a year together with interest and penalties. That section also provides that such an assessment can be made at any time but that a reassessment may only be made within four years of the date of the original assessment.[3] There is an exception to the four year rule and that is where the taxpayer has made a misrepresentation attributable to neglect, carelessness or wilful default or has committed fraud or has filed a waiver with the Minister.[4] The expiry of the four year period for reassessment is of great importance to a corporation since it can affect its future tax planning. Quebec and Alberta's provisions are the same as those found in the Income Tax Act (Canada). Ontario, however, does not follow the federal format for reassessment in its entirety. That province diverges in two significant respects. First, the time period for reassessment in Ontario is six years. Secondly, Ontario permits reassessment at any time if financial statements have not been filed with the return as required by section 67 of The Corporations Tax Act.[5] The potential problem for both a corporation and the federal government involves the six year reassessment time period. Obviously as far as the corporation is concerned it would rather not still be subject to reassessment in one province once the time limit for reassessment has expired both federally and in the other provinces. The problem for the federal government is of a more practical nature. If Ontario should reassess after the four year period has expired federally but before the six year period has expired provincially then the federal government's hands are tied. They cannot reassess and, assuming that the provincial reassessment produced more tax payable, will be unable to collect any revenue that may be owing federally. Ontario's ability to reassess at any time if the required financial statements have not been filed also gives that province an opportunity to reassess once the statutory time limit has expired. The Income Tax Act (Canada) does not have an equivalent to section 67(2) of The Corporations Tax Act requiring the filing of financial statements with the return and therefore a corporation cannot be reassessed federally for failure to comply with this requirement. It should be noted, however, that the federal return must contain the "prescribed information" required by the Minister of National Revenue and presumably this could include financial statements and in that case failure to comply would open the door to reassessment federally.

As mentioned, the federal authorities can reassess at any time if the corporation has filed a waiver of the four year time limit. Ontario also provides for reassessment if a federal waiver has been filed under subsection 152(4) of the Income Tax Act (Canada) and in addition authorizes its own provincial waiver which permits reassessment after the six year period.[5] What is interesting is that neither Quebec nor Alberta permit reassessment at any time after filing of a federal waiver. Those two provinces each provide for their own provincial waivers but do not accept a federal waiver for provincial purposes. The result is that these provinces rely heavily on administrative cooperation with the federal government. If the provinces are not advised by the federal officials that a waiver has been filed federally and that a reassessment is in progress then they can find themselves unable to reassess at the expiry of the four year time period. Alberta has tried to alleviate this problem by a recent amendment that permits provincial reassessment within six months of a federal reassessment.[6] Yet this is not a total solution since Alberta's hands are tied until the federal reassessment is made. Meanwhile Quebec's hands are tied completely on federal reassessment unless they have exacted a provincial waiver from the corporation.

C. Payment of tax

Basically, the rules respecting payment of corporate income tax and interest thereon are the same in the three non-agreeing provinces as they are federally. Tax is paid on an instalment basis at the end of each month of the taxation year. The remaining tax due is then payable at the end of the second month following the end of the fiscal year.[7] Quebec has a minor variation on the federal rules in that it does not distinguish between a corporation claiming the small business abatement and one that does not claim the deduction when determining when the remaining tax shall be paid. The federal government, Ontario and Alberta all give a corporation that claims the small business abatement an extra months grace with respect to payment of the remaining tax.[8] The only provincial differences of any note in this area concern corporations exempted from making instalment payments. The federal government, Quebec and Alberta exempt corporations holding forth the prospect of paying patronage dividends or credit unions that have a taxable income of no more than $10,000 for the year.[9] Ontario, however, has a slightly different rule. It exempts any corporation that has tax payable of less than $2,000 for the taxation year from payment by instalment.[10] Alberta grants a further exemption to a corporation that claims the small business abatement and that estimates its taxable income to be less than $500,000.[11] Therefore the situation could arise where a corporation with a permanent establishment in both Alberta and Quebec, for example, would be required to pay tax by instalments in Quebec but not required to do so in Alberta.

D. Appeal procedure

Once an assessment has been made a corporation that disagrees with the assessment may, within ninety days, file a notice of objection to the assessment. This procedure is the same federally and provincially although of course a separate notice of objection must be filed in each jurisdiction. The powers of the respective Ministers of Revenue on receipt of a notice of objection are similar in all jurisdictions. Once the notice of objection has been filed each jurisdiction provides for an appeal procedure. It is worth noting that while the appeal procedures are similar one further step is provided federally. That is an appeal to the Tax Review Board prior to an appeal to the Federal Court and from there to the Federal Court of Appeal. None of the three provinces have established a Tax Review Board and the appeals are, in Ontario to the Supreme Court,[12] in Alberta to the Court of Queens Bench[13] and in Quebec to the Provincial Court.[14] Presumably the volume of appeals at the provincial level is not sufficiently onerous to warrant an intermediate appeal level.

E. Collection of taxes

When it comes to the collection of taxes owing, the provinces, particularly Alberta and Ontario, have chosen to give themselves rather extended powers. For example, in Ontario the province can register any taxes, interest, penalties or other costs owing under The Corporations Tax Act in the land registry office and thereby impose a lien on real property owned by the corporation.[15] That lien receives priority over any subsequent encumbrances on the property and can even be attached to land leased by a corporation and in respect of which the corporation is not the registered owner. The lien extends not only to taxes, interest, penalties and other costs owing at the time of registration but also to taxes, interest, penalties and other costs that may become due.[16] Ontario has tried to create a statutory lien that is to take priority over all subsequent liens, including presumably those registered on behalf of the federal government and other provincial governments. This provision highlights a problem that is becoming increasingly important for the federal and provincial governments. What is the priority among governments when it comes to the collection of taxes? Ontario's legislation is restricted to the context of a lien on land but it begs the broader question of who gets the first chance to collect owed taxes from an insolvent corporation.

The problem in sorting out the respective government's claims has been put this way:

> Courts elsewhere and before this have bemoaned the results thrust upon them by the interaction of federal and provincial laws with reference to

> debtor-creditor priorities. The resolution of anomalies in this complex field is a legislative process. The duty of the Court is to interpret the legislation as it finds it. The result must follow, and if it is a result with which the community interests do not coincide, it is a matter for the Legislature.[17]

Unfortunately the legislation with respect to debtor-creditor relationships in the income tax area is remarkably silent on the issue of priority of claims.

At present, with the exception of Ontario in a limited way, no jurisdiction has purported to give itself statutory priority over other jurisdictions with respect to the collection of income tax owing. The federal government and Alberta have both included in their legislation sections that provide that any taxes, interest, penalities and other amounts payable under their legislation are debts due to the Crown and recoverable as such.[18] Quebec and Ontario have not enacted this provision. Yet, such a section does nothing to establish priority.[19] The Income Tax Act (Canada) also provides that taxes withheld in accordance with that Act are held in trust for the Crown.[20] Again, no priority is established. Interestingly enough, the Income Tax Act (Canada) once contained a section that did give the Crown priority with respect to withheld taxes.[21] It read as follows:

> 123(6) Every person who deducts or withholds an amount under this Act is liable to pay to Her Majesty on the day fixed by or pursuant to this Act an amount equal to the amount so deducted or withheld and, except in the case of bankruptcy, this liability constitutes a first charge on his property and, notwithstanding the Bank Act or any other statute or law or other than the Bankruptcy Act, ranks for payment in priority to all other claims, <u>including claims of Her Majesty in right</u>

> <u>of a province or in any other right,</u> of whatsoever kind arising before or after the commencement of this Act, except only the judicial costs, fees and lawful expenses of an assignee or other public officer charged with the administration or distribution of his property.

This section was repealed in 1956 and has never been replaced. There has never been an equivalent section in respect of non-withheld taxes.

Therefore only Ontario purports to establish any kind of priority and that is limited to a lien on land. Therefore the solution to the issue of priority must be determined by the common law and the case law. At common law debts due to the Crown and their collection are a matter of crown prerogative. It has also been established that the Crown's right to recover a debt owing to it supercedes any right a citizen may have.[22] However, where the federal Crown and provincial Crown both have a right to recover a debt, the situation is different. Their rights rank in <u>pari passu</u> in the absence of any statutory enactment to the contrary.[23] It should be noted that such a statutory enactment cannot be a provincial enactment that purports to abrogate the federal Crown prerogative. In those instances where a province has attempted to assert its priority at the expense of the equal priority of the federal Crown, the legislation has been struck down as ulta vires the province.[24] Following this reasoning, it could well be that should Ontario attempt to claim priority of lien over any lien subsequently imposed by the federal government, it runs the risk of having section 92 of The Corporations Tax Act struck down as an abrogation of the federal prerogative to collect debts owing.

On the other hand, there is no legal barrier to the federal government establishing its priority over a provincial jurisdiction. In Attorney-General of Canada v. Workmen's Compensation Board for the Province of British Columbia[25] the Supreme Court of British Columbia confirmed the doctrine that debts owing to the Crown in right of Canada and the Crown in right of a province rank in pari passu. The court then held that the claim of the federal Crown took priority over that of the provincial Crown as represented by the Workmen's Compensation Board of British Columbia. Munroe J. reasoned that because the federal legislation permitted garnishment proceedings to be carried out while the provincial legislation merely made the provincial Crown a judgment debtor, the federal Crown had taken legislative steps to establish their priority. Once the federal Crown chose to exercise its statutory rights then the provincial Crown no longer ranked in pari passu.

The federal government was not so successful in its pursuit of income tax owing as a debt in a more recent decision. Dauphin Plains Credit Union Limited v. Xyloid Industries Ltd. and the Queen[26] involved the resolution of a claim by the federal government for income tax notionally withheld from employees' wages before a receiver was appointed to manage the affairs of the employer. The federal representatives argued that there was a "deemed trust" provision in the Income Tax Act (Canada) that would require an employer to hold income tax withheld from an employee's wages in trust for the federal Crown. The Supreme Court of Canada rejected this argument and held that since the repeal of subsection 123(6) of the Income Tax Act (Canada) there had been no provision in the Act that would deem such a trust. This decision confirms the view that if the federal government wishes to give itself priority with respect to income tax owing over its provincial counterparts it must do so in legislation. However, that ability to acquire priority through legislation does not extend to the provinces at the expense of the federal government.

F. Elections

One administrative area of concern for corporations involves the various elections that may be made or that are required to be made under the Income Tax Act (Canada), the Income Tax Application Rules and the Regulations made pursuant to the Income Tax Act (Canada). There are eighty-seven elections contemplated by the federal legislation and sixty-nine of these are applicable to corporations.[27] A corporation's concern arises over the effect of an election made for federal purposes on the computation of provincial tax payable. There is no problem with respect to calculation of provincial tax in the agreeing provinces because an election made for federal purposes automatically applies provincially. In Quebec a separate election is required by The Taxation Act for all provincial purposes and the procedures involved are to be found in that Act. The situation is different in Ontario and Alberta. Ontario provides that an election made by a corporation under the Income Tax Act (Canada) will apply in Ontario if the federal section under which the election is made has been made applicable for Ontario purposes.[28] The foregoing is subject to two conditions. First, if a different amount would be determined under the provincial legislation then that different amount will apply. Secondly, the federal penalities for late filing of elections do not apply provincially. Therefore it is not the amount elected for federal purposes that is adopted but rather the election itself. As will be seen, this is important when considering the election of different amounts for federal and provincial purposes.

Alberta's legislation goes one step further than Ontario's. It provides that an election made under the federal Act may be filed for provincial purposes by a corporation and if that is done the rules in the Income Tax Act (Canada) apply.[29] It then goes on to provide that if the federal election is not filed provincially, the Provincial Treasurer shall accept an election made in accordance with the rules in the federal Act.[30] Once again, it is not the amount elected that is adopted for provincial purposes, only the election itself. Thus Alberta's legislation covers a situation not contemplated by the Ontario legislation. Alberta anticipates a separate provincial election made in accordance with a federal section that governs a federal election. Ontario corporations are restricted to an election made federally under the federal rules as made applicable in Ontario and accepted for provincial purposes or provincially in accordance with The Corporations Tax Act. Alberta corporations, meanwhile, have the opportunity to elect different amounts for federal and provincial purposes provided that those amounts are permissable within the operation of the federal rules. Ontario corporations can only elect a different amount for provincial purposes if a different amount is permitted by the Ontario legislation.

The next question is in what circumstances can a corporation elect a different amount for provincial purposes than the amount it has elected federally? Ancillary to this is the issue of what effect can a different elected amount have on the calculation of a corporation's tax payable, and when would it be beneficial for a corporation to elect a different amount? Perhaps the best way to answer these questions is to take a look at two different types of elections that may be made under the Income Tax Act (Canada) and their application provincially.

One of the more straightforward elections is to be found in subsection 83(2) of the Income Tax Act (Canada). A private corporation may elect to pay a capital dividend out of the corporation's capital dividend account and if it does so that dividend is not included in the income of its recipient. Section 2101 of the Regulations made under the Income Tax Act (Canada) prescribes the procedure to be followed when making this election. Both Ontario and Alberta make subsection 83(2) applicable without change for the purposes of their legislation.[31] Therefore an election made under that section will have effect in the respective provinces. As mentioned, Ontario would not in these circumstances accept an election for provincial purposes that differed in amount from that made federally. Alberta, on the other hand, could accept an election in a different amount. However the nature of the capital dividend election itself would prohibit an election in a different amount for provincial purposes. The election of a capital dividend is the election of an amount that is paid directly to shareholders of the taxpayer corporation. Because the figure is a real one and not merely a notional one, in practice it must be the same for federal and provincial purposes.

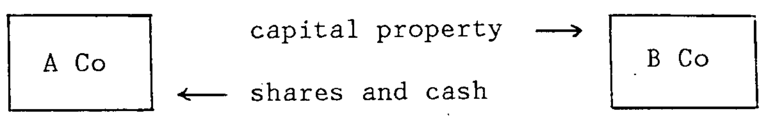
Nevertheless there is a series of events that, should it occur, could produce a valid election of different amounts for federal and provincial purposes. This scenario revolves around the non-application for provincial purposes of Part III of the Income Tax Act (Canada). That Part provides for a tax on an excessive election from the capital dividend account of three-quarters of the excess. It also provides that a corporation may, instead of paying the excessive election tax, elect to have the excess treated as an ordinary taxable dividend.[32] Assume that a corporation elects under subsection 83(2) to pay a dividend from the capital dividend account of $150,000. That amount is then excluded from the recipient's income for federal purposes and for Ontario and Alberta purposes. Further assume that the election, on review by the federal authorities, is considered to be an excessive one and that in fact the amount available for distribution as a capital dividend is only $100,000. For federal purposes the corporation can either pay an excessive election tax of $37,500 or it can elect under subsection 184(3) to treat the excess $50,000 as an ordinary taxable dividend in which case the amount of the capital dividend is reduced to $100,000. Yet, neither of these alternatives is available to the corporation in respect of Ontario or Alberta calculations and consequently the question is will there be a corresponding reduction in the amount of the capital dividend in Ontario and Alberta? If the answer is no, then we have a capital dividend of $100,000 federally and a capital dividend of $150,000 in Ontario and Alberta.

There is no indication in either Ontario's or Alberta's legislation of the treatment that this excess would receive. One would assume that the amount of the capital dividend could be reduced for provincial purposes if only to retain parity between the amount remaining in the capital dividend account for federal and provincial purposes. Yet, the legislation is not clear on this and the argument could be made by a corporation that, in the absence of any statutory provision to the contrary, it can claim the higher amount provincially. It is of interest that Quebec's legislation provides that the amount of the capital dividend account is the same for Quebec and federal purposes.[33] Neither Ontario nor Alberta impose such a requirement and the inference can be drawn from this that different amounts are permissable.

One of the most important elections made by a corporation pursuant to the Income Tax Act (Canada) is the election of an agreed amount for the purposes of a property transfer to a corporation. A look at a hypothetical example of a section 85 rollover indicates the problems encountered by a province that permits election of a different agreed amount for provincial purposes. It also illustrates the benefits that can accrue to a corporation that takes advantage of the situation. As discussed earlier, Ontario only permits the election of a different amount where it is expressly provided for in The Corporations Tax Act. In the case of a section 85 rollover no such provision exists so the federal election applies. This is not the situation in Quebec and Alberta. Quebec provides its own rollover election rules and procedures in sections 518 to 528 of The Taxation Act, the Quebec equivalent of section 85 of the Income Tax Act (Canada). Alberta makes section 85 applicable in Alberta[34] and, as discussed earlier, permits the election of a different amount provincially if the corporation does not file its federal election in Alberta.

Therefore the situation can arise where corporations in Quebec and Alberta that roll over property into other corporations resident in those provinces can elect a greater agreed amount for provincial purposes than they do for federal purposes. Two advantages are immediately apparent. If the corporation rolling the property over has less taxable income federally than provincially, then it is advantageous to it to include any gain in its income. Meanwhile the corporation into which the property is rolled has acquired a higher adjusted cost base in respect of the property transferred to it and on disposition of the property it will be better protected from any gain it may incur. The province, on the other hand, will lose revenue amounting to the tax not collected on the gain and not collectable in the future on disposition of the property because the amount will be part of the recipient corporation's adjusted cost base. The following example illustrates the problem:

SECTION 85 ROLLOVER
BETWEEN TWO ALBERTA CORPORATIONS



Cost of property to A Co.	$ 70,000
Fair market value of property on rollover	$200,000
Consideration recieved from B Co. ($70,000 cash, $130,000 shares)	$200,000
Elected agreed amount for federal purposes	$ 70,000
Elected agreed amount for provincial purposes	$100,000

Tax Consequences

	Federal	Provincial
Capital gain to A Co.	NIL	$ 30,000
Adjusted cost base to B Co.	$70,000	$100,000

G. Tax avoidance and tax evasion

As far as a corporation is concerned some of the most critical sections of the Income Tax Act (Canada) are those that deal with tax avoidance and tax evasion. In order to organize its affairs a corporation needs a clear understanding of the rules of the game and therefore clarity in both the federal and provincial legislation is vital. If the legislation differs from jurisdiction to jurisdiction, then a corporation faces the dilemma of trying to rationalize the two approaches and come up with a course of action that offends neither jurisdiction.

In respect of tax avoidance by Canadian residents, the relevant sections of the federal Act include sections 55 and 84.1. Both these sections have been adopted without change by Ontario and Alberta.[35] Quebec, however, while reitterating subsection 55(1) in section 308 of The Taxation Act, has chosen to omit subsection 55(2). The practical result of this ommission for a corporate taxpayer in Quebec is not as beneficial as it might, at first glance, appear to be. Subsection 55(2) of the Income Tax Act (Canada) effectively stops a corporation from turning what would normally be a capital gain into a tax free dividend. Therefore it would appear that tax planning that would be caught by subsection 55(2) for federal purposes would be valid in Quebec and not offend the Quebec legislation. That is of little comfort to corporations since a federal prohibition is sufficient to stop such schemes. The only corporation that could possibly benefit from Quebec's ommission would be a corporation that, despite having a tax free dividend converted to a gain pursuant to subsection 55(2), had no taxable income federally but did have taxable income in Quebec. That taxable income would now presumably be reduced by the corporation being able to receive a dividend rather than a gain. One wonders why Quebec chose to omit this subsection and yet include the more general subsection 55(1) of the federal Act. Perhaps they were of the opinion that subsection 55(1) was sufficient to prohibit the transactions contemplated by subsection 55(2), although in light of the federal experience with the ineffectiveness of subsection 55(1) this seems unlikely. Perhaps it was a deliberate decision to permit a corporation to organize its affairs in a way that is prohibited federally. Perhaps they preferred to let the federal government administer the subsection rather than set up the machinery to do so themselves. Whatever their reason the fact remains that Quebec is the one jurisdiction in Canada where a corporation is not restricted by this controversial subsection.

Quebec has, however, enacted a set of rules equivalent to those found in section 84.1 of the Income Tax Act (Canada).[36] Ontario and Alberta have also adopted section 84.1 without change.[37] Therefore the anti-dividend stripping rules that prevent the premature extraction of a pre 1972 capital gain tax free are applicable in respect of both federal and provincial corporate income tax.

It is in the area of tax evasion that the differences between the federal and provincial rules become more obvious. Part XVI of the Income Tax Act (Canada) contains three sections that deal with specific methods of evading tax. Section 245 prohibits an artificial reduction in income by use of deductions or indirect payments or transfers. Section 246 allows the Treasury Board to counteract tax avoidance or reduction of tax payable by artificial means. Subsection 247(1) ensures that dividends are not stripped out of corporations under the guise of capital gains. Subsection 247(2) allows the Minister of National Revenue to deem corporations to be associated with each other in certain circumstances.

Ontario has adopted section 245 without change in section 21(1) of The Corporations Tax Act and Quebec has restated it in section 1080 of The Taxation Act. Alberta has not adopted or re-enacted the rule in section 245. Therefore, presumably, Alberta is restricted in its power to determine what is an artificial transaction to the extent that it must rely on the federal government to make such a determination. In addition, Alberta does not adopt or re-enact section 246 of the Income Tax Act (Canada). Practically, however, neither omission is a significant problem for the province unless the corporate taxpayer has no taxable income federally without the use of the artificial transaction or avoidance scheme and is using the transaction or scheme for the purposes only of avoiding provincial tax. If this is the case Alberta will have to attempt to persuade the federal authorities to make such a determination even though the corporation's actions do not impinge on the federal tax payable. As far as tax avoidance goes, Ontario is in a similar position to Alberta because it does not adopt section 246. Quebec does restate section 246 for provincial purposes.[38]

When it comes to the anti-dividend stripping provisions in the federal and provincial legislation, one see a different approach taken by each of the three non-agreeing provinces. Admittedly the importance of subsection 247(1) of the federal Act has diminished over the years but it is still relevant. Alberta does not adopt subsection 247(1) nor does it enact its own anti-dividend stripping section. It, therefore, relies on the federal application of the section. However, without enactment of an equivalent section or adoption of the federal subsection no amount determined under subsection 247(1) and directed to be included in income calculated federally can be so included for Alberta purposes. This could be a major omission from income. Ontario does not technically adopt subsection 247(1) but it does go one step further than Alberta because it provides that:

> 21(2) In computing the income of a corporation for a taxation year there shall be included an amount that is included in computing the income of the corporation under Part XVI of the Income Tax Act (Canada) pursuant to section 247 of that Act.[39]

Thus, the amount determined federally is applied in Ontario to the corporations income but the Ontario Minister of Revenue does not have the power to decide whether or not there has been avoidance of tax.

Quebec takes the opposite approach.[40] It not only gives the Quebec Minister of Revenue the same powers as those exercised by the federal Minister of National Revenue but those powers are apparently not subject to review by the courts, except in exceptional circumstances.[41] In Quebec, when the Minister of Revenue is of the opinion that the object of a transaction is to decrease the assets of a corporation or cause these assets to disappear in such a manner that tax that would otherwise be payable has been or is avoided, he may determine the amount of that tax that must be included in income. One immediate difference between this provision and subsection 247(1) is that in Quebec the Minister is restricted to transactions where the object, not one of the principal objects as 247(1) permits, is to avoid tax. However, this restriction is compensated for by the fact that unlike the federal Minister's decision, the decision of the Quebec Minister of Revenue is not subject to judicial review unless it can be shown by the taxpayer that the ministerial discretion was exercised in bad faith.[42]

H. Deemed association of corporations

The power to deem of corporations to be associated has been treated differently by the federal government and the three non-agreeing provinces. This causes confusion for corporate taxpayers over whether or not they are considered to be associated for provincial purposes. The statutory definition of associated corporations is found in subsection 256(1) of the Income Tax Act (Canada) and this subsection has been adopted by both Ontario and Alberta.[43] Quebec does not enact a statutory definition of association. The problems really surface in the application of subsection 247(2). That federal subsection gives the Minister of National Revenue the power to deem corporations to be associated. Alberta accepts a federal deeming of association and provides that if corporations are associated federally under subsection 247(2) then they are to be considered associated for the purposes of The Alberta Corporate Income Tax Act.[44] The only provincial power to deem corporations to be associated is granted to the Provincial Treasurer in respect of calculation of entitlement to the royalty tax credit.[45] These Alberta provisions leave a corporation in no doubt as to whether or not it is associated with one or more corporations in Alberta. The situation is not so straightforward in Quebec and Ontario.

It would appear that two questions arise when considering the provincial problems presented by the issue of deemed association. First, does a province consider corporations that are associated for the purposes of the federal legislation to be associated for the purposes of the provincial legislation? Secondly, does the province have its own power to deem corporations to be associated for the purposes of calculating provincial tax payable? The answer is a qualified no to both questions in Ontario and Quebec. Quebec does not give the Minister of Revenue the power to deem corporations to be associated. It also does not directly adopt a federal deemed association. Section 771 of The Taxation Act indirectly incorporates a limited concept of associated corporations by reference to subsection 125(1) of the Income Tax Act (Canada). Section 771 provides that the tax payable by a corporation is an amount that is calculated by reference to the amount a Canadian controlled private corporation may deduct pursuant to subsection 125(1). Therefore the subsection 125(1) calculation is brought into the calculation of Quebec tax payable. The operation of subsection 125(1) is dependent on the concept of associated corporations because the deduction made under subsection 125(1) is based on a corporation's business limit and total business limit. Those expressions are defined in subsection 125(2) and associated corporations have limits of nil. This rather convoluted set of statutory references results in Quebec only using the federal concept of associated corporations for a specific limited purpose. Federally associated corporations will be associated for the purpose of reducing provincial tax payable by a percentage of the federal small business deduction. The deeming of association is limited to that set of circumstances and does not extend to Quebec's own incentives for "eligible business".

Ontario's Minister of Revenue does not have the power to deem corporations to be associated and a federal deeming of association under subsection 247(2) is not made applicable generally for Ontario purposes.[46] It does come into play in the calculation of Ontario's small business incentives through a reference in sections 33, 34 and 35 of The Corporations Tax Act to subsection 125(1) of the federal Act.

Therefore corporations can be deemed to be associated with each other for federal purposes but not provincial purposes in Ontario and Quebec. The converse is true in Alberta and the seven agreeing provinces. These corporations deemed to be associated by the Minister of National Revenue will be associated for all provincial purposes. Corporations would do well to act with these facts in mind.

In conclusion, differences in the administrative provisions of the Income Tax Act (Canada) and the legislation of Quebec, Ontario and Alberta can adversely affect corporations with a permanent establishment in these jurisdictions. Those adverse effects arise especially in the areas of assessment and reassessment and the powers to deem corporations to be associated. Both those areas are full of uncertainties that, as discussed, put the corporate taxpayer in an invidious position when it comes to planning its affairs and the tax consequences of those affairs. The possibility of reassessment in Ontario after the federal time limit for reassessment has expired, the lack of administrative co-operation generally between the non-agreeing provinces and the federal government and the question of whether or not corporations are associated both federally and provincially all contribute to this uncertainty.

Several problems are also presented by the different approaches to tax evasion. First, what is legitimate within the scope of both the federal and provincial legislation must be determined by each corporation. Then, if the conclusion is reached that a transaction or scheme is permitted by one jurisdiction but prohibited by another, a decision must be made on the ramifications of that for the corporation. Finally if an advance ruling is sought and the proposed transaction or scheme receives a favourable reception in one jurisdiction but unfavourable in another, the only course open to the corporation is to hope that negotiations with both jurisdictions will produce an acceptable result. Once again the corporate taxpayer has to rely on inter-governmental co-operation and goodwill, both very unpredictable and uncertain concepts.

Inter-governmental co-operation appears to be the key to improvement in the administrative treatment of the corporate taxpayer. Yet, there is one drawback to more co-operation. As seen, there are a few advantages for the taxpayer to be found as a result of the uncertain state of affairs. These advantages are primarily in the area of elections and result from the election of different amounts for federal and provincial purposes. Nevertheless it would seem that in this case the disadvantages are more numerous than the advantages. Yet change is unlikely unless more pressure is put on the federal and provincial governments by those corporations that can show the difficulties and hardships they have encountered.

CHAPTER IV - FOOTNOTES

1 It should be noted that at present Alberta accepts the federal return for provincial purposes although Alberta officials have indicated that they are currently drawing up their own return to replace the federal one for provincial purposes.

2 The administrative provisions referred to in this chapter are contained in The Taxation Act, R.S.Q. 1977, c. I-3, ss. 1000 to 1086; The Corporations Tax Act, R.S.O. 1980, c. 97, ss. 67 to 100; The Alberta Corporate Income Tax Act, R.S.A. 1980 c. A-17, ss. 36 to 84 and the Income Tax Act, R.S.C. 1952, c. 148, ss. 150 to 180 and ss. 220 to 247.

3 The Income Tax Act, R.S.C. 1952, c. 148, s. 152(4).

4 Ibid.

5 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 73(7)(a)(iv).

6 The Alberta Corporate Income Tax Amendment Act, S.A. 1982, c. 1, s. 20(1) amends section 43(1)(b)(ii) of The Alberta Income Tax Act.

7 The Income Tax Act, R.S.C. 1952, c. 148, s. 157.

8 The Income Tax Act, R.S.C. 1952, c. 148, s. 157(1)(b)(i); The Corporations Tax Act R.S.O. 1980, c. 97, s. 70(2)(b)(i); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 38(1)(b)(i).

9 The Income Tax Act R.S.C. 1952, c. 148, s. 157(2); The Taxation Act, R.S.Q. 1977, c. I-3, s. 1028; The Alberta Corporate Income Tax Act. R.S.A. 1980, c. A-17, s. 38(3).

10 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 70(3).

11 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 38(1.1).

12 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 78.

13 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 50.

14 The Taxation Act, R.S.Q. 1977, c. I-3, s. 1066.

15 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 92.

16 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 94(1)(b).

17 Dauphin Plains Credit Union Limited v. Xyloid Industries Ltd. and the Queen (1980) C.T.C. 247 at 265, per Estey J. (dissenting).

18 The Income Tax Act, R.S.C. 1952, c. 148, s. 222; The Alberta Corporate Income Tax Act R.S.A. 1980, c. A-17, s. 57.

19 It should be noted that because the federal government collect corporate income taxes on behalf of the agreeing provinces, no problems of priority arise.

20 The Income Tax Act, R.S.C. 1952, c. 148, s. 227(4).

21 The Income Tax Act, R.S.C. 1952, c. 148, s. 227(6), repealed by S.C. 1956, c. 39, s. 27.

22 This proposition is well established. In R. v. Wells 16 East 278 at 282, Macdonald, C.B. said "I take it to be an incontrovertible rule of law that where the King's and the subject's title concur the King's shall be preferred".

23 See, In re Silver Bros. Limited (1932) A.C. 514; In re Walter's Trucking Service Ltd. (1965) 50 D.L.R. (2d) 711.

24 See, for example, Gauthier v. The King (1918) 56 S.C.R. 176; Crowther v. Attorney-General of Canada (1959) 17 D.L.R. (2d) 437; Re Sternschein, Sternschein v. The Queen (1965) 50 D.L.R. (2d) 262.

25 (1968) C.T.C. 111.

26 Supra, note 17.

27 For a full list of all the elections available under the Income Tax Act (Canada), the regulations made under that Act and the Income Tax Application Rules, see, Recommendations on the Income Tax Act 1980/81 by the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants, Appendix I.

28 The Corporations Tax Act, R.S.O. c. 97, s. 1(4).

29 The Alberta Corporate Income Tax Act, R.S.A. 1980 c. A-17, s. 2(6).

30 Ibid

31 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 23(1); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 14(1).

32 The Income Tax Act, R.S.C. 1952, c. 148, s. 184(2) and (3).

33 Regulation respecting The Taxation Act, O.C. 1981-80, Quebec Gazette, s. 590R2.

34 The Alberta Income Tax Act, R.S.A. 1980, c. A-17, s. 14(1).

35 The Corporations Tax Act, R.S.O. 1980, c. 97, s13(1); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 9.

36 The Taxation Act, R.S.Q. 1977, c. I-3, ss. 517.1 to 517.6

37 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 23(1); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 14(1).

38 The Taxation Act, R.S.Q. 1977, c. I-3, s. 1082.

39 The Corporations Tax Act. R.S.O. 1980, c. 97, s. 21(2).

40 The Taxation Act, R.S.Q. 1977, c. I-3, ss. 1083 to 1085.

41 See, Roncarelli v. Duplessis (1959) S.C.R. 121 and E.J. Richardson, Tax Planning for Corporations in Light of Differences in Federal and Provincial Income Tax Legislation, Report of Proceedings of the Thirty-First Tax Conference, (1979), 766 at 801.

42 Ibid.

43 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 1(1)(a); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 1(1).

44 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 2(9).

45 The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 26.1(9), (10).

46 The Corporations Tax Act, R.S.O. 1980, c. 97, s. 1(1)(a); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 1(1).

CHAPTER V

THE FUTURE

A. Introduction

It is very easy to criticise an existing state of affairs and the levying and collection of corporate income tax in Canada certainly lends itself to all kinds of criticism. What is not so easy is to suggest viable improvements to the system. This is even more difficult in a federal country where the viability of any recommendations for change is dependant upon acceptance by not only the federal government but by the ten provincial governments as well. One would suspect that, in retrospect, the Carter Commission would agree that unanimous acceptance is difficult to achieve. That Commission cited one of the main goals of Canada to which the tax system should contribute was "to maintain and strengthen the Canadian federation".[1] In fact, the lack of harmony on tax issues could be said to have seriously weakened Canadian federation. The Prime Minister obviously took this view when he said:

> What is required is a new orientation to inter-governmental co-operation --- a clearer definition of the roles of the two orders of government may well help to achieve this --- a new orientation which would focus the attention of governments on the whole complex issue of public services and on the whole of Canada's tax system, as they affect the citizen. This new orientation, this focus, is what federal-provincial relations must come to mean to the citizen, instead of the unhappy disputes which have persisted during the post war period as to the share of certain taxes which each government ought to get.[2]

Will there be a new orientation to inter-governmental co-operation in the corporate income tax field? If there is, will it be a solution to: the problems already discussed? This chapter will examine three potential courses open in the corporate tax field to the federal and provincial governments. One is the inter-governmental co-operation espoused by the Prime Minister. Another is the antithesis of this, that is more provincial autonomy and independence in the field. The third is tax harmonization, a popular concept in theory but as yet untried in practice in the corporate tax area in Canada.

B. Co-operative federalism

It has been said that Canadian inter-governmental fiscal relations "are as unharminous and unconstructive as at any time in the history of Confederation and even the term 'co-operative federalism' has been dropped from our vocabulary".[3] These are strong words but, when applied to corporate income tax, true. Co-operative federalism represents federal-provincial coordination through consultation in the administration of matters that are shared by both levels of government.[4] Co-operative federalism has, over the last few years, become somewhat unfashionable. In the corporate tax area the coordination of co-operative federalism is practically non-existent as far as the federal government, Quebec, Ontario and Alberta are concerned. It does exist between the federal government and the agreeing provinces but the damage is done by the three provinces that chose to opt out. The essence of co-operative federalism is total co-operation and thus it cannot exist without the participation of all jurisdictions.

Yet, co-operative federalism has been suggested as the panacea to cure all the problems with the Canadian corporate income tax system. In order to determine whether it is feasible to expect such a result, the effect of a new spirit of co-operation on some of the areas of the system criticised earlier will be examined. The most obvious area for more communication and co-ordination between all the provinces and the federal government is the administration of the system. It is curious that while Quebec, Ontario and Alberta value the independence of their administrations so highly, this is the area where one senses that neither the provinces nor the federal government would be averse to more co-operation. At the present time, for example, the federal government, Ontario and Alberta all include a provision in their corporate income tax legislation permitting the respective provincial officials to communicate and exchange information with each other.[6] That in itself goes a long way to assisting the provinces in their pursuit of the revenue due to them as taxes from corporations. In addition there have been isolated incidents of committees being set up for particular purposes in the quest to solve inter-provincial and federal-provincial problems.[7]

Yet, this is not enough. There is no formal line of communication at the administrative level between the federal government and the non-agreeing provinces and between the non-agreeing provinces themselves. As we have seen, instances arise where the taxpayer is adversely affected by an inter-jurisdictional discrepancy and is unable to do more than hope that one of the jurisdictions involved will recognise the difficulty and alleviate the problem.[8] A formal line of communication between the jurisdictions would at least give the taxpayer a body to which the complaint could be directed. As far as the jurisdictions are concerned, any disadvantage involved in a sacrifice of independence should be outweighed by the advantage of knowledge acquired that would otherwise be unknown. The aim of collecting all taxes due is shared by both the federal government and provinces alike. The easiest means to achieve that aim surely involves more co-operation.

Perhaps a lesson can be learned from the operation of a federal-provincial body that has had some success in the tax policy area. That body is the Federal-Provincial Continuing Committee on Fiscal and Economic Matters set up in 1955.[9] Its terms of reference are "discussion and exchange of information on fiscal and economic matters, and to examine questions that may be referred to it by the federal-provincial Premiers Conference".[10] It is the most visible sign that federal-provincial communication about tax policy still exists. It includes representatives from both the agreeing and non-agreeing provinces, an important factor since this is the one opportunity for the federal government and agreeing provinces to learn about any proposed changes to the legislation of the non-agreeing provinces. Nevertheless, there is still room for improvement in the operation of this committee. According to one senior Department of Finance official, policy discussions on proposed taxation policy often take place after the federal government has made a decision to implement a particular policy.[11] This tends to detract from the value of any decisions made by the Committee. Perhaps the best that can be said is that at least there is a forum for discussion of the policy issues. Discussion after the fact is better than no discussion at all.

An interesting recommendation that would be of considerable assistance to the corporate taxpayer caught in the middle of an inter-jurisdictional dispute or by an anomaly in the legislation is that a code of tax conduct be established and adhered to by all governments. When the Parliamentary Task Force on Federal-Provincial Arrangements made this recommendation they commented that:

> [S] uch a code of tax conduct would not preclude the use of provincial government expenditure policy or regulatory devices to achieve particular economic or social objectives, but it might at least help to maintain reasonable administrative and compliance costs.[12]

These comments are especially apt when considering the application of a code of tax conduct to corporate income tax. Whether this recommendation will be implemented or not probably depends on how much of a benefit the non-agreeing provinces can foresee in the form of increased revenues through better administrative and collection procedures. The benefit to the corporate taxpayer would be an incidental result of such action.

A new approach to corporate income tax administration based on co-operative federalism, whether in the form of the establishment of a committee or introduction of a code of conduct, would directly affect the federal budget process. As discussed, provincial participation in the discussions leading up to the introduction of the federal budget is extremely limited.[13] There is no formal communication between the Minister of Finance and his provincial counterparts about proposed tax changes to be contained in the Budget. The rationale for this is that familiar excuse, budget secrecy. Yet, there is a glimmer of light on the horizon. The Green Paper on Budget

Secrecy and Proposals for Broader Consultation introduced in the House of Commons in April, 1982 by the Minister of Finance acknowledges that budget secrecy is somewhat of an over-rated reason for non-communication of budget information prior to the budget's introduction.[14] This theme is picked up by the Committee on the Budget Process of the Canadian Tax Foundation which emphatically calls for more communication between federal officials and those of the provinces before the Budget decisions are finalized "without the spectre of budget secrecy unduly inhibiting their discussion".[15] A new approach to communication of information to the provincial governments about the federal Budget is well overdue. If the federal government should agree to be more forthcoming with this information, then there is a good chance that as a 'quid pro quo' the provinces will agree to divulge more information about their future tax policies to the federal government and other provincial governments prior to introduction in the provincial Budget.[16] That would be a true example of co-operative federalism.

A fundamental question that arises when considering the effect of co-operative federalism on the corporate income tax system is: are co-operative federalism and regionalism compatible? Does the existence of one preclude the existence of the other? Regionalism and its effects seem to have become the latest preoccupation of political scientists and others who write about Canadian federalism.[17] The consensus seems to be that regionalism is an integral part of a federalist country and therefore is compatible with co-operative federalism.[18] It has been put this way:

> Federalism presumes the existence of both nationalism and regionalism. It is the coexistence of centripetal and centrifugal forces,

> of pressures for centralization and decentralization, of desires for unity and diversity, of attachments to the nation and the region which are the very foundations of federalism as a principle of political organisation.[19]

If regionalism is a part of co-operative federalism the next question is, in the context of the corporate income tax system, how far must the pendulum swing away from nationalism towards regionalism before that co-operative federalism no longer exists? It can be argued that the pendulum has already swung too far. Three out of ten provinces do not participate in the national system. That in itself is enough to suggest that an excess of regionalism has obliterated co-operative federalism. More evidence of a regionalistic approach is found when a close look is taken at the tax incentives offered by the three non-agreeing provinces. The Alberta royalty tax credit is a classic example of a province offering an incentive to the type of corporation that it is in the provincial government's interest to assist. The Alberta economy depends to a large extent on the fate of the oil and gas industry. In Quebec and Ontario it is the small business and especially the manufacturing corporations that are assisted through tax incentive schemes. Again, regionalism is prevelant because these corporations form the backbone of the Quebec and Ontario economy.[20] Even some of the non-agreeing provinces have come up with their own tax incentives for corporations. British Columbia, for example, provides for a logging tax reduction[21] while Saskatchewan grants a royalty tax rebate.[22]

Given, therefore, that the corporate income tax system in Canada has become one that leans more towards a regional approach than a national approach, what effect would more attention to co-operative federalism have on the regional incentive schemes? Presumably in order to recapture the spirit of co-operative federalism the emphasis would have to be put more on a nationalistic approach and that results in less regionalism. Less regionalism means fewer provincial tax incentive schemes designed to assist local corporations. The vacuum left by such a change in emphasis would have to be filled by the federal government which in turn would provide the tax incentives of a regional nature.[23] Therefore co-operative federalism, while not precluding regional tax incentive schemes, would require that they be provided by the federal authorities and not the provincial authorities.

The final item to be examined when considering the application of more co-operative federalism to the corporate income tax system is the operation of the allocation rules. This is perhaps the most obvious area where a little co-operative federalism would assist the corporate taxpayer by eliminating the possibility of double taxation. The problems presented by the different rules and the differences in application have been examined. Tax commentators have come up with some interesting methods of solving these problems. One commentator has suggested ridding the rules of the sales factor and instead basing them on profits.[24] First he assumes that a corporation's activities are all equally profitable. He then postulates that is a determination is made in respect of a permanent establishment of the annual payroll of that activity and the value of company property in the province then profits earned in any province will be an amount that bears the same relation to total profits of the company as payroll and property in the province bears to the total payroll and property of the corporation. One drawback to this analysis is that it assumes that profits are earned wherever business activity is carried on, and this is not necessarily so. Nevertheless, the attraction of this suggestion is that it may well appeal to provinces such as Alberta that view the present rules as orientated too extensively towards the manufacturing corporation. Elimination of the sales factor could make the rules more acceptable generally.

On the other hand, there are those who feel that the rules still have merit. It has been said that:

> The existing rules, with all their faults, have the virtue of being sufficiently simple, as well as being sufficiently familiar, to be understood by taxpayers and to be capable of being readily administered by tax collectors.[25]

Certainly this comment is valid in respect of the federal rules but one wonders whether the corporate taxpayer views the rules in Quebec and Ontario and especially their application as "sufficiently simple". The solution to the taxpayer's problems with the allocation rules must be based on co-operation between the federal government and the provinces. That co-operation should take two forms. First, the allocation rules should be the same in all jurisdictions. Secondly, the rules should be applied in an atmosphere of compromise and common sense, thereby eliminating the present anomalies that occur in their application. Yet, even this would not be enough. The rules may be uniform and thereby equitable but their application will still result in inequities. The reason is that the rules are based on the definition of permanent establishment and that term has a different meaning for federal purposes and in Quebec, Ontario and Alberta. Those differences in interpretation are fundamental to the corporate income tax systems of the three non-agreeing provinces and no amount of co-operative federalism will be able to overcome that barrier.

Therefore a new spirit of co-operative federalism applied to the Canadian corporate income tax system can obviously only improve the system and thereby the lot of the corporate taxpayer. However, it is certainly not a solution to all the problems. The concept is extremely laudable in theory but in practice almost impossible to implement. Therefore the best that can be hoped for is a little more co-operation at the administrative level where sacrifices of political principle or, even worse, tax revenues are not involved. That would be a good beginning.

C. Provincial autonomy

The evolution of the Canadian tax system has been described by one commentator as "the piecemeal disintegration of the national tax system".[26] If this is so, then perhaps events have reached the stage where a truly "national" corporate income tax system is impossible to achieve. The Canadian corporate income tax system could consist of two distinct components. The federal government could, on its own behalf, levy and collect corporate income taxes as it now does but each province would have its own corporate income tax rules and administration. This exercise in provincial autonomy may not, in light of recent events, be as far fetched as it would have seemed to be ten years ago. Alberta has recently decided to pursue its own course and British Columbia is threatening to do so.[27]

Perhaps the best solution is to let this happen and encourage all provinces to initiate their own systems. There are advantages in this for both the federal government, the corporate taxpayer and the provinces.

The advantage to the federal government is, of course, that it will no longer have to administer the corporate income tax systems of seven provinces. The saving in dollars would be considerable. As far as the corporate taxpayer is concerned it could be said that it would be no worse off than it is at present. The ideal situation is total conformity in the corporate income tax systems of the federal government and the provinces but if that does not exist the degree of non-conformity if irrelevant. Any non-conformity at all presents problems for the corporate taxpayer. Another more positive advantage to the corporate taxpayer would be the opportunity to jurisdiction shop. If the provinces are given a free hand to develop their own tax systems, they will be able to offer incentives to those types of corporations that they wish to encourage. A new corporation would be well advised to pick its permanent establishment with this in mind and look for the province offering the most advantageous tax incentives.

The advantages to the provinces are obvious. Each province will be able to design its own corporate income tax system to meet its own requirements. The only restrictions on the design will be those of a constitutional nature and the economic viability of the system. From a constitutional viewpoint, the tax must be direct. On the economic side, the tax must not be so onerous that it drives corporations out of the province thereby diminishing tax revenues. Yet, the opportunity is there to increase revenues from corporate income taxes provided that the correct balance is struck between the tax burden imposed on corporations and their ability to pay it. There will be much more room for a province to fine tune its system. Ironically enough, another advantage of provincial independence in this field might well be the promotion of more collaboration on tax policy by the provinces. It may be that such collaboration proves necessary in order to administer systems that parallel each other.

Unfortunately, for every advantage there is a disadvantage. For the federal government this means a loss of control over the provincial systems. For the corporate taxpayer the problems are more serious. A corporation paying tax in more than one province will be faced with the added expense of filing more than one return and generally complying with the legislation of more than one jurisdiction. We have seen how complicated life can be for a corporation that has to abide by the differing legislation of Quebec, Ontario and Alberta. The situation would be exacerbated by the addition of seven more non-agreeing provinces.

For the provinces one of the more mundane disadvantages is the expense of setting up and administering their own corporate income tax systems. Perhaps, however, the real hardship would befall those provinces that, because of regional disparity, are unable to compete on equal terms with the more affluent provinces. This regional disparity is in evidence when a look is taken at the fiscal capacity of each province. That fiscal capacity varies dramatically. For example, the total revenues, including federal transfer payments, of Alberta are more than double those of Prince Edward Island.[28] It is these stark realities that strike fear into the heart of provincial politicians from the less affluent provinces when the talk is of more provincial autonomy in the tax field. This can be seen in a statement made in 1963 by the Premier of Nova Scotia. He said:

> [I] n the light of the disparity in natural resources and economic development in the various provinces, the federal government must retain a sufficient portion of the tax fields in Canada to enable it to discharge its direct constitutional responsibilities and to assist provinces with low tax potential so as to enable them to furnish a national standard of services of (sic) the Canadian citizens residing within their boundaries.[29]

The less affluent provinces cannot afford the inter-provincial tax competition that more provincial autonomy would bring. They do not have the resources to be able to design a corporate income tax system that would bring them sufficient revenues. When the fiscal capacity of the provinces is examined it is easy to see why Quebec, Ontario and Alberta are able to run their own corporate income tax systems. They can afford it. Other provinces cannot.

The prospect of the Canadian corporate income tax system becoming one where every province fends for itself by levying and collecting its own corporate income tax is slim. As seen, the economic problems are many. Yet, even more fundamental problems can be found when the political realities of the situation are considered. No federal government would want to be the one to relinquish federal power in this area. No federal government would want to incur the wrath of the corporate taxpayers who could face increased costs in order to comply with the legislation of ten provinces. No federal government would want to endure the outcry that would ensue from those provinces that cannot afford to administer their own systems.

Political autonomy as a solution to the problems with the Canadian corporate income tax system is a form of overkill.

D. Tax harmonization

One issue that has never received much debate in Canada is "tax harmonization". This economic term has been succinctly described as "the removal of tax rate differentials among fiscal jurisdictions which are closely linked by commodity trade and sometimes factor exchange relationships".[30] When applied to Canadian corporate income tax it assumes a broader meaning to encompass both tax bases and tax rates. The Carter Commission was of the opinion that "even greater uniformity of tax bases than now prevails among governments would be highly desirable, as would uniformity of rates".[31] Yet the Commission took a realistic approach to this kind of harmonization when it indicated that it would not be easy to achieve.[32] This conclusion has proved to be accurate in light of the fifteen years that have elapsed since it was reached. Those fifteen years have seen no move at all towards harmonization of the tax base or tax rates.

An example that Canada can look to on the efficacy of tax harmonization is the European Economic Community. The Neumark Committee was set up by the E.E.C. to examine harmonizing taxation and that Committee recommended a single tax rate on all production by E.E.C. countries.[33] That recommendation is presently in the process of being implemented. At first glance it would appear that if the independent sovereign states that comprise the E.E.C. can get together and implement tax harmonization, then surely the members of a one country federation should be able to do it. Two points should be made here. First, the E.E.C.'s harmonization policy only affects commodity transactions, not corporate income taxes. Secondly, each of the countries participating in the E.E.C. starts off on an equal footing with the others. In Canada the division of legislative power puts the federal and provincial governments in different positions and harmonization of the tax bases involves both these governments.

At this stage, a distinction must be made between vertical tax coordination, that is harmonization of tax bases between the federal and provincial governments, and horizontal tax coordination which is harmonization of tax rates among the provinces. Total harmonization in Canada would involve both these types of coordination. The advantages are obvious. The cost of collecting taxes drops considerably since one central body is responsible for tax collection. Inter-provincial tax competition no longer exists. The cost to the corporate taxpayer drops as only one return is required. The system is uniform, simple to administer and simple to comply with. Double taxation is eliminated and there is no requirement for an allocation formula.

The disadvantages of total harmonization revolve around the inevitable sacrificing of provincial autonomy that such a system requires. The provinces, while receiving revenues to spend, would have no direct authority to establish the amount of those revenues. The present freedoms they have to determine their own economic and fiscal policies would disappear. Total harmonization would make the provinces totally dependent on the federal government for a major source of revenue. This, no doubt, would be viewed by them as a most regressive step.

There is, however, an alternative to total harmonization. Harmonization of the tax base alone as between the federal and provincial governments, that is vertical tax coordination, would go a long way to solving many of the problems with the present Canadian corporate income tax system. It should be much more acceptable to the provinces than total harmonization because it will allow them to set their own tax rates. The corporate taxpayer will benefit because, as with total harmonization, there will be no difference in the computation of taxable income between the jurisdictions. All the anomalies already discussed that are a result of provincial tinkering with the tax base would disappear.

In fact, this form of harmonization could be considered to be merely an extension of the present system. It would not change the fundamental character of the Canadian corporate income tax system. Instead it would restrict the power of the provinces with respect to the tax base but at the same time give them a free hand with respect to tax rates. The rules would be the same across Canada, the rates would not. This solution has been suggesed in the wider context of harmonization of both individual and corporate income tax.[34] The theory is that the corporate income tax system lends itself more to such harmonization because of the inter-provincial nature of corporations and their affairs. Because the system should be attractive to corporate taxpayers, it would be interesting to see what effect a concerted effort on their part to lobby for its implementation would have.

E. Conclusion

"The World of Dominion-Provincial finance has, indeed, an air of grotesque unreality, untrammeled by logic and the ordinary restrictions and meanings of words."[35] So said one political scientist more than thirty years ago. Little has changed since that time. That "grotesque unreality" is evident in Canada's corporate income tax system. What may on the surface appear to be compatible and similar tax systems turn out, on closer examination to be nothing of the kind. The corporate taxpayer with a permanent establishment in Quebec, Ontario or Alberta has two major problems. First, it must deal with at least two different administrations. Secondly, it must in the organisation of its affairs pay close attention to those subtle differences between the federal legislation and that of the three provinces. Those differences may appear to be subtle but their effect is far from subtle. Inattention to them can have serious adverse consequences for the corporation. As to whether or not a federal country should have a corporate tax system of this nature, that is another question. The Carter Commission was of the opinion that the federal government and the provinces should maintain a common corporate tax base. It further recommended that the system be administered by one government, namely the federal government.[36] This has not happened and in light of present federal-provincial relations is not likely to happen. Nevertheless, all governments must reconsider these proposals, or at least a variation of them, based on more co-operation and harmonization. If the opportunity to do this is not taken now it will probably never be taken. One more province choosing to administer its own corporate income tax system will be the final blow that extinguishes any remaining vestiges of federal-provincial and inter-provincial co-operation and harmony in the Canadian corporate income tax system. It will also be a classic example of federalism that operates to fracture a system rather than to consolidate and improve it. That for the corporate taxpayer, and indeed Canada, would be an unnecessary tragedy.

CHAPTER V - FOOTNOTES

1 Report of the Royal Commission on Taxation, Vol. 2, (Carter Commission) (1966), at 7.

2 Right Honourable Pierre Trudeau, The Constitution and the People of Canada, (Queen's Printer, Ottawa), (1969), at 12.

3 Donald V. Smiley, Federal-Provincial Fiscal Relations---Some Current Issues, Report of the Proceedings of the Twenty-Sixth Tax Conference (1974), Canadian Tax Foundation, 20 at 23.

4 Co-operative federalism has been the subject of numerous articles in recent years. See generally, D. V. Smiley, Co-operative Federalism: An Evaluation, Volume 4, Documents of the Royal Commission on Bilingualism and Biculturalism (Ottawa, Queen's Printer, 1970) pp. 111-128; J.R. Mallory, The Five Faces of Federalism, contained in Canadian Federalism: Myth or Reality (3rd ed.) ed. J. P. Meekison 19; A. R. Kear, Co-operative Federalism: A Study of the Federal-Provincial Continuing Committee on Fiscal and Economic Matters, Canadian Public Administration, Vol. VI, No. 1 March 1963, 43-56.

6 The Income Tax Act, R.S.C. 1952, c. 148, s. 240(4); The Corporations Tax Act, R.S.O. 1980 c. 97, s. 91(3); The Alberta Corporate Income Tax Act, R.S.A. 1980, c. A-17, s. 77(4).

7 For example, the Quebec-Ontario agreement on certain aspects of the allocation rules, at 92.

8 See generally the discussion of the allocation rules at 85-92.

9 For a full description of the history of the Federal-Provincial Continuing Committee on Fiscal and Economic Matters, see Kear, *supra*, note 4, at 305.

10 K. W. Taylor, Co-ordination in Administration, Proceedings, The Institute of Public Administration of Canada, Toronto, (1957) at 261.

11 See, Douglas G. Hartle, The Revenue Budget Process of the Government of Canada: Description, Appraisal and, Proposals, (1982) Canadian Tax Paper No. 67, Canadian Tax Foundation, at 11.

12 Fiscal Federalism in Canada, Report of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements, August 1981 at 185.

13 See pages 46-47.

14 Green Paper -- The Budget Process -- A paper on Budget Secrecy and Proposals for Broader Consultation, reproduced in (1982) 30 Can. Tax J. 170-178.

15 Committee on the Budget Process, On Opening Up the Budget Process: A Report to the Hon. Allan J. MacEachen, Minister of Finance (1982) 30 Can. Tax J. 161 at 166.

16 It should be noted that provincial officials apparently feel that they are much more willing to divulge this information at the present time than the federal government and resent the federal government not reciprocating in kind. See Hartle, supra, note 12, at 40.

17 This current interest in regionalism is demonstrated by the inclusion by J. Peter Meekison in the third edition of his book Canadian Federalism: Myth or Reality of an entire section comprising six articles about regionalism. The previous two editions of the book did not contain this section.

18 See, Canadian Federalism: Myth or Reality (3rd. Ed.), ed. J. Peter Meekison, 280-363.

19 David M. Cameron, Whither Canadian Federalism? The Challenge of Regional Diversity and Maturity, contained in Canadian Federalism: Myth or Reality (3rd ed.) ed. J. Peter Meekison, 304 at 309.

20 For a full description of these incentives, see Chapter III.

21 The Income Tax Act, R.S.B.C. 1979, c. 10, s. 6.

22 The Income Tax Act, R.S.S. 1978, c. I-2, s. 8.

23 For a discussion of the kinds of tax incentives of a regional nature that the federal government could offer see generally R. M. Bird, Tax Incentives for Regional Development, Report of the Proceedings of the Twenty-First Tax Conference, (1968) Canadian Tax Foundation, 192; Charles E. McLure, Tax Incentives for Regional Development: A Critical Comment, (1970) 18 Can. Tax J. 545; R. M. Bird, Further Thoughts on Regional Tax Incentives (1970) 18 Can. Tax J. 549.

24 A. Kenneth Eaton, Essays in Taxation, Canadian Tax Paper No. 44, (1966), Canadian Tax Foundation, 100-102.

25 Ernest H. Smith, Allocating to Provinces the Taxable Income of Corporations: How the Federal-Provincial Allocation Rules Evolved, (1976) 24 Can. Tax J. 545 at 569.

26 D. V. Smiley, Federal-Provincial Fiscal Relations, Some current Issues, Report of the Proceedings of the Twenty-Sixth Conference (1974) Canadian Tax Foundation, 20 at 21.

27 Federal-Provincial Fiscal Arrangements in the Eighties, A Submission to the parliamentary Task Force on the Federal-Provincial Arrangements, (1981) at 55. British Columbia has served notice of its intention to withdraw from the tax collection agreement unless the federal government agrees to administer proposed dividend and venture capital tax credits.

28 Ibid, 43.

29 Robert Stanfield, Attitudes Towards Financial Relations, Nova Scotia's view, contained in Canadian Federalism: Myth or Reality (2nd ed.) ed. J. Peter Meekison, 304 at 308.

30 Wayne R. Thirsk, Tax Harmonization and Its Importance in the Canadian Federation, contained in Fiscal Dimensions of Canadian Federalism, ed. Richard M. Bird, Canadian Tax Foundation (1980) at 118-119.

31 Report of the Royal Commission on Taxation, Vol. 6 (Carter Commission), (1966), at 188.

32 Ibid.

33 For a full analysis of the Neumark Committee's report, see C. S. Shoup, Fiscal Harmonization in Common Markets (1967) (New York: Columbia University Press).

34 Donald R. Huggett, Tax Base Harmonization, (1977) Intergovernmental Relations, Ontario Economic Council, 55 at 62.

35 Robert MacGregor Dawson, The Government of Canada (University of Toronto Press, 1947) at 120.

36 Report of the Royal Commission on Taxation, Vol. 6 (Carter Commission) (1966), 193-194.

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