TAX AVOIDANCE -- THE CANADIAN EXPERIENCE

by

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Section 245 was proposed as part of the tax reform package initiated by the government on 18 June, 1987. It introduced an extended general anti-avoidance rule into Canadian tax law. The rule has been in effect since September 13, 1988, but has yet to be judicially considered.

This paper adopts a methodology which incorporates a political perspective. In particular, the rule is analyzed within the general environment - the socio-political, economic and historical backgrounds - in existence at that time. It was felt that such an approach was necessary to explain certain issues. For example, why the Canadian government decided to introduce section 245 and why certain modifications were made to the proposal in its passage through the legislative process.

Overall, this paper hopes to extend our understanding of the rule by exposing the factors which created a favourable political environment for the enactment of the provision.
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CHAPTER I

INTRODUCTION

A. GENERAL

Tax avoidance is certainly not a recent or novel phenomenon.\(^1\) In fact, in light of its apparent immortality, one may be excused for regarding it as a natural consequence of the imposition of taxes, owing its existence to the fallibility of human nature!\(^2\) However, whatever one attributes tax avoidance to, its existence is inescapable and will continue as long as the incentive and opportunity to avoid taxes persist.\(^3\) As regards the former, it seems that the incentive will always be

\(^1\) It is noted that the term "tax avoidance" is a misnomer in a legalistic context, in the sense that if tax-minimizing schemes are classified as such, then the legal consequences are that the tax liability is not reduced (or avoided) in accordance with the transaction. Conversely, if schemes are successful, then they are given effect to by the taxing authorities, and therefore, technically, should not be termed "tax avoidance". cf. D.C. Nathanson, "General Anti-Avoidance Rule and Tax Reform - The Business Purpose Test: Proposed Section 245" paper presented at Insight Conference, November 14, 1988 at 11. However, unless otherwise indicated, the term "tax avoidance" is used in this paper in a loose, non-legalistic sense, to generally mean attempts at avoiding tax.


\(^3\) It is noted that this is a somewhat simplistic viewpoint, and that other factors (for example, those mentioned in note 2) may play a role in generating attempts at tax avoidance.
present, at least in industrialised nations, due to the fact that the revenue needs of these countries do not allow the establishment of sufficiently low rates of tax to make structured tax avoidance uneconomic.\(^4\) In relation to the latter, the opportunity to avoid tax will continue in industrialised nations as long as comprehensive bases which tax all sources uniformly are not implemented.

However, in reality, tax systems are generally inconsistent with this comprehensive base model.\(^5\) In practice, not only are differentiations made between types of income, but also taxpayers are accorded different treatment by tax legislation due to the existence of special incentives. As regards the former, it follows that if one form of "income"\(^6\) is not taxed (or is taxed at a lower rate, etc.), then the propensity is to attempt to avoid taxes by converting what otherwise would be fully taxable into a non-taxable or less taxed receipt. For example, in Canada at present, capital gains are differentiated from other types of income (on the basis of policy reasons, i.e.


\(^5\) The classic exposition of such a model being the Carter Commission: Royal Commission on Taxation Report (Ottawa: Queen's Printer, 1966) (Chair: K. LeM. Carter).

\(^6\) This term is used loosely to connote some kind of receipt, not in the technical sense contained within the tax legislation.
to encourage investment), and as such are non-taxable within the
limits of the lifetime capital gains exemption and are not taxed
in full, with only three-quarters of the gain being taxable.
That such differences are utilised to avoid tax can be seen from
the "surplus-stripping" schemes of the 1960s and 1970s.\(^7\)
However, such differential treatment of forms of income is
generally less commonplace now,\(^8\) with the result that would-be
avoiders must resort to other means to reduce their tax bills.

This brings us to the second general means available for
avoiding taxes: making use of preferential tax provisions, to
reduce the tax that would otherwise be payable.\(^9\) Such

\(^7\) For a fuller discussion on the utilisation of this type
of tax avoidance scheme in Canada, see R.A. Friesen & D.Y.
Timbrell, "Shams and Simulacra II - The Capital Gains Aspect"
(1979) 27 Canadian Tax Journal 135; T.E.J. McDonnell, "Tax
Avoidance: Section 137(2) as a Charging Section" (1968) 16
Canadian Tax Journal 281; G. McGregor, "Dividend Stripping: The
Business Purpose Test" (1968) 16 Canadian Tax Journal 16; S.
Silver, "Surplus Stripping: A Practitioner's View" (1974) 22
Canadian Tax Journal 430.

\(^8\) For example, in the United Kingdom, capital gains have
been fully taxable since 1972.

\(^9\) For evidence that such provisions remain of recent
concern, one need look no further than the figures produced by
the Canadian government valuing the loss of revenue in the
utilisation of these measures. So, for example, in 1985 the
Department of Finance in Account of the Cost of Selective Tax
Measures estimated such losses as running into the tens of
billions of dollars: Canada, Department of Finance, Tax Reform
'87: Report of the Standing Committee on Finance and Economic
Affairs tabled in the House of Commons on November 16, 1987
(Don Mills: Richard De Boo, 1987) at 21. More recently, the Canadian
government highlighted the use of special tax preferences in
its tax reform package of 1987 as the means by which high-
earning individuals and corporations were able to reduce their
tax liabilities: Canada, Department of Finance, Tax Reform 1987:
provisions are known colloquially as "loopholes", or more technically as tax expenditures.\textsuperscript{10} Briefly, they are provisions in the tax legislation which have no revenue-raising function, whose purpose instead is to achieve non-tax social or economic policy objectives.\textsuperscript{11} In most cases they are functionally equivalent to a direct government spending program.\textsuperscript{12} However, it should be noted that, in light of their very nature, tax systems cannot disallow all transactions which make use of these special incentives to reduce taxes. Otherwise, the effect is to nullify these provisions, as the purpose of their introduction is to encourage certain types of behaviour, by offering the

\textit{Income Tax Reform} (Ottawa: the Department, June 18 1987) at 7-8 and 11 (especially, Table 2.3).

\textsuperscript{10} This concept was developed by the late Stanley Surrey, an American legal scholar, while he was the Assistant Secretary for Tax Policy in the U.S. Treasury Department. For a description of the development of the concept see S.S. Surrey, \textit{Pathways to Tax Reform} (1973) as referred to in N. Brooks, "Future Directions in Canadian Tax Law Scholarship" (1985) 23 \textit{Osgoode Hall Law Journal} 441 at 457, footnote 39.


\textsuperscript{12} A distinction should be made between those taxpayers whose affairs fall naturally within one of the tax preferences, for example, students who benefit from the deduction of tuition fees, and those taxpayers who arrange their affairs so as to benefit from special incentives, for example, by creating a tax shelter. It is only in respect of the latter that concern is expressed regarding the "abuse" of preferential tax provisions, in the sense that benefits are conferred in circumstances that were unintended by Parliament.
incentive of reducing (or avoiding) tax. Thus, if states wish to place limits on which tax-minimization schemes will be successful (in the sense that they are given effect to by the taxing authorities), then some basis of distinction must be adopted. Consequently, standards such as "artificiality" or "business purpose" are often utilised.¹³

Before proceeding further, it should be explained that it is not intended that the merits of tax avoidance be discussed here. Debate has occurred in the past over whether any tax minimization transactions should be curtailed, regardless of the blatancy with which such schemes "flirt with the four corners of the statute".¹⁴ However, in the present climate, namely,

¹³ However, a further ground of distinction referred to in respect of the Canadian tax system is the "smell test" or the repugnancy index: D.A. Ward, "Has Revenue Canada Become 'Big Brother'?" (1984) 117 C.A. Magazine 4:22-36 at 22. See also, J.A. Stacey, "Revenue Canada's Administration of the General Anti-Avoidance Rule: An Update" in Report of Proceedings of the Forty-Second Tax Conference 1990 Conference Report (Toronto: Canadian Tax Foundation, 1991) 4:2 at 4:3 in relation to the enactment of section 245 of the Income Tax Act, RSC 1952, c.148 [the Act]: "[w]hile the 'smell' test was being legislated, what was not so clear was whose olfactory senses were to be applied". Such a test is arguably indicative of the absence of a clear distinction within the Canadian tax system prior to (and even after) the enactment of section 245, on which to distinguish between acceptable and non-acceptable tax minimization.

¹⁴ For example, such debate was particularly prevalent in the United Kingdom in the 1960s and 1970s, see A.A. Shenfield, The Political Economy of Tax Avoidance, The Institute of Economic Affairs, Occasional Paper 24 (London: The Institute of Economic Affairs, 1968), particularly 19 ff. and B. Bracewell-Milnes, supra, note 2. Other material includes M.B. Angell, "Tax Evasion and Tax Avoidance" (1938) 38 Columbia Law Review 80. For a Canadian discussion on the merits (or evils) of tax avoidance, see Carter Commission Report, supra, note 5 Vol. 3 at
animosity towards tax planning, it would take a brave person indeed to countenance openly all types of tax minimization. The current debate therefore is based on the fundamental assumption that some sort of limit must be imposed on tax planning, and from this, the door is left open merely for discussion of the appropriate standard for distinguishing between acceptable and unacceptable tax minimization, and the means of giving effect to such a standard.

In considering the Canadian tax system, it is proposed that this paper concentrate on section 245 of the Act,\textsuperscript{15} which sets forth the basis of the distinction currently adopted in Canada, namely between "abusive tax avoidance" and its antithesis, "legitimate tax planning".\textsuperscript{16} The standard for determining whether a tax-minimization scheme is "abusive" or not, and therefore within the ambit of section 245, consists of three factors: the taxpayer's motive, the policy of the particular statutory provision in play and the policy structure of the Act read as a whole.\textsuperscript{17}

\textsuperscript{15} This provision is more commonly known as the General Anti-Avoidance Rule (or the "GAAR").

\textsuperscript{16} Technical Notes issued by the Minister of Finance, contained in: Canada, Department of Finance, \textit{Tax Reform 1987: Income Tax Reform}, supra, note 9 at 137.

\textsuperscript{17} V. Krishna, \textit{Tax Avoidance: The General Anti-Avoidance Rule} (Toronto: Carswell, 1990) at 40.
B. METHODOLOGICAL APPROACH

The enactment of section 245, from the time of its initial proposal, received a great deal of attention, albeit primarily within the tax and business communities. It consequently generated a staggering amount of literature,\(^ {18}\) including an entire book devoted to this provision alone!\(^ {19}\) However, quantity does not ensure quality, and a great deal of this literature was limited to either merely describing or interpreting the rule itself, or, if analyzing it, generally doing so from a limited, legalistic perspective, without challenging any underlying assumptions. It is proposed that this thesis advance beyond these limitations and adopt instead a more incisive approach.

The conventional approaches adopted in tax policy analysis turn on the distinction between technical tax policy analysis and tax expenditure analysis.\(^ {20}\) Technical tax provisions are described as structural provisions essential to implement the tax, whereas


\(^{19}\) Krishna, supra, note 17.

\(^{20}\) Brooks, supra, note 10 at 457.
tax expenditures are not essential features of the normal tax system, but are functionally equivalent to government spending programs.\textsuperscript{21} Methods of analyzing tax policy recognise this distinction:\textsuperscript{22} technical tax provisions are analyzed according to tax criteria;\textsuperscript{23} tax expenditures are analyzed according to budgetary criteria.\textsuperscript{24}

Section 245 clearly falls within the category of a technical tax provision, and accordingly, normative traditions should be utilised. However, before these policy analysis tools are automatically applied, it should be noted that they have been discredited somewhat in recent times,\textsuperscript{25} a common theme being that they do not adequately take account of political reality.

\textsuperscript{21} Ibid.

\textsuperscript{22} Ibid.

\textsuperscript{23} The traditional normative standards being equity, efficiency and simplicity: \textit{ibid}.

\textsuperscript{24} Basically, the criteria involves questioning whether there is a need for the particular federal subsidy, which may be answered in the negative, either on the merits of the program or on the philosophical view that government intervention in the market is per se bad: McDaniel, \textit{supra}, note 11 at 392-3. A further ideological hypothesis which could result in a negative answer is that tax expenditures are inappropriate instruments for effecting non-tax policies.

In explanation, it should be noted that the tax structure, at any given time, is the result of a highly complex political process which at the very heart involves politicians vying for votes of the electorate which will bestow the prize of political power: politicians are less concerned with what is in the interests of society, than with what will keep them in office.\textsuperscript{26} It is only by studying this broader picture that we can account for the apparent inadequacies (by the standards of normative traditions) that persist in the tax system and also explain the elusiveness of the "good" system - major changes or reforms, although advocated as promoting fairness, simplicity or whatever, never quite seem to match up to these norms in reality. Therefore, exclusive reliance on normative traditions has inherent limitations imposed by its failure to take into account the political and social reality of taxation.\textsuperscript{27}

Support for implementing a politically-conscious approach can be drawn from existing work. Increasingly, the literature on tax matters is moving beyond normative traditions, and is instead adopting a more pragmatic approach by highlighting the political

\textsuperscript{26} W.I. Gillespie, "Tax Reform: The Battlefield, the Strategies, the Spoils" (1983) 26 \textit{Canadian Public Administration} 182 at 183.

\textsuperscript{27} This is not to say that the two approaches cannot be integrated, for example, Winer & Hettich, supra, note 25 at 416-20, consider the implications that their positive political economy model has for normative theories in taxation, in particular, equitable taxation.
political economy approach is deemed relevant to this paper due to its inclusion of the political element. In particular, the writings of Winer and Hettich are highlighted. It is felt that their model can make the greatest contribution to the methodology of this thesis, due to its incorporation of the political 'voice' together with its assumption that the tax system is a natural outcome of self-interested decision making. Basically, the model integrates four strands: economic response, self-interested political behaviour, the political equilibrium with costs and benefits.


32 Ibid. ("Economic and Political Foundations of Tax Structure") at 701. Other theoretical literature on taxation assumes public decision makers choose and implement policies according to general and social criteria such as efficiency and equity.

33 Taxpayers' economic adjustments are commonly referred to as the 'exit' and have been much discussed in the literature on taxation: Winer & Hettich, supra, note 25 at 412.

34 Governments wish to maximize their expected support to ensure their continued stay in office. Individual support for the government depends on the benefits from public goods and the loss in full income; on characteristics which determine how a particular individual's net economic benefit from the fiscal system is translated into a probability of voting for the government and on the individual's political influence (which is effected by such factors as membership and strength of interest groups and personal wealth): Hettich & Winer, supra, note 31 ("Economic and Political Foundations of Tax Structure") at 702.
component of taxation, albeit, sometimes only implicitly.\textsuperscript{28} However, explicit politicization of taxation is integrated in some models that are specifically formulated to incorporate the political element. In particular, a body of literature has developed within the discipline of economics, generally known as the political economy of taxation.\textsuperscript{29} Unfortunately, integration of the political component in this manner, namely in conjunction with economics, often makes the models rather complex to one not knowledgable in this field. Being one who falls within this latter category, it is hoped that the probable oversimplification of these models will be overlooked.\textsuperscript{30} The


\textsuperscript{30} Other models have been posited which do not rely quite so heavily on economics. For example, Gillespie, supra, note 26, has developed a positive model which does not explicitly incorporate the economic component. However, in essence, his model closely resembles (although is not as extended as) that of Hettich & Winer in that he basis it upon the concepts of
influence of administration costs\textsuperscript{35} and the heterogeneous nature of economic and political behaviour among taxpayers.\textsuperscript{36} These factors, it is contended, generate the essential elements of the tax system (tax bases, rate structures and special provisions). At any given time, the structure of the tax system, comprising these three elements, reflects the equilibrium that has been reached in terms of the balancing of political costs\textsuperscript{37} and benefits.\textsuperscript{38}

\begin{footnotesize}
\begin{itemize}
\item\textsuperscript{35} Administrative costs affect the tax structure as savings are made in grouping taxpayers into rate brackets where, despite interpersonal differences, they pay the same taxes. Any resulting political losses are offset by these savings which can be used to provide more public goods and therefore obtain increased support: Hettich & Winer, \textit{ibid.} at 706.

\item\textsuperscript{36} For example, heterogeneity occurs in economic terms in the ability of taxpayers to alter their behaviour and to escape into non-taxed activities. Politically, variations exist in wealth, interest group membership, voting and political activity: Winer & Hettich, \textit{supra}, note 25 at 412.

\item\textsuperscript{37} See, \textit{supra}, note 34 and accompanying text. Political costs to the government are determined as being the resulting loss in income, together with the political effectiveness or influence of the taxed individual: Winer & Hettich, \textit{supra}, note 25 at 411.

\item\textsuperscript{38} See, \textit{supra}, note 34 and accompanying text. Political benefits are the benefits from public goods: Hettich & Winer, \textit{supra} note 31 ("Economic and Political Foundations of Tax Structure") at 702. Other benefits have been identified as including the provision of services and transfer payments for its citizens: Gillespie, \textit{supra}, note 26 at 184.
\end{itemize}
\end{footnotesize}
However, as regards this paper, it is the application of this model to the incidence of tax reform,\textsuperscript{39} which, it has been claimed "...provides a new perspective for understanding the transformation of tax systems"\textsuperscript{40} that is most relevant. Hettich and Winer suggest that shocks to the system necessitate re-establishing the equilibrium by the adjustment of revenue instruments.\textsuperscript{41} Therefore, continual change can be regarded as the logical outcome of the government's attempt to retain office. They identify several factors which they believe may explain major tax changes in the past, for example, as regards economic responses, changes in the age distribution, in labour force participation and in the rate of inflation.\textsuperscript{42} In relation to political reactions, examples include changes in the cost of political organization, in constitutional restrictions, in the cost of acquiring information and in political

\begin{itemize}
\item \textsuperscript{39} Tax reform has been defined by Gillespie, \textit{supra}, note 26 at 186, as "a major change in the structure of a tax or of the total tax system. This could involve either a change in the comprehensiveness of the base of the revenue source or a large change in the effective tax rate for a revenue source...or some combination thereof." Winer & Hettich proffer a similar definition: "[tax reform is] any substantive change in the equilibrium structure of the tax system, regardless of what form it takes or for what purpose it has been initiated": \textit{supra}, note 25 at 412.
\item \textsuperscript{40} Winer & Hettich, \textit{supra}, note 25 at 414.
\item \textsuperscript{41} \textit{Ibid}.
\item \textsuperscript{42} \textit{Ibid}.
\end{itemize}
entrepreneurship. As a result of these shocks, the equilibrium adjusts and will involve changes that affect several aspects of the tax structure at the same time.

It is proposed that the above models be the foundations of the methodology employed in this paper. It should be noted that it is not proposed that these be followed religiously, as several inherent limitations exist so as to render this inappropriate. First, it is proposed that only the revenue-raising side of the public budget be examined. It should be explained that a complete picture could really only be gained by analyzing the expenditure process also, as obviously the distribution of goods, services and other benefits affects the existence and extent of "benefits" (for example, exemptions, deductions etc.) provided through the tax system. However, the relevance of incorporating both sides is questionable in light of the contention that no direct linkage exists anyway, in terms of voter support, between expenditure and tax structures as, arguably, individual taxpayers see no connection between the level of services provided and their own tax burden. It is not proposed that the merits of this controversial proposition be discussed on the basis that other more concrete reasons exist for not incorporating both sides: first such models are

43 Ibid. at 414-5.

44 Hettich & Winer, supra, note 25 at 703.
difficult to construct, and second, generally accepted practice verifies the concentration on only one side of the budget (the literature focuses almost exclusively on the expenditure side). From the above therefore, it is submitted that this paper will not be immediately disadvantaged because it concentrates primarily on the tax structure side of the public budget.

However, more serious limitations exist due to the focus of this paper being predominantly on a single provision within the whole tax structure. Hettich and Winer emphasize that all the essential elements of the tax structure are interdependent, and that any analysis should approach the structure as integrated systems of essential elements and not merely as collections of unrelated or ill-designed components. However, bearing in mind space constraints, it will be preferable to concentrate on one issue and analyze it in depth, rather than skate thinly over the whole tax system. Therefore, it is proposed that this paper concentrate primarily on the enactment of a single provision within the tax structure. This approach, on the face of it, obviously fails to fulfil the above criteria by not only omitting to study the interplay of all the elements of the tax

\[^{45}\text{Hettich & Winer, supra, note 31 ("A Positive Model of Tax Structure") at 69.}\]

\[^{46}\text{Ibid. at 68.}\]

\[^{47}\text{Supra, note 31 ("Economic and Political Foundations of Tax Structures") at 709.}\]
system, but moreover, not even focusing on any single element in the first place. However, it is submitted that the narrow perspective of this paper is not fatal. To explain, it is not intended that the thesis study section 245 in an isolated manner. It is proposed that the provision be analyzed in its economic, historical, political and social surroundings. This will necessitate considering the essential elements of the tax structure as a whole, albeit perhaps indirectly, to assist in the explanation of, for example, the introduction of the rule.

Lastly, the models will not be applied without modification due to their implications for tax reform analysis. Winer and Hettich suggest that such analysis could be utilised to explain reforms as the outcome of self-interested behaviour by government agents in response to shifts in economic and political factors. However, they go on to posit that such work would require the formulation of hypotheses about how exogenous factors influence the nature of political cost functions associated with different tax instruments, and how they cause shifts in such functions.

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48 Supra, note 25 at 414.
49 Ibid.
It is proposed that a similar approach be adopted in respect of section 245, namely its analysis within its political and economic environment. However, it is not intended that the factors which influenced and ultimately shifted the political cost functions (thus resulting in tax reform) be identified as suggested above. The reasons and justifications for deviating from this approach are as follows. First, difficulties exist in ascertaining political costs functions - governments have only limited knowledge of such functions,\(^5\) consequently, someone who does not have nearly the extent of resources available to government at their disposal stands little chance. Secondly, as outlined above, due to space constraints, it is proposed that the focus of this paper be on section 245 (opposed to the whole tax reform package), albeit, the package will receive some consideration as part of the process of analyzing the context of the provision. This therefore renders it impossible to identify either political cost functions, or the political factors influencing them, which are specific to the GAAR.

To conclude thus far, it is suggested that the methodology of this paper draw on the models discussed above, rather than religiously applying them. In particular, the fundamental themes of the models will be the basis of this paper, namely, the assumptions that taxation is a political process, and that it is the equilibrium outcome of self-interested behaviour of

\(^5\) Ibid. at 415.
the government. However, due to the difficulties outlined above, it is not suggested that attempts be made to identify the factors which effected the shift in the equilibrium and resulted in the tax reform in June 1987. Instead, it is proposed that the focus be on the provision itself (and not the whole reform package), although it will be analyzed within its context - as part of the readjustment of the equilibrium process. It is submitted that the perspective adopted be the rule as reflecting the outcome of the factors leading to the disequilibrium, rather than the other way about, namely, starting out by identifying the factors resulting in the rule. This is merely a change in procedure as both methods generate the same outcome: exposure of the factors which made it viable for section 245 to be enacted. From a practical standpoint, it will be easier to adopt the former method, as the latter would involve the analysis of factors responsible for the disequilibrium, and the resultant tax reform package, and then, a further scaling down of those factors to determine which ones are specific to the GAAR. Furthermore, such an approach may lead to the exclusion of factors not applicable to the tax reform package, but which are relevant to the GAAR, for example, the legal background.

The application of such an approach will involve analyzing section 245 within its whole environmental backdrop, from the economic conditions to the political and social factors and historical context. It is recognised that these factors are
intertwined and interdependent, and any attempt to separate them is a difficult, if not impossible task. However, to achieve any degree of coherence and logic in this study, such an attempt must be made. The reader has been forewarned, and may thus find that many propositions overlap from one context to the other. However, the only alternative would result in distortion of the arguments in trying to fit them within neat categories. To amplify, an example of the interrelation of these contexts is as follows: adverse economic conditions arguably affect taxpayers' attitudes to the avoidance of tax (ie. they are less tolerant of it in times of economic hardship than they are during an era of prosperity) which in turn may result in the political conditions being amenable to the introduction of a legislative measure to curb tax avoidance, the interpretation and application of which may be influenced by the economic conditions prevalent at the time (for example, the taxing authorities may adopt a more aggressive attitude in a harsh economic climate).

The validity of adopting such a politically-conscious approach is verified in light of the amount of opposition that was vented against the rule at the time of its proposal. Reflection on the enactment of the provision raises several issues: what was the government's purpose, was it promoting some norm such as fairness or equity (as it claimed) or, was it acting in its own self-interest to ensure its re-election; why did the government propose the rule in the first place when it must have been able
to predict beforehand the vehement opposition it would generate, considering the wide consultation process it embarked upon in drafting the White Paper; why was the rule not substantially changed in its passage through Parliament, especially as it originated in a White Paper and not as a legislative proposal and, in general, was it folly on the government's part to enact such a reform, if on the face of it, the political costs outweighed the benefits? It is submitted that attempts to answer these and other questions can only be made by looking beyond the rule to the wider context which existed at the time. With hindsight, we can say that political, social, economic and other relevant factors obviously made it viable for the government to proceed with the reform package, and in particular, section 245. Not only were the initial proposals enacted without too many major changes (and section 245, with no major changes), but the Conservative Government was successful in retaining its office at the general election which occurred in the year following the presentation of the tax reform package. Experience has shown us (the classic example being the dilution of the Carter Commission Report) that if the

51 A federal election was held on November 21, 1988.

52 Supra, note 5. This Report was described, at the time, by the then Finance Minister Mitchell Sharp as "one of the most far-reaching, explosive, revolutionary set of proposals ever put before the Canadian people" [as quoted by D.K. Huggett, "An Apocryphal Apocalypse?" in Brooks, ed., supra, note 11 381 at 381]. However, despite these glowing credentials, the recommendations were never effected in full: they were only partially implemented some nine years after the report was first commissioned, and only then, in a greatly diluted form. [For a
underlying political and economic factors do not support the proposed changes, then a disequilibrium is likely to be created, and the changes are not likely to be implemented in the first place, or if given effect to, then not sustained.

To conclude therefore, it is proposed that an approach be adopted which highlights the general environment in existence at the time of the enactment of section 245. Hopefully, such an approach will extend our understanding of the provision in explaining why the Canadian government decided to introduce it and why certain modifications were made to the proposal in its passage through the legislative process.

In achieving these objectives, it is proposed that the rule first be analyzed in isolation from its external environment. In particular, it is suggested that the salient points be discussed and the process of enactment outlined, with the changes made to the initial draft being highlighted. From here, it is then intended that the environment in which this whole process took place be synthesized, to illustrate how it is a product of these exogenous factors.

 fuller description, see D.G. Hartle, "Some Analytical, Political and Normative Lessons from Carter" in Brooks, ed., ibid. 397 at 412-3.] This outcome is generally attributed to the power of special interest groups who opposed the report: J. Gillies, "Federal Tax Reform in a Pluralistic State: Can it Be Done?", in Brooks, ed., ibid. 343 at 343. For a more detailed discussion, see Chapter IV, Historical Context, notes 16-32.
was well received, in fact, quite the contrary was true: the
bulk of the commentary on the proposed provision strongly
denounced it for a variety of reasons. The range of criticisms
was aptly summarised by the House of Commons Finance Committee, and
was generally focused on the scope, necessity (or lack of),
unconstitutionality and impact of the rule. The full

change, new deductions are introduced and old ones are
cancelled. In other words, most of the white paper
proposals do not go to the fundamentals of the system.

But the anti-avoidance proposal takes away taxpayers's
inherent right to plan their economic affairs under well-
defined rules and it makes all planning subject to
government consent. It ... allows the government to tell
each an every taxpayer how much in taxes he or she will pay.
Drache, supra, note 2.

Canada, House of Commons, Tax Reform '87: Report of the
Standing Committee on Finance and Economic Affairs tabled in the
House of Commons on November 16, 1987 (Don Mills: Richard De
Boo, 1987) ["the Blenkarn Report"] at 197-200.

For example, that it was too wide in that it would
disallow certain transactions that would otherwise be consistent
with the object and spirit of the Act on the basis that these
transactions lacked a business purpose and were designed to
serve only a social or economic purpose. Due to criticism
regarding the scope, the rule was slightly altered in that the
business purpose was substituted with a non-tax purpose test.

For example, it was contended that existing statutory and
judicial anti-avoidance measures were adequate to effectively
combat offensive tax avoidance. These arguments were
particularly relied upon by the Joint Committee of CBA/CICA:
"Recommendations on the Federal Reform Proposals of June 18,
1987 to Amend the Income Tax Act", Submission to the House of
Commons Standing Committee on Finance and Economic Affairs,
reprinted in V. Krishna, Tax Avoidance: The General Anti-
Avoidance Rule (Toronto: Carswell, 1990) Appendix A.2, 101 at
103 and "Powerful Committee Takes More Shots at Tax Reform"
(December 1988) Bottom Line 22.
CHAPTER II

SECTION 245

A. SECTION 245 - ITS RECEPTION

Section 245 was initially proposed as part of the tax reform package presented by the Conservative government in 1987.\(^1\) It generated a great deal of interest and publicity from the moment of its initial proposal, albeit generally only within the tax professional and business communities.\(^2\) Its introduction was heralded by one commentator as being "probably the single most significant legislative development in the history of Canadian income taxation."\(^3\) However, this is not to imply that the rule

\(^1\) The main government documents detailing the tax reform measures were as follows: Canada, Department of Finance, *Tax Reform 1987* (Ottawa: the Department, June 18, 1987); Canada, Department of Finance, *Tax Reform 1987: Income Tax Reform* (Ottawa: the Department, June 18, 1987); Canada, Department of Finance, *Tax Reform 1987: Economic & Fiscal Outlook* (Ottawa: the Department, June 18, 1987).


\(^3\) V. Krishna, "GAAR: The Ultimate Tax Avoidance Weapon" (1988) 2 Canadian Current Tax C75. Reasons for its perceived importance are suggested in the following statement:

[W]hen fiscal and economic circumstances dictate, tax rates
force of the condemnation even forced a Department of Finance official to publicly come to its defence. Moreover, the tirade against the rule was both constant and came from influential quarters: not only was it challenged by the tax professional and business communities, but also by an element of the government itself. It is against this backdrop that it is proposed that

7 For example, it was argued that the rule was, inter alia, void for vagueness, contrary to the rule of law or inconsistent with the Charter of Rights and Freedoms.

8 For example, it was alleged that the uncertainty it would generate would severely hamper business life and moreover, would increase compliance costs by forcing taxpayers to seek advance rulings. It was also argued that the rule vested too much power (and thus potential for abuse) in Revenue Canada as, until judicially considered, it would be determining its scope and application, a role it is not equipped to undertake.


10 The provision was criticised from the moment of its initial conception, up to and beyond, its final enactment. In particular, opposition was vented at every step throughout the legislative process - the changes effected in subsequent drafts (there were 2 major drafts - the original version and the 18 December 1987 draft) were attacked, even though such alterations may have been introduced in response to previous criticism. In all, it indicates that the tax community was determined not to be mollified.

11 Blenkarn Report, supra, note 4, which although supported the general principle of a GAAR, recommended that a different form be adopted - significantly, without a business purpose test. Compare this with the strong derisory comments made by the Standing Senate Committee on Banking Trade and Commerce: Canada, Department of Finance, Tax Reform '87: Report of the Standing Committee on Banking, Trade and Commerce tabled on December 1, 1987 (Don Mills: Richard De Boo, 1987) at 55: "... a vast majority of briefs and testimony referred to the Government's new anti-avoidance provision. With good reason, not a single voice was heard in support of this proposal".
the mechanics of section 245 will be briefly discussed.

**B. SECTION 245 - ITS SUBSTANCE**

Succinctly put, the purpose of GAAR is to prevent "abusive" tax avoidance transactions or arrangements by introducing a business purpose test (or technically, a non-tax purpose test) and a step transaction doctrine. In the practical sense, it implements this objective by providing that such transactions will not be given effect to by the taxing authorities: instead the tax consequences will be determined as is "reasonable in the circumstances". The rule is frighteningly simple in its scope of application: with one exception, any tax motivated transaction or series of transactions that result in a tax benefit will be regarded as an "avoidance transaction". The exception relates to the recognition afforded by the government to the fact that the Act is intended to apply to transactions with real economic substance, and that the Act itself encourages transactions that are primarily tax-motivated, for example, "butterfly" reorganisations under paragraph 55(3)(b). Consequently, the rule will not apply to deny tax benefits that result from transactions which are not contrary to the "object and spirit of the provisions of the Act read as a whole", even

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12 subsection 245(2).

13 subsection 245(3).

though they are primarily tax motivated. One final point to note in the mechanics of the GAAR is that it is intended as a provision of last resort after the application of the other provisions of the Act, including specific anti-avoidance measures.

C. SECTION 245 - EXTERNAL AIDS TO INTERPRETATION

From the time of the proposal of section 245, it seems that the government foresaw the problems that would be generated by the uncertainty of the rule. However, rather than changing the format of section 245 itself, the government attempted to assuage fears by, inter alia, producing explanatory notes both at the time of introduction of the proposed provision and

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15 Ibid.

16 Ibid. at 345.

17 It is arguable that section 245 was deliberately structured to be uncertain to enhance its threatening presence, as the more uncertain taxpayers are of their position, the less likely they are to be adventuresome: R.D. Brown et al, "GAAR and Tax Practice: More Questions than Answers" in Report of Proceedings of the Forty-First Tax Conference, 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990) 11.1 at 11:3. However, for a discussion on the problems of drafting a more precise provision, see the comments by Mr Jim Wilson (General Counsel/General Director, Tax Counsel Division, Department of Finance) in "Minutes to the Commons Standing Committee on Finance and Economic Affairs (Chairman: Don Blenkarn) for June 29, 1987 on the general anti-avoidance rule proposed as part of the June 18 tax reform package" as quoted in Krishna, supra, note 6, Appendix A.7 at 134-6.

18 Tax Reform 1987: Income Tax Reform, supra, note 1, Annex 1 at 137.
later in April 1988, to explain the December 1987 amendments.\textsuperscript{19} Furthermore, it committed itself to publish one or more interpretation bulletins or circulars at a later date,\textsuperscript{20} which it duly did with the issuance of Information Circular 88-2, "General Anti-Avoidance Rule: Section 245 of the Income Tax Act", October 21, 1988\textsuperscript{21} and a supplement\textsuperscript{22} thereto.\textsuperscript{23}

\textsuperscript{19} Explanatory Notes to Draft Legislation and Regulations Relating to Income Tax Reform, supra, note 14. Notes were also published at the time of these amendments: Canada, Department of Finance, Supplementary Information Relating to Tax Reform Measures tabled in the House of Commons by the Honourable Michael H. Wilson, Minister of Finance (Ottawa: 16 December 1987).

\textsuperscript{20} Tax Reform: Income Tax Reform, supra, note 1 at 130.

\textsuperscript{21} It is interesting that an Information Circular was published rather than an Interpretation Bulletin. The former is usually a statement of the application or administrative procedure of the Act, rather than an interpretation of the law. It has been suggested that this course of action connotes Revenue Canada's recognition of the uncertainty regarding the interpretation and indeed, fundamental significance of the new provision. J.S. Wilkie, "The World According to GAAR" (1988) Canada Tax Letter, No. 368 (De Boo, 1988).

\textsuperscript{22} Supplement 1, July 13, 1990. This Information Circular and Supplement are the only policy statements of Revenue Canada's position as regards tax avoidance. A previous statement contained in Information Circular 73-10R2 (24 April 1978) was deleted when the Circular was revised by Information Circular 73-10R3 "Tax Evasion", 13 February 1987: H.J. Kellough, "A Discussion of the White Paper's Proposed General Anti-Avoidance Rule" 1987 British Columbia Tax Conference, tab 6 at 14.

\textsuperscript{23} The Finance Department also released a booklet, "Questions and Answers on Tax Reform", containing general information on the White Paper proposals (including the GAAR): D. Beach, "Finance Department Book Answers Tax Reform Questions" Financial Times (19 October 1987) 26.

These efforts have been promoted by the government as being successful in achieving their purpose, note comments made by one Department of Finance official: "...much has been done to
However, none of these publications was met with great enthusiasm by the tax community, being criticised on the basis of their limited value in providing guidance as to the application of the rule. In particular, the circular merely outlines various transactions, and then makes terse statements as to whether such transactions will be treated as being "abusive" or not. There is a distinct lack of explanation as to the thought-process involved in classifying these different transactions, and therefore, unless transactions fall exactly within the examples given in the circular, taxpayers are bereft of any substantive guidance as to how a particular transaction would be treated by the taxing authorities, with the result that advance tax rulings will increasingly be sought. It is minimize the uncertainty surrounding the implementation of the new rule. The long period of consultation, the changes made to the original version of the rule, the extensive technical notes, and the promise that Revenue Canada will provide further information before the rule is implemented will help reduce the uncertainty to an acceptable level": Dodge, supra, note 9 ("A New and More Coherent Approach to Tax Avoidance") at 22.

For example, B.J. Arnold & J.R. Wilson, "The General Anti-Avoidance Rule - Part 3" (1988) 36 Canadian Tax Journal 1369 at 1376 who observe that Revenue Canada's decisions regarding the applicability of the rule in some examples (in this case, Examples 22 and 23 in the Circular) are based not on an object and spirit approach, but instead on some unspecified standard that looks very much like a "smell" test.

Possible reasons advanced for the limited nature of the Circular include: Revenue Canada believe the substantive law on tax avoidance to be unchanged and that it was too premature in the stage of the GAAR's life to make a general statement of interpretation. Wilkie, supra, note 21.

As previously mentioned, the increased costs generated in seeking advance tax rulings have been the subject of criticism: supra, note 8.
therefore difficult to discern with any degree of accuracy the
genral approach to be taken by Revenue Canada beyond the
specific transactions discussed.\textsuperscript{26}

The Explanatory Notes are not only subjected to the same
criticism,\textsuperscript{27} but in addition, their practical significance was
initially questioned in light of the controversy over their
admissibility in court.\textsuperscript{28} In response the government proposed
that a provision be included expressly directing that recourse
may be had to these Notes.\textsuperscript{29} However, after an heated debate
regarding the merits of such a provision,\textsuperscript{30} the measure was

\textsuperscript{26} Note, however comments made to the contrary: "[T]he main
value of the circular...lies in what it discloses about Revenue
Canada's general approach to the application of the rule":
Arnold & Wilson, "The General Anti-Avoidance Rule - Part 3",
supra, note 24 at 1374.

\textsuperscript{27} However, for a contrary view that the Explanatory Notes
are arguably of greater assistance, in that they go beyond
merely providing examples of the circumstances in which the GAAR
will be applied by also outlining the rationale of the rule and
explaining its operation: Arnold & Wilson, \textit{ibid.} at 1372. But,
note other viewpoints, for example, that they contain only a
partial list of transactions and the references to general
purpose do not necessarily add anything to the legislation: H.A.
Jacques, "A Practical Overview of GAAR and Parts IV.1 and VI.1
Dividend Taxes", 1988 \textit{Prairie Tax Conference} (Toronto: Canadian
Tax Foundation, 1988), tab 11 at 8.

\textsuperscript{28} For example, Kellough, \textit{supra}, note 22 at 72-5.

\textsuperscript{29} Subsection 245(10) of the December 16, 1987 amendments.

\textsuperscript{30} For example, that such a provision would accord the Notes
quasi-legislative status, that problems may occur in the future
regarding their modification if government policy changed, or
what the position would be if Revenue Canada administrative
policy conflicted with the Notes. For a vehement critique of
the subsection, see Joint Committee of CBA/CICA, "Comments on
the GAAR" as reprinted in Krishna, \textit{supra}, note 6, Appendix A.5
deleted and disappeared from the final version of the rule. Thus, it is still not clear what status will be accorded these Notes if, or when, the legislation is considered by the courts.\(^{31}\)

\(^{31}\) An important initial point to note in debating this issue is that questions regarding the admissibility of external aids only arise if there is an ambiguity in the interpretation of the provision: Kellough, supra, note 22 at 74. However, considering the uncertainty that currently shrouds section 245, there would not seem to be much doubt that ambiguities would exist in its application before the courts.

For a general discussion on the admissibility of extrinsic evidence in courts, see V. Krishna, "Use of Extrinsic Evidence in Determining the "Object and Spirit" of Tax Legislation" (1985) 1 Canadian Current Tax C117.


In light of the above and the admissibility of Interpretation Bulletins and Parliamentary debates as recorded in Hansard, it is submitted that, in continuation of this judicial trend, explanatory notes would most probably be accepted as extrinsic evidence by the courts.
D. SECTION 245 - ITS INTERPRETATION AND APPLICATION

It has generally been conceded that the rule will develop on two levels: administratively and judicially\(^{32}\) with the courts being the final arbiters in determining the exact scope and ambit of section 245. However, the rule has not yet been considered by the judiciary, and until that time, Revenue Canada's administrative approach prevails.

One may be justified in expressing surprise regarding this lack of judicial interpretation, considering that the provision has been in force for almost four years. During this period however there has been some activity in relation to the provision: advance tax rulings have been issued,\(^{33}\) technical interpretation letters obtained\(^{34}\) and allegedly, the GAAR has been


\(^{33}\) See for example, Advance Tax Rulings No. ATR-42, "Transfer of shares" (dated December 13, 1991); ATR-44, "Utilization of deductions and credits within a related corporate group" (dated February 17, 1992) and ATR-47, "Transfer of Assets to Realtyco" (dated February 24, 1992). In the first two rulings, the tax-minimizing schemes were stated to be "avoidance transactions", but yet subsection 245(2) was considered to be inapplicable on the grounds that they did not constitute a misuse of the provisions and/or an abuse of the Act read as a whole. In the latter ruling, the subsection was tersely stated not to apply, without any indication of the premises on which this decision was based.

threatened, cited in proposal letters and reassessments have been issued. However, as of yet, the writer is not aware of any case pending before the courts where the application of the GAAR is an issue. Suggestions, notably from a purely academic perspective, for this lack of judicial interpretation may include the hesitation on the part of Revenue Canada to rely on section 245, particularly when the same result can be achieved by arguing the applicability of other measures (statutory or judicial), or if the rule is being invoked to defeat tax planning schemes, then the unwillingness of taxpayers or Revenue Canada to have the matter settled in court.

Of the two options, it is suggested that the correspondence mentioned above (for example, advance tax rulings etc.) is indicative somewhat of Revenue Canada's propensity to rely on the GAAR as authority for not giving effect to tax-minimization transactions. This would be consistent with the more aggressive attitude that Revenue Canada has adopted in recent years towards

35 "[A] Toronto tax lawyer was recently involved in a real estate syndication deal that seemed to be affected by the general anti-avoidance rule. The deal was finally aborted after repeated phone calls and letters to Ottawa." E. Roseman, "Anti-Avoidance Law Irks Tax Planners" The Globe and Mail (28 November 1988) B1 at B4.


37 However, it should be noted that this statement should be qualified in the sense that it is based only on a reading of current tax literature, and that often such information is widely known within the tax community, yet not communicated to the public at large.
tax planning. If this is the case, then the issue remains as to why the application of the provision has not yet been challenged in court. One viable reason is perhaps that at present there has not been a sufficient lapse of time since the enactment of the rule for reassessments to be issued, the internal appeal procedure of Revenue Canada to be exhausted and for cases to thus find their way into the judicial structure. Alternatively, perhaps there is a reluctance on both the part of taxpayers (due to the costs of litigation, uncertainty of success — particularly the payment of tax and interest if unsuccessful etc.) and Revenue Canada (in case the courts limit the scope of the rule) to have the matter debated in court. Whatever the reason, in the interim period before judicial consideration, taxpayers are left at the mercy of Revenue Canada.

38 For predictions on the possible judicial interpretations to be given to the GAAR, see R.D. Brown et al supra, note 17 at 11:5 and Arnold & Wilson, "The General Anti-Avoidance Rule - Part 3" supra, note 24 at 1409-1410.

39 A possible caveat to the exclusiveness of Revenue Canada's discretion in determining the application of section 245 (in the absence of judicial interpretation) relates to the potential involvement of politicians. Arguably, it is possible that taxpayers could appeal to politicians regarding the application of the provision. The politicians could in turn apply pressure to Revenue Canada to determine the issue in favour of the taxpayer. The conceivable of this hypothesis is supported by past experience which gives some indication of the involvement of Cabinet Ministers in the administration of the Income Tax Act. For example, the decision regarding the success of tax minimization schemes undertaken by the Reichmanns in their takeover of Gulf Canada (resulting in tax breaks of over $500 million) were supposedly taken at Cabinet level: L. McQuaig, Behind Closed Doors: How the Rich Won Control of the Tax System ... And Ended Up Richer (Markam, Ont.: Viking, 1987) at 294-9. See also, "Wilson May Reveal Corporate Tax Breaks" Montreal Gazette (31 October 1985) B1.
E. SECTION 245 - ITS LEGISLATIVE HISTORY

The government first expressed its intention to enact a general anti-avoidance rule in its February, 1987 budget. Consequently, the GAAR was included within the 1987 tax reform package as a means of assisting in the achievement of the overall objectives of broadening the tax base and reducing tax rates. Draft legislation was duly included in the White Paper, revised during the legislative process (with the revised version set out in Bill C-139), and enacted, with the effective date being September 13, 1988. However, this very brief and clinical synopsis does not reveal the turmoil which surrounded the rule during its passage through the parliamentary process. Neither can the changes that were made to the original draft be regarded as indicative, being of such a limited nature. However, these modifications are proof of the final outcome of the negotiations between the government and the business and tax communities, and as such, should at least be highlighted.

40 Canada, Department of Finance, Budget Papers, Securing Economic Renewal: The Budget Speech, February 18, 1987, 11 as cited in B.J. Arnold, Brian J. & J.R. Wilson, "The General Anti-Avoidance Rule - Part 1" (1988) 36 Canadian Tax Journal 829 at 839. Several reasons were proffered by the Government to explain its introduction, including, inter alia: avoidance arrangements erode the tax base and undermine the fairness of the Canadian tax system; the existing rules were inadequate to prevent such avoidance transactions; technical anti-avoidance rules are undesirable - they make the system more complex, they sometimes create unintended loopholes and they do not deal with transactions completed before the amendments become effective; Canadian Courts have continuously rejected the business purpose test: Tax Reform 1987: Income Tax Reform, supra, note 1 at 129. See also, Dodge, ("Tax Reform and the Anti-Avoidance Proposals"), supra, note 9 at 2-4.
In all, there were two main drafts of the rule: the initial version and a December 1987 draft, the latter being modified by two further revisions, before the final version of section 245 was enacted.¹

Briefly, the main differences between the original version as contained in the June 18, 1987 White Paper² and the final version as enacted are as follows:
- the original version of the rule applied notwithstanding any other provision of the Act. This notwithstanding clause was deleted.
- the business purpose test was changed to a non-tax purpose test
- the inclusive nature of "avoidance transaction" was altered to be non-exclusive
- the purpose clause was replaced by subsection 245(4) which excludes transactions that do not involve a misuse or abuse of the provisions of the Act
- the adjustment provisions were substantially revised
- an effective date was added

¹ Another version was suggested by the House of Commons Standing Committee on Finance and Economic Affairs, Blenkarn Report, supra, note 4 at 205-7.

- the provision added by the December 16, 1987 version authorizing courts to have recourse to the explanatory notes as an aid to construction of the rule was deleted.
- the provisions regarding the issuance of an assessment, reassessment or additional assessment in respect of a request for an adjustment were altered.

Initially, one may think that this extensive list of changes radically altered the initial proposal. However, the rule remained largely the same as regards its impact and substance.\(^{43}\) Therefore, overall it is fair to say that these changes were only of a limited nature - they did not strike at the structure of the rule.\(^{44}\) On the face of it, the most notable alteration is perhaps the replacement of the business purpose test with a non-tax purpose test, particularly as it affected the scope of the rule, and arguably because the main impetus for the enactment of section 245 in the first place was the apparent rejection by the Supreme Court of Canada\(^{45}\) of the business purpose test.\(^{46}\) However, it is debatable whether the


\(^{44}\) One commentator observed: "[the changes amounted to a] tinkering with a number of specific items." Kellough, ibid.


substitution really amounted to much in that it only restrictively narrowed the ambit of rule,\textsuperscript{47} so that in effect the non-tax purpose test is essentially the business purpose test in all other respects, except for this small technical amendment.\textsuperscript{48}

This concludes the discussion on the substance and legislative history of section 245. From this solid grounding, we can now turn to the analysis of the rule in its socio-political and economic context to enhance our understanding of both the provision and the influence of the exogenous factors which surrounded its enactment.

\textsuperscript{47} The amendment was of a relieving nature in that it excluded transactions which were previously caught by section 245, namely, those transactions which were not carried out for "business" purposes, yet were not primarily tax motivated either, the most notable example being family transactions.

\textsuperscript{48} Dodge, \textit{supra}, note 9 ("A New and More Coherent Approach to Tax Avoidance") at 18-19.
CHAPTER III

POLITICAL AND SOCIAL CONTEXT

A. UNDERLYING ASSUMPTIONS

In analyzing the political and social context within which section 245 was enacted it is proposed that the assumptions underlying this analysis first be discussed. In particular, the primary assumptions are that the tax system is the outcome of the political process and that the overall aim of the government in introducing the provision was to retain office. This latter premise involves two strands which were being promoted simultaneously: first, the government wanted to maximize votes with the electorate to ensure its re-election, and second, it wanted to placate the special interest groups, in particular, the business sector and high-income individuals. These propositions are discussed in greater detail below. The enactment of the GAAR is a good illustration of these competing factors.

The first assumption outlined above can be explained in the following basic terms: the whole concept of taxation is purely a creature of statute. In democratic states, statutes are the creation of legislative bodies. Therefore, tax legislation, like all other legislation, is a product of this political process.
This brings in the second assumption as at the very heart of the political process lies the government. In most democratic states it is the government which predominantly determines the legislative agenda. In particular, it controls, to a large extent, the formulation and enactment (by way of party loyalty) of proposals. In doing so, governments are susceptible to outside influences - they do not just pass laws which they think will be in the interests of society. The very essence of the democratic state means that they have to be voted into office by the electorate. Therefore, politicians are vying for votes and governments are seeking to be re-elected. However, it does not follow that politicians are only doing what will most likely appeal to the electorate. They are also attempting to placate the powerful members of society, in particular, the strong special interest groups. This helps to explain why the tax

\[1\] However, this is not to say that governments do not pass laws which are in the interests of society. Rather, they enact laws which, inter alia, will hold political appeal and hopefully get them re-elected - such laws may or may not be in interests of the electorate. What is important is that the electorate believes the laws are to their benefit (whether it is in their own self-interest or assisting disadvantaged groups). Relating this hypothesis to this paper would therefore explain why the 1987 tax reform package was presented in the way that it was. For example, it emphasized the supposed fairness of the reforms although the underlying structure was essentially unfair. For a fuller discussion, see, for example, infra, notes 77-80 and accompanying text.

\[2\] L. McQuaig, Behind Closed Doors: How the Rich Won Control of Canada's Tax System ... And Ended Up Richer (Markam, Ont.: Viking, 1987) seems to limit the powerful to high-earning individuals and the corporate sector. One example (at p.xxiv) of the numerous that are scattered throughout her book is as follows:
system is full of loopholes as such tax breaks are, in effect, equivalent to direct funding programs,\(^3\) and are less politically costly.\(^4\) Furthermore, these breaks can be tailored, so although available to all taxpayers, will only be utilised by high-income

Behind those doors [ie. of the tax world] is an interesting, little known world where rich individuals and large corporations have found ways to shift the burden of billions of taxes from their own backs-onto the backs of other Canadians. They have been able to do this by influencing Ottawa to put in place and keep in place tax laws that work to their advantage.

However, this is a simplistic view as it does not take into account the existence and relative strengths of special interest groups. Admittedly, special interest groups are more likely to be powerful if they comprise of rich individuals or corporations, such as the Business Council on National Issues, as obviously, greater financial resources means that their attempts at lobbying can be more effective. However, power and wealth are not mutually exclusive. The strength of special interest groups depends on other factors, for example, the average perceived value of the issue at stake to the individuals who have a common interest; the number and geographic dispersion of these individuals; the ability of the organization to provide some benefit over and above the pursuit of the common interest through lobbying, as an added inducement to membership and the ability of the organization to minimize the number of "free riders" - individuals who would share in the benefits provided by the organization but would not contribute their share of costs if they could be avoided: D.G. Hartle, The Expenditure Budget Process of the Government of Canada: a Public-Choice Rent Seeking Perspective, Canadian Tax Paper No. 81 (Toronto: Canadian Tax Foundation, 1988) at 62.

\(^3\) Supra, chapter 1, notes 10-1 and accompanying text.

\(^4\) McQuaig, supra, note 2 at 7-12. This is primarily due to the hidden nature of tax expenditures. In other words, they are not subjected to the same public scrutiny as grants are, being wrapped up in the technical language of the Income Tax Act. See also, N. Brooks, "Confusing Tax Reform with Government Spending" Financial Post (26 October 1987) 18.
earning individuals and corporations. Therefore, tax breaks can be a good means of keeping the special interest groups quiet in a politically costless way.

One may question why the rich and powerful are afforded weight and influence if it is votes that are important at times of elections to keep governments in office. Several reasons can be advanced for this phenomenon. First, the business community has greater resources at its disposal with which it can mount more effective opposition. The public at large, on the other hand

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5 Although tax breaks are technically available to everyone, only the well-to-do are really able to take advantage of them. The vast majority of tax breaks only apply to people who run their own businesses or can afford to make investments. Therefore, millions of Canadians are excluded. But even some tax breaks that are widely used by ordinary Canadians confer far larger benefits on the rich. McQuaig, supra, note 2 at 12.

A detailed study carried out in 1979 by Allan Maslove, Professor of Public Administration, Carleton University, concluded that the benefits of tax breaks go disproportionately to the rich—about one hundred times more: *ibid.*

6 For example: "In the latter part of the decade [1970s], the tax incentives clearly constituted an attempt to placate some of the business community's outrage over what it saw as the Trudeau government's growing commitment to state intervention in the economy." D.A. Wolfe, "Politics, the Deficit and Tax Reform" (1988) 26 Osgoode Hall Law Journal 347 at 364.

7 For example, according to a study in 1981 by the Economic Council of Canada, an estimated three hundred business, professional and trade associations at national level spend in excess of $122 million a year on lobbying. This does not even include the significant resources allocated to lobbying by individual companies. Compare this with the handful of public interest groups whose resources, in total, amount to about $2 million per annum: McQuaig, supra, note 2 at 195. Evidence that this disparity in resources affects the ability of special
is generally confused, disorganized and ill-informed and will probably not make much of a fuss if the powerful minority gets its way. Furthermore, these resources can be used to monopolize the media to ensure full exposure of the business sector's point of view and influence the public's perception of the matter. However, it is felt that this statement must be qualified in the sense that newspapers are business operations - publishers are business men striving to maximize profits. Therefore, newspaper operators are primarily concerned with reporting news which is appealing to audiences. Generally, there is a bias in favour of public interest groups which stems both from the ideological bias of the journalists and the "human

interest groups to mount effective opposition can be gleaned from the following comments:

Virtually by definition, closely knit, well-informed and well-financed, organized special (narrow) interest groups have the resources to maintain a protracted struggle to keep their tax advantages; public interest groups are usually not closely knit, are poorly informed in relative terms, and are financially weak. Protracted proceedings held in the nation's capital soon dissipate the financial resources, and often the enthusiasm, of volunteer workers. Hartle, "Some Analytical, Political and Normative Lessons from Carter" in W.N. Brooks, ed., The Quest for Tax Reform (Toronto: Carswell, 1988) 397 at 413.

8 McQuaig, supra, note 2 at 300.

9 "The enormous influence of organized special interest groups lies in their capacity ... to deliver votes directly by influencing the decisions of marginal voters through, for example, media manipulation ....": Hartle, supra, note 7 at 416.

10 Hartle, supra, note 2 at 65.

11 Ibid.
interest" aspect of such stories. It is human interest stories that sell newspapers and magazines and attract radio listeners and television viewers. Therefore, there is no guarantee that the business sector can secure news coverage, if such articles are not regarded as being of newsworthy character.

Hartle, supra, note 7 at 414.

Ibid.

However, it is felt that some qualification of this statement is necessary. Note the following comments regarding the ability of special interest groups to "buy" favourable news coverage:

The capacity of special interest groups to influence the mass media cannot be overstated. Such groups are sophisticated: they are not beyond, for example, paying a highly respected journalist to write a story that discredits their opponents. The journalist submits the story as a feature to a magazine or newspaper without any reference to the fact that it was funded by the interest group and, indeed, was vetted by the group. Hartle, supra, note 7 at 414.

See also, L. Shifrin, "Pitfalls Await Tax Reformer" Winnipeg Free Press (14 October 1986) 6. One example of the manipulation of public perceptions by high income-earning taxpayers relates to the American tax reforms. Notably, misinformation was distributed to the effect that the U.S. reforms provided for only two tax brackets, instead of three: ibid.

Furthermore, without supporting evidence, it is hypothesised that businesses may be able to "buy" news coverage by promising to purchase (or threatening to withdraw) advertising space. It is through the sale of advertising that revenues are primarily obtained: Hartle, supra, note 2 at 65.
Another reason for business having so much clout with government is through the provision of campaign donations. Business can influence governments with the promise, or threat of removal, of financial assistance. Although no figures are proffered for the 1988 election campaign, other election experiences serve to illustrate how dependent political parties are on receiving donations from the business community. For example, in the run-up to the 1974 election, thirty one per cent of the Progressive Conservative funds were supplied directly by dominant corporations or corporations controlled by them. Relating this to the 1987 tax reform package, the Progressive Conservatives were at that time in a particularly vulnerable position due to an election looming sometime within the near future.

15 McQuaig, supra, note 2 at 196.

16 L. MacDonald, "Why the Carter Commission Had to Be Stopped, in The Quest for Tax Reform, supra, note 7 at 362. The following comments reinforce this state of affairs:
Special interest group contributions, in cash or in kind, are used to secure the spot announcements on radio and TV, the posters, the pamphlets, the campaign buttons and hats, the planes and the trains and the buses and the hotel rooms -- in sum, the razzle-dazzle that puts the party's image across.
Hartle, supra, note 7 at 416.
A further reason for the business sector's influence over the government lies in the resources which business has at its disposal. 17 Consequently, business can easily intimidate a government with threats that it will withdraw investment. 18 Whether in fact it would withdraw investment if the government decided to "call its bluff" is a moot issue. The important point is the government cannot easily take the risk, so the bargaining strength of the corporate sector lies merely in their threats, not their action.

Finally, on a human level, cabinet ministers are more likely to understand and identify with members of the business sector, rather than with welfare or public interest groups. 19 This is because quite often cabinet members previously worked in business and were part of, what is colloquially known as, the "Bay Street set". 20 At the very least, cabinet ministers are

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17 For example, the one hundred and fifty Chief Executive Officers who make up the Business Council on National Issues oversee 1.5 million employees and $700 billion in assets: McQuaig, supra, note 2 at 192.

See, also, L. MacDonald, "Why Carter Had to Be Stopped", in The Quest for Tax Reform, supra, note 7, 351 at 362: "Through their control over most of our society's investment resources, the largest corporations ... are collectively Canada's most powerful economic and social planners."

18 McQuaig, supra, note 2 at 196.

19 Ibid.

20 For example, Michael Wilson had "Bay Street in his blood". He had been executive vice-president of Dominion Securities before entering politics and had "absorbed the values
intent on nurturing their affiliation with the corporate sector due to the reasons given, for example, to receive campaign donations. This all adds up to give the corporate sector greater influence and clout with the government.

In total, special interest groups, notably those with a corporate slant, are able to exercise considerable influence over the government. This is reflected in the tax structure which contains many provisions which are of benefit to these groups.

It is from this perspective that section 245 be approached. This provision is ideal for illustrating the conflict between the two different strands of government action discussed above, namely, pleasing the general electorate and special interest groups at the same time. In total, it may be fair to say that the 1987 tax reform package was weighted in favour of the

of the business community and brought with him to Ottawa a distinctly Bay Street point of view." McQuaig, ibid. at 313.

For example, Finance Minister Michael Wilson appointed William Mackness, right-wing Bay Street insider (he was vice-president and chief economist of the Bank of Nova Scotia) as his special advisor. Ibid.

However, what of the argument that tax expenditures are inserted into the tax structure to promote some noble socio-economic goal, for example, the promotion of the Canadian film industry? The response is to question whether tax expenditures do in fact achieve their purpose. In particular, studies done reveal that tax expenditures are not successful in stimulating the economy: McQuaig, supra, note 2 at 66.
corporate sector and high-earning individuals, or at least, did not harm them as much as it could have. However, on the face of it, section 245 represents a departure from this state of affairs. It clearly was a provision which adversely affected the corporate sector to a great extent. This perhaps explains why the provision was attacked so ferociously by business and its tax representatives. In fact, no other provision within the white papers received as much attention. Great pressure was exerted on the government to either withdraw the rule, or at least, to greatly amend it. Yet, in the face of such opposition, the government still enacted the provision, and moreover, in a form which did not greatly differ from the

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23 For a fuller discussion, infra, notes 77-80.

24 Evidence that the new GAAR was intended to have a significant impact on the corporate sector is apparent from the estimated amount of extra revenue which the provision was supposed to generate - namely $2240 million over the period 1988-92. This gain was undoubtedly the highest of all the gains estimated to be generated under the other corporate base-broadening proposals in the white papers. Canada, Department of Finance, Tax Reform 1987: Income Tax Reform (Ottawa: the Department, June 18, 1987) at 67.

25 "Business and tax professionals alike have reserved their heaviest fire for the white paper's proposed general anti-avoidance rule": S. Poddar & A. Coyne, "Crunch is Near for Tax Reform Review" Financial Post (19 October 1987) 4. This would indicate why section 245 was repeatedly singled out by the Department of Finance as in need of justification and explanation. Note the writings of one Department of Finance official: D.A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36 Canadian Tax Journal 1 and "Tax Reform and the Anti-Avoidance Proposals" 1987 British Columbia Tax Conference, tab 4.
initial proposal. This is perhaps indicative of a combination of factors, one of which, was the wish to appeal to the electorate under the threat of a forthcoming election.

From here it is proposed that the social and political background within which section 245 was enacted be analyzed. It is hoped that some indications will be exposed as to why the government did not retreat on its position in any major way in the enactment of the provision, despite the furore which surrounded its introduction.

B. THE LOOMING ELECTION

(i) General Introduction

At the time of the introduction of the tax reform package in June 1987 the government had to call a general election by the fall of 1989. Moreover, it was generally expected that an election would be called earlier, sometime in 1988. The threat of this forthcoming federal election greatly affected the tax reform package. In particular, it influenced perhaps the very initiation of the reform package, the structure or content

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26 The Progressive Conservatives were voted into office in September 1984. A general election has to be called within five years, setting a deadline of September 1989 for the ruling party.

of the package, its presentation and the attitude adopted by the government when the package was criticised. To state the obvious, the reason for the influence of the forthcoming election was the desire of the government to maximize its support with the electorate with the hope that it would be voted back into office.\textsuperscript{28}

At the time of the introduction of the 1987 tax reform package the Progressive Conservatives were in a particularly vulnerable position. Having entered office in 1984 with the largest majority in Canadian history (211 seats),\textsuperscript{29} the government was doing very badly in the public opinion polls in the year of the tax reform package. At the beginning of the year, it was in third place in the polls, with a low of twenty-two per cent support.\textsuperscript{30} Matters did improve towards the end of the year, 

\textsuperscript{28} Note the statements by one commentator that "[t]he federal Tories' main (only?) goal is to win the next election - which is why they may lose it." P. Worthington, "Electioneering by 'Tax Reform'" Financial Post (2 August 1986) 9.

\textsuperscript{29} McQuaig, supra, note at 307.

\textsuperscript{30} D. McGillvray, "Grim Warning for Tory Party in Latest Poll" Financial Times (16 February 1987) 9; J. O'Donnell, "Tories Drop to Last Place in New Poll Gallup Says" Toronto Star (15 January 1987) A1 & M. Scott, "Government's Rating is 45-year Low:Poll" Montreal Gazette (19 February 1987) A1. These low ratings relegated the government to being the most unpopular federal administration in at least forty-five years: Scott, \textit{ibid}. This poor support may have been partly due to a trend that has been evident in most periods of majority government: generally there is a decline in support for the governing party after an election victory, followed by a recovery in the period before the next election: M. Adams and D. Dasko, "Tories Rally to Second Place as NDP Drops to Third" The Globe and Mail (29
with the ratings pushing the party into second place with thirty-two per cent support of decided voters. However, this all made chilling reading for the government, particularly with a general election due by the fall of 1989.

(ii) Political Appeal

It is submitted that this state of affairs greatly affected the attitude of the government towards their tax reform proposals. It wanted to utilise the political appeal of tax reform to increase its support. This is not to say that tax reform was embarked upon solely to bolster the government's support with the electorate. Indeed, tax reform had been an issue in the December 1987) A1 & A9 at A1 & A9.

31 Adams & Dasko, ibid.

32 But to anyone who takes a look at the political calendar, his [Honourable Michael H. Wilson, Minister of Finance] timing makes perfect sense. By unveiling his tax reforms in next year's budget, Wilson will be in a position to implement them in 1988, the year Prime Minister Brian Mulroney is expected to call a general election.

Traditionally, the mid-point of a government's mandate is when it begins to phase out tough, austerity-minded measures and replace them with popular, consumer-oriented policies. And this is exactly what Wilson appears to be doing.

....

As the Progressive Conservatives head out on the campaign trail, they will be able to point to reduced personal tax rates, simpler tax forms and higher take-home pay for most workers as a few of their accomplishments. It would be harder to come up with a more attractive record to put in front of Canada's 17 million voters.

Goar, supra, note 27.
1984 election campaign and the government had been serious about it since early on in its mandate. However, there is general recognition that the political appeal of tax reform was a major impetus.

However, the government had changed the pace of tax change during its mandate. It initially favoured a gradualist approach to prevent "uncertainty that might harm Canada's economic performance": Canada, Department of Finance, Tax Reform 1987 (Ottawa: the Department, June 18, 1987) at 19. However, it later opted for a major tax reform exercise on the basis that many of our major trading partners had undertaken widescale reform and that significant changes to sales tax and social transfer programs should, for reasons of fairness, be integrated with personal income tax: ibid. at 21.
In presenting the tax reform proposals, the government focused on the objective of fairness.\textsuperscript{35} In doing so, it was acting in its own self-interest in attempting to maximize the appeal of the tax reform proposals to the electorate.\textsuperscript{36} The government was perfectly aware that this was the criterion that was most

\textsuperscript{35} This is captured in the catch-phrase used to sell the package which is emblazoned on the front of all the white paper documents: "Lower Rates, Fairer System".

This begs the question - what does fairness mean? It has been implied that its definition depends on which side of the fence you are sitting on. So, for example, for the government, it is a thinly disguised message that the taxpayer/voter will pay less, for the Opposition, it is that the taxpayer/voter will pay more: B. Little, "Some Fallacies About Fairness: Tax Reform Has Revived Politicians' Preoccupation with the Notion of Fairness" (October 1987) 4 Report on Business Magazine 19 at 19. However, unless indicated otherwise, fairness in this paper is taken to be the government's version. In particular, fairness connoted that higher-income individuals and profitable corporations carry a larger share of the income tax burden; individuals in similar economic circumstances be taxed more equitably (this related to the removal of special incentives); the income tax system be better integrated with the social transfer system (this dealt with the conversion of tax exemptions and deductions) and the progressivity of the personal income tax and the sales tax be improved: Tax Reform 1987, supra, note 34 at 3. In particular, for reasons of convenience and relevance, it is proposed that reference to the concept of fairness in this paper be taken as being the increase in the tax burden of high-earning individuals and the corporate sector.

The other objectives of the tax reform exercise were identified as being competitiveness, simplicity, consistency and reliability: Tax Reform 1987, \textit{ibid.} and Tax Reform 1987: Income Tax Reform, supra, note 24 at 1-2.

\textsuperscript{36} Politicians, especially when they face an election in the next year or so, cannot bring themselves to go to the heart of the what tax reform should really be. It is simpler, and more rewarding politically, to toss out rhetorical flourishes for the benefit of voters who, the politicians sense, are likely to view tax reform only from the narrow perspective of their own self-interest. Little, supra, note 35 at 19.
palatable to the electorate.\(^{37}\) This is corroborated by a government poll, carried out in March 1987, which revealed that seventy-six per cent of those surveyed wanted the fairness of the tax system improved.\(^{38}\) Therefore, the government emphasised at every opportunity the fairness of the white paper proposals. It would even be accurate to say that it went as far as distorting the electorates' perceptions or even misleading them, in its efforts to sell the package as promoting fairness.\(^{39}\)

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\(^{37}\) There are reasons other than fairness to reform a tax system, but they fail the political sex appeal test. One reason is to make Canadian business more competitive in world markets, but politicians assume that few people can grasp this. Another reason is to simplify the unwieldy and inconsistent system, but the virtues of tax simplicity are more often preached than practised. Beside a handful of public policy analysts, who knows, let alone cares, whether the tax system is 'internally consistent and consistent with other government programs,' as the government's white paper on taxation puts it? And who, outside the government itself, values a reliable tax system that generates a predictable revenue system?

To hear Wilson tell it, those are major reasons for reforming the tax system. But the greatest reason - tax reform being a political exercise - is to make it fairer. Little, ibid. at 19-20.

\(^{38}\) "Poll Spelled Trouble for Tax-Reform Plans" Montreal Gazette (25 July 1987) A7. These conclusions were supported by another survey conducted for Southam News by Angus Reid Associates which revealed that Canadians overwhelmingly believed that the tax system was unfair: J. Ferguson, "Most Canadians Oppose Tax Reform Proposals" Calgary Herald (21 March 1987) A3.

\(^{39}\) For example, by emphasising the increased burden on the corporate sector the government was misleading the electorate in that the reductions in personal income tax rates were met predominantly, not by the increased corporate tax, but by changes to the federal sales tax and the acceleration of tax payments. For a fuller discussion, infra, note 79 and accompanying text.
For the cynics amongst us, some explanation is necessary to justify the claim that the government was acting in its own self-interest, and not the public interest in general. The most persuasive evidence that is available is the tax structure itself. If the tax system was constructed solely in the interests of the majority of taxpayers (i.e. the general public) then it would not be in the form it is today. As discussed earlier, the current tax system is littered with special tax breaks, inserted with the intention of pleasing the corporate sector and high-income earning individuals. Moreover, these continued to exist after the tax system had gone through a process of so-called "reform" in 1987. Although, some tax breaks were eliminated or trimmed by virtue of this tax reform exercise, special Canadian situations and sacred cows were respected, for example, the lifetime capital gains exemption was only reduced (to $100,000 from $500,000) for most sectors, rather than removed altogether.

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40 Supra, notes 3-6 and accompanying text.


42 For a fuller discussion on the continuance of special incentives, see infra note 145 and accompanying text.
The GAAR was an integral part of the tax reform package. The government presented the section as being an important element in the achievement of its objectives, in particular, the criterion of fairness. Arguably, the desire of the government to produce a tax reform package to pass off to the electorate as achieving a fairer system influenced section 245. In particular, it is submitted that it was perhaps an impetus for the introduction of the GAAR and also its inclusion within the tax reform package. The introduction and inclusion of the provision assisted the government to ostensibly present an image of fairness - in particular, of easing the tax burden from the shoulders of the low and middle class taxpayers onto the rich.

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43 Dodge, supra, note 25 ("Tax Reform and the Anti-Avoidance Proposals") at 2.

44 The government could have presented the proposal at some other time, for example, in its February, 1987 Budget. This would have been more logical. For example, if the government was as concerned as it claimed about widescale abusive tax avoidance (Dodge, ibid. at 2-3) it would have made more sense to introduce the rule as quickly as possible. Instead, the government included it within the package so that implementation was delayed. This resulted in alternative means of curbing tax avoidance having to be adopted in the interim period - for example, two abusive transactions were outlawed by press release in the period between the introduction of the proposal and its implementation: D. Beach, "Wilson Strikes at Tax Avoidance" Calgary Herald (13 October 1987) F6 and P. DeMont, "Closing the Loopholes: General Tax Rule Dealt Blow" Financial Times (5 October 1987) 3.
and corporate sector. This is evidenced by the numerous references to section 245 which are scattered throughout the white paper documents.\footnote{For example, Tax Reform 1987, supra, note 34 at 3, 5 & 57 and Tax Reform: Income Tax Reform, supra, note 24 at 2, 25, 42, 129-33 and 137-44 (Annex 1: Explanatory Notes to the General Anti-Avoidance Rule).}

It is also submitted that the looming election could have influenced the calculation of the projected revenue increases generated by the application of the GAAR. To explain, the estimation of this particular increase was the most pliable and unprincipled of all the base-broadening measures. With the other measures, the government was at least removing or limiting something that already had a value to it. With the GAAR, on the other hand, it is difficult to see how the government could have calculated the figure for its future application. For example, on what basis could it predict the frequency of application of the rule (especially as it is Revenue Canada and not the Department of Finance which is responsible for the administration of the provision), the behavioural changes that would occur as a result of the tax reform (for example, that taxpayers would discontinue using the special incentives affected by the white papers and rely instead on other tax shelters not so affected) and the extent and value of abuse in the future (abuses flair up when a loophole is discovered - these cannot be predicted)? A possible indication of the
difficulties encountered in estimating the revenue increases generated by section 245 is the lack of information on the methodology used in the calculations.\textsuperscript{46} Therefore, perhaps the government was prone to shape the calculations to meet the circumstances. For example, the election prompted the government to present the tax reform package as achieving a fairer system. But to do so, it had to support its claims of imposing a heavier burden on the corporate sector with economic facts and figures. These figures had to look impressive, particularly as any gains from the base-broadening measures were significantly offset by reductions in the corporate tax rates. Therefore, this may have encouraged the government to give the benefit of the doubt to the application of the GAAR and to predict that it would be used extensively to curb tax avoidance, thereby generating a substantial increase in revenue. This is not to suggest that the government did this deliberately - just that the calculation of something as uncertain as the future application of section 245 is so unpredictable and fortuitous that the government could really give any figure, obviously within some limits (for example, if it had stated that the GAAR would generate $100 billion within its first year, it might have been disbelieved!), to this prediction and honestly believe its estimations to be accurate. The problem is that there is no way of proving, or for that matter, disproving, the figures the

\textsuperscript{46} Infra, note 75.
government gave. It should be noted that this proposition is hypothetical - no corroborating evidence is proffered. However, it is hoped that it has at least been shown that this process is perfectly reasonable and foreseeable.

Before discussing the other influences of the looming federal election on the GAAR in greater detail, the constraints imposed on the government at that time should first be mentioned. To reiterate, the government, in pursuing its own self-interest of re-election, sought to structure and present the tax reform package so as to maximize the appeal it would hold for the electorate.\(^7\) Therefore, it sought to pass off the tax reforms as promoting the objective of fairness. However, it had to do so within constraints, primarily the economic conditions prevalent at the time\(^8\) and the concerns of special interest

\(^7\) Verification of this proposition can be gleaned from the following: "In fact, finance department officials flatly acknowledged to Maclean's that they designed the first stage of tax reform to appeal to the selfish interests of the majority of taxpayers." M. Janigan, "Cautious Reform" (29 June 1987) 100 Maclean’s 34 at 35.

\(^8\) The government could not reduce tax rates further if this had entailed reducing the overall revenue collected by taxation, thus adding to the deficit. The government perceived that this would involve incurring political costs that would exceed the political benefits of reducing tax rates. This conclusion was borne by the results of a government poll, Decima Research Ltd., which revealed that seventy-five per cent of Canadians surveyed stated that getting the deficit under control should be the government's top economic priorities: "Poll Spelled Trouble for Tax-Reform Plans" supra, note 38. This is indicative of a political equilibrium whereby the perceived costs and benefits are weighed up against each other to achieve a result that maximizes the benefits while minimizing the political costs.
groups. However, despite these limitations, the government still attempted to produce a package that was palatable to the electorate.

As outlined above, the election provided an impetus for the introduction of the GAAR and its inclusion within the tax reform package. This proposition relates to the important role played by the provision in the presentation of the image of fairness which the government wished to give. The rule added to the creation of this image, first in its own right, second, as part of the corporate base-broadening measures, and third, in economic terms.

The first means by which the provision contributed to the promotion of fairness, and thus the political appeal of the tax reforms, was its very inclusion in these proposals. The concept of the provision and what it stood for - attacking the privileged position of the corporate sector and high-earning individuals - greatly assisted the creation of an image of

[49] The government could have further reduced personal income tax rates by, for example, increasing the tax burden on the corporate sector. Again, this would have entailed political costs that outweighed benefits. This is supported by the complaints made by the business sector regarding the relatively small increase in the tax burden which it had to endure under the tax reform proposals. See for example, the allegations by the Canadian Chamber of Commerce, Canada's biggest business lobby group, that the reforms "ask too much from the corporate community": D. Stewart-Patterson, "Business Lobby Slams Wilson's Tax Reform Plans" The Globe and Mail (20 August 1987) B5.
fairness. Evidence of the government's recognition is the references to the rule which are scattered throughout the white paper documents.\textsuperscript{50}

The provision also contributed to the political appeal of the tax reform by being an integral component in the total image that the government attempted to sell. In particular, it was incorporated within a whole array of other measures which were supposedly designed to increase the tax burden of the corporate sector. For example, the government drew attention to the low levels of tax paid by businesses before the reforms;\textsuperscript{51} it claimed that this would end by virtue of the reforms - the means by which tax liabilities were reduced (ie. special incentives) were going to be restricted or eliminated in vast numbers;\textsuperscript{52} those incentives that were retained were justified on what seemed viable grounds;\textsuperscript{53} and the cuts made to the corporate tax

\textsuperscript{50} Supra, note 45.

\textsuperscript{51} Tax incentive deductions and credits ... undermine tax fairness, as they result in profitable corporations paying little or no tax. After adjusting for factors such as receipt of intercorporate dividends and income already taxed in a foreign country, some 110,000 out of 320,000 profitable corporations did not pay tax in 1983. Tax Reform 1987: Income Tax Reform, supra, note 24 at 13.

\textsuperscript{52} "The corporate tax proposals presented in this paper will ... cut back significantly on tax preferences." Ibid. at 24.

\textsuperscript{53} "The tax reform proposals put forth in this White Paper strike a balance between removing specific preferences and recognizing Canadian priorities and needs." Ibid. at 4.
rates were legitimated.\textsuperscript{54} In all, the government managed to give the impression that it had done all that it could to hurt the corporate sector, and that although incentives remained and corporate rates were lowered, the increase in the corporate tax burden was sufficient.\textsuperscript{55} The GAAR was obviously an integral part of this vision as it prevented the remaining incentives being abused, and moreover, also precluded abuses of incentives enacted in the future. In all, it greatly assisted the government in painting a rosy picture of helping the low and middle classes at the extent of the corporate sector.\textsuperscript{56}

Section 245 was also important in terms of the contribution it made to substantiating the claims of fairness with facts and figures. To verify that it was shifting the burden from individuals to the corporate sector, the government required some sort of economic validation.

\textsuperscript{54} For example, it would make the Canadian system more competitive with the U.S.; high rates should be reduced because nobody pays them anyway and high rates breed inefficiency. N. Brooks & L. McQuaig, "Michael Wilson's Great Reforms: Taxing Our Intelligence" (November 1987) 21 ThisMagazine 14 at 17.

\textsuperscript{55} "[I]s it [the corporate tax increase] enough? Wilson thinks so .... 'We've gone as far as we can at the moment,' Wilson said." Solomon, supra, note 41.

\textsuperscript{56} Moreover, the government seemed to have succeeded. Few commentators, particularly newspaper journalists, ever got past the initial impression created. The media in general concentrated instead on the criticism made by the corporate sector that the increases were too large, or on the threat of the future sales tax (ignoring the increases made to the then current federal sales tax).
The first part of the equation - the shifting of the burden from individuals - was implemented in the white paper proposals by the reduction of the personal income tax burden of individuals. For example, the cuts in personal income taxes amounted to $2 billion alone in 1988, and were alleged to total nearly $11 billion for the period 1988-1992. This reduction may appear quite substantial if considered in isolation. However, if one views it in the context of the personal income tax burden prior to the tax reform - approximately $38 billion per annum - it pales somewhat into insignificance. However, this did not prevent the government presenting the cuts as if the electorate were getting a great saving bestowed upon them - something to be grateful for.

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59 Tax reform measures will ... reduce personal income tax for eight out of ten Canadian households and almost nine out of ten Canadians over 65. Personal tax will fall by an average of $460, or roughly 5 per cent of their tax bill, for eight out of ten taxpayers with incomes between $30,000 and $50,000.

Moreover, the personal income tax cuts were distributed in such a way to maximize electoral appeal. So for example, in relation to the vast majority of taxpayers, rather than reducing just a few of their tax bills, the government lopped off at least a small amount from the tax liabilities of over eighty percent (or 8.9 million households) of Canadian taxpayers. By spreading the tax gains thinly over a large volume of taxpayers, the government was able to maximize the proportion of the electorate which would be feeling somewhat benevolent towards the government as a result of these tax cuts.

60 "[The] income tax proposals ... are a thinly disguised pre-election tax break for lower-income and middle-class Canadians." P. Cook, "A Raspberry for the Opposition on Tax Reform" The Globe and Mail (7 July 1987) B4. Also, "[t]he Conservatives' political salesmanship will naturally take advantage of the pre-election timing of the initial tax cut." "The Context of Tax Reform", supra, note 34.

61 Tax Reform 1987, supra, note 34 at 37.

62 "Wilson has reduced income-tax rates in the first stage of reform. The process is intended to induce modest feelings of well-being in the taxpayer." P. Hadekel, "Don't Be Duped by Tax Reforms's Flusher Paycheques" Montreal Gazette (15 July 1988) D5.

The Opposition Parties attempted to diffuse these feelings by constantly highlighting the increases in tax liabilities that had occurred since the government had taken office: J. Kohut, "Tories Find Tax Tables Turned as Reform Becomes Issue in Vote" The Globe and Mail (24 October 1988) B1. In this respect, the study by Allan Maslove, Professor of Public Administration, Carleton University, which revealed the full extent of the tax increases since the government took office [C. Goar, "Tax Reform is Less Than it Seems: Canadians Still Aren't Compensated for Tory Tax Hikes Since 1984" Montreal Gazette (1 July 1988) B3] was a godsend for the Opposition. In the face of this adverse publicity, one may have expected the government to down-play its tax reform as an election ploy. However, this was not the case as the government was fond of quoting the tax savings that the
It may be argued that the government was promoting objectives other than its own self-interest in reducing personal income tax rates. For example, perhaps the government was bringing the personal income tax rates in line with those in the U.S. However, the disparities between the two nations would not be an important factor for the vast majority of taxpayers as they would certainly not be significant enough to cause relocation to take advantage of the lower rates in the U.S. If such arguments are valid at all, then it is only in relation to the corporate sector and high income-earning individuals. For these taxpayers, the disparities have a greater impact, and furthermore, as a practical matter, they would find it easier to relocate their income to the U.S.

Moreover, the government orchestrated the timing of the tax savings so as to maximum the political appeal. For example, the rate reductions were scheduled to come into effect on 1 January 1988. However, supposedly to give employers time to adjust, the electorate would enjoy by virtue of tax reform: Kohut, *ibid*. It may be that the government was relying on the political school of thought that voters have very short memories so that the recent tax cuts and rebate would be a lot fresher in voters' minds than the increases since 1984: *ibid*.

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63 McQuaig, *supra*, note 2 at 73.


the tax cuts did not show up in pay cheques until 1 July 1988, just in time for the expected scheduling of the federal election. Furthermore, this necessitated the payment of a tax rebate for this period, which was not to be paid out until early 1989 when tax returns for 1988 were filed.

Subject to the economic argument advanced below, there does not seem to be any viable reason for the government to structure the tax savings in this way, other than to please the electorate. For example, why not just introduce the tax cuts so as to be effective from 1 July 1988? That would seem to be more logical, particularly from an economic perspective in light of the bulging deficit at that time. Furthermore, by arranging the timing so that a rebate would be paid, the government appears to have achieved two favourable results: first, it benefitted economically by being able to receive interest on the rebate funds by not having to pay them out until the following year, and also, it enhanced the political appeal of the tax cuts by arranging for taxpayers to receive a lump sum rather than more frequent payments of smaller amounts, the former obviously giving the impression of a greater saving.


67 "Tories Could Use Tax Bill to 'Buy' Votes", supra, note 65.
In summary, it has been shown that the tax reform proposals effected reductions in personal income tax liabilities. In doing so, the government was acting in its own self-interest to enhance its support with the electorate. The cuts were orchestrated to maximize political appeal, for example, the means of distributing the savings and the timing of the reductions. However, the overall objective was to present an image of fairness - to shift the tax burden from individuals to the corporate sector. The above discussion substantiates the first part of the equation. It is to the second part of the equation - the increase in the tax burden of the corporate sector - that we now turn.

The government claimed to have substantially increased the tax burden of the corporate sector. However, to be persuasive, it had to verify this claim with facts and figures. The GAAR played a significant role in the achievement of this objective.

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68 "Tax reform will result in corporations making a significantly higher contribution to the total tax revenues collected by the federal government." Tax Reform 1987, supra, note 34 at 50.
The net corporate tax increase was estimated to be $5 billion over the five years following the tax reforms.\(^6\) This gives the impression of being a substantial increase when given as a total figure. However, when broken down to a yearly basis, the increases do not appear quite so significant. For example, in 1988, the increase was only $470 million, and in 1989, $410 million.\(^7\) Overall, the corporate tax burden was only modestly increased from 15.6% to 17.2%.\(^8\) Moreover, this increase did not return the corporate tax burden to the level it had been when the government had taken office in 1984.\(^9\) However, the government still made a show of presenting these figures as promoting a fairer system — of harming the corporate sector by imposing a greater tax burden on them.\(^10\) In achieving this objective, the GAAR played an important role. This was primarily due to the increased revenue which the rule was supposed to generate — some $2,240 million over the period 1988–


\(^7\) Tax Reform 1987: Income Tax Reform, supra, note 24 at 31. This would help explain why the white papers refer to the total figure more frequently, rather than the annual increases. Ibid.

\(^8\) Tax Reform 1987: Income Tax Reform, ibid. at 50. The primary reason for the overall net position not being more damaging on the corporate sector was the that the base-broadening measures were offset with corporate rate reductions.

\(^9\) In 1984-5, corporate income taxes accounted for 20.3 per cent of the federal major tax revenues — close to a historic low. (For example, in 1975-6 they made up 26.3 per cent of revenues.) Brooks & McQuaig, supra, note 54 at 19.

\(^10\) Supra, note 68.
This increase, in relation to the other corporate base-broadening measures, was undoubtedly the highest overall and markedly the greatest during the first two years (thereafter, it was estimated that the revenue gained in the reduction of Capital Cost Allowance would increase and finally overtake the gains under the GAAR). Thus, in terms of revenue increases generated by base-broadening measures, section 245 was obviously the most lucrative of the proposals in the white papers. Without it, the government would not have been able to present such an impression of helping the poor at the expense of the rich. This is evidenced by the following figures: absent the GAAR, in 1988, the corporate income tax increase would have been a mere $60 million (not quite so impressive as $470 million!); in 1989, the increase would have been zero - in fact, there would have been a decrease in corporate taxes of $30 million. (Thereafter, the impact of the rule was not quite so pronounced.) Therefore, it is accurate to conclude that the provision played an important role in the image of fairness which the government sought to project.

However, these revenue-generating figures cannot be blithely accepted - some qualification is necessary. First, they do not relate solely to the application of the GAAR. The provision was lumped together with the proposals on preferred share issues by

non-taxable companies in estimating the increased revenues. No indication was given in the document as to the basis of allocation of the increased revenue between these two separate anti-avoidance measures. The decision to combine these provisions may have been a shrewd political move on the part of the government as the figures would have been more vulnerable to challenge if presented on their own. Second, no indication was given as to the methodology employed in the calculation of these figures,\(^7\) thus further restricting the grounds on which they could be attacked. Indeed, the reliability of these figures may be more doubtful when one considers that the science of tax estimation has been described as being "just this side of witchcraft"!\(^7\) However, despite these caveats, the inclusion of the GAAR within the tax reform package made a substantial impact in bolstering the government's presentation of the image of fairness. In particular, the estimated revenue funds enabled

\(^7\) In particular, there was no discussion in Tax Reform 1987: Income Tax Reform, supra, note 24 at Annex 3, "Notes to the Tables and Methodology".

\(^7\) P. Demont, "Tax Break Proposals Cause Deficit Headaches" Financial Times (23 November 1987) 3. Moreover, the accuracy of the projected increases for the GAAR is further questioned when one regards the methodology employed for the other base-broadening measures. In particular, in calculating the figures relating to the removal/curtailment of special incentives, the government assumed that certain of these tax breaks would be eliminated in 1988 although most of them were not scheduled to disappear or be trimmed until several years later. Moreover, the figures fail to take account of behavioural changes, namely that high-income individuals and the corporate sector would switch their investment from those incentives affected by the tax reforms into new shelters not so affected. Brooks & McQuaig, supra, note 54 at 21.
the government to present an image that it was verifying its claim that the burden on the corporate sector was going to be substantially increased.

From the presentation of the tax reform package, one may be excused for assuming that these reductions were going to be paid for by equivalent increases in the corporate burden. Not so. In the first two years in particular, the corporate increases amounted to only about twenty to twenty-five per cent of the personal income tax reductions. Moreover, not only did the income tax increases have to be met, but in 1988-89 there was an net overall increase (after all the increases and reductions) of $1,190 million. Therefore, in 1988-89, the government came up with an extra $2895 million (to pay for the income tax

77 Brooks & McQuaig, supra, note 54 at 19: "The white paper tries hard to leave the impression that the extra revenue [to finance the rate reductions] will come mostly from heavier corporate taxes."

The means by which the government fostered this image included, for example, the corporate tax measures being presented parallel to the personal income tax measures, thus giving the impression that the former offset the latter. The federal sales tax increases and acceleration of tax payments (the primary means for meeting the personal income tax cuts), on the other hand, were hidden away quite far into the white papers, for example, Tax Reform 1987, supra, note 34 at 58-9. Moreover, some indication of the objectives of the presentation can be implied from the space that was assigned to each set of measures. So, for example, in the white paper document, Tax Reform 1987, ibid., the corporate tax proposals were spread over nearly sixteen pages. Compare that with the page and a half which the increase to the federal sales tax was given.

78 Tax Reform 1987, supra, note 34 at 75.
reductions and the $1,190 million net overall increase), of which only $530 million was due to the corporate income tax increases. In other words, the increased burden on the corporate sector only amounted to roughly eighteen per cent of the overall increases that were generated. So, where did the other seventy-two per-cent come from? Well, it came from increases to the federal sales tax (of $1,105 million) and acceleration of tax payments (of $1,600 million). However, this is not the part of the package which the government emphasised. Instead, it drew attention to the measures it was taking to increase corporate tax revenues - thus promoting an image of fairness.

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79 Ibid.

80 Supra, notes 51-5 and accompanying text. A strong advocate of the unfairness of the tax reform package based on similar reasoning is Linda McQuaig, supra, note 54 (with Brooks) & 2. She also claims that the tax reform package was carefully dressed up to look like a boon to the lower and middle classes: Perhaps more than anything, the June 87 tax reform was an exercise in clever public relations. The government had gone to extraordinary lengths to make its proposals sound fair, holding back relevant information and even presenting the numbers in ways that diminished the gains to be enjoyed by the rich. The goal of fairness, which had ranked below deficit-reduction in the Tories' earlier tax changes, had been elevated to the number one priority in the white paper. Supra, note 2 at xviii-xix.

However, she alleges that this was all a cover-up to enable the government to achieve its original motive - to decrease its emphasis on income taxes and increase the emphasis on sales tax, thus continuing the trend of shifting the tax burden from the rich to the middle class: supra, note 2 at xix. It is submitted that this leftist ideology is the cause of her undoing. In particular, it prompted her to discard other factors which had a significant bearing on tax reform, for example the election itself (according to McQuaig, this was the motive for the presentation of the package as promoting fairness, but not an
The GAAR played an important role in the achievement of this purpose.

To summarise thus far, it is apparent from the above discussion that the looming federal election had an impact on the tax reform package, and the GAAR in particular. It is suggested that the election was a major impetus for the introduction of the tax reform package as the government viewed it as a means of bolstering its flailing electoral support. Thus, the government structured and presented the package to maximize its political appeal. In particular, it focused on the concept of fairness - of reducing the tax burden of lower and middle class individuals while increasing the burden of the corporate sector and high-earning individuals. The introduction and inclusion of the GAAR within the reform package was an important element in the promotion of this objective, both in the presentation and economic verification of this criterion. However, it is also

objective for embarking on tax reform in the first place), the U.S. tax reform experience (which one notable commentator has alleged was the main impetus for the Canadian experience: Hartle, supra, note 7 at 401-2). It is conceded that the shift in emphasis towards the sales tax did occur in the tax reform package. However, it is proposed that this was more incidental to tax reform than an actual cause. In particular, the government had to make up the shortfall resulting from the personal income tax reductions. As discussed before, supra, note 49, the government obviously perceived it to be more politically costly to make up this difference by, for example, increasing the tax burden on the corporate sector. To conclude, this thesis casts aspersions on the beliefs of McQuaig by showing that other factors had an influential affect on the tax reform package, beyond simply its presentation.
accurate to say that the objective of fairness was more illusory than real. The tax reforms did reduce the income tax burden of individuals - but they did not raise the corporate level by a comparable amount. Instead, the shortfall was made up in other ways, notably, increases in the federal sales tax and the acceleration of tax payments.81

81 Additional factors, other than the financing of the personal income tax rate cuts, have been identified as exposing the fallacious nature of the fairness of the tax reforms. However, due to space constraints and the narrow perspective of this thesis, it is not proposed that these factors be discussed. Some have been identified, in passing, in this paper where the context deems them relevant. For a more detailed analysis of the fairness of the overall tax reform package, see generally Brooks, supra, note 4; Brooks & McQuaig, supra, note 54 and McQuaig, supra, note 2.
However, in addition to proposals in the tax reform package which were included and/or presented as promoting fairness, measures were orchestrated which although did not fall into the fairness category were nonetheless designed to maximize

\[^{82}\text{An important measure within the tax reform proposals which was designed to promote the concept of fairness and thus be politically appealing was the was the conversion of personal exemptions and other deductions to credits. Although this manoeuvre did not have any impact on the GAAR (so was not included in the earlier discussion), it is felt that some acknowledgement of these measures should be made due to the important contribution they made to the image of fairness. There can be little doubt that they were included to maximize electorate support as welfare groups had been clamouring for this move for a long time prior to the tax reform exercise in 1987: Brooks & McQuaig, supra, note 54 at 16 and McQuaig, supra, note 2 at 339. The electoral appeal of the conversions is supported by the criticisms which these measures have attracted. For example, the credits were not refundable and the tax deductions that most benefitted the rich were not converted into credits: }\text{Brooks & McQuaig, ibid. at 18. This reinforces the "dressing up" of the tax reform package to be fair as if the proposals had been structured to promote a fairer system these criticisms would have been addressed.}\]

Moreover, in keeping with its promotion of self-interest, the government was careful to treat favourably the disadvantaged groups of society - especially the low income earners and the elderly. To be appealing to the electorate, the government structured the tax reform package (and in particular the conversion of personal exemptions and other deductions to tax credits) so that 850,000 lower-income Canadians were removed from the tax rolls. This may sound a trifle cynical, but such cynicism may well be justified when one considers the following: first, that many families below the poverty line would still be paying income tax after the reform. Secondly, the tax reforms were just removing some of the one million taxpayers who had been added to the rolls since the government took office in September 1984. Finally, it was alleged that these taxpayers would be back on the rolls within three to four years anyway due to partial indexation: Brooks & McQuaig, \text{ibid. and L. Shifrin, "Wilson's Plans Politically Brilliant" Toronto Star (22 June 1987) A21.}
electoral support. Moreover, they had some bearing on the GAAR, albeit, sometimes only marginal.

One means by which the government sought to promote electoral appeal (not relying on the fairness concept) was in relation to the economic outcome of the tax reforms. In particular, the government claimed that the package was "fiscally neutral". However, in reality, it structured the proposals so that the first year of reforms would generate an extra $1,190 million. One viable reason for this is that the government wished to use this extra revenue in the run-up to the election, for example, to assist in the reinforcement of its claim that it was solving the deficit problem or to assist in the funding of social programs. However it utilised the revenue it certainly would have been a boost to the government in its expected election year. Furthermore, after the first year (the expected election year) the revenues actually decreased to a negative amount, before achieving a somewhat neutral position by 1991-2.

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83 Tax Reform 1987, supra, note 34 at 75.

84 This was particularly pertinent at that time considering that the government was supposedly $3 billion off its deficit reduction projections: C. Motherwell, "Tax Loophole Plugs Called Empty Threat [citing John Bulloch, president of the Canadian Federation of Independent Business]" Winnipeg Free Press (19 February 1987) 8.

85 For example, in 1989-90 the overall position was negative $1,310 million: Tax Reform 1987, supra, note 34 at 75.
Political considerations aside, it would be fair to say that this was not economically prudent considering the country's economic conditions at the time.\textsuperscript{86}

Another important measure which can be said to promote electoral appeal, yet was not geared towards fairness, was the splitting of the tax reform package into two stages.\textsuperscript{87} This division was recognised as being a "shrewd political move"\textsuperscript{88} due to the contentious nature of the introduction of a new sales tax.\textsuperscript{89} To amplify, the structuring of the package in this way was designed to appeal to the electorate with the objective of increasing the support of the government. By postponing the sales tax until after an election the government was able to avoid undertaking

\textsuperscript{86} For a fuller discussion on the prevailing economic conditions, see Chapter IV "Economic Context".

\textsuperscript{87} Stage One dealt with personal income tax and corporate tax reforms: Tax Reform 1987: Income Tax Reform, supra, note 24. Stage Two, on the other hand, floated the idea of the introduction of a new sales tax: Canada, Department of Finance, Tax Reform 1987: Sales Tax Reform (Ottawa: the Department, June 18, 1987). Although both were presented as white papers, Stage One proposals were a good deal more definite and precise than Stage Two. The latter consisted of three options being outlined, with no commitment made to either.


\textsuperscript{89} The government was forewarned about the electorate's animosity towards the sales tax reforms. The government knew from its own polling, done in March 1987, that there would be widespread opposition to an expanded sales tax: 71 per cent of those surveyed were uncomfortable with the idea of a sales tax on food: "Poll Spelled Trouble for Tax-Reform Plans", supra, note 38.
any exercise that could incur excessive political costs in terms of losing electorate support. Moreover, the government could duck questions regarding its plans on the basis that it was still studying the three proposals outlined in the its white papers. Verification that this move was designed to gain electorate support is the concern that was expressed over the splitting of the tax reform package - both by the House of Commons Finance Committee and the business sector in general. In other words, the government, in structuring the

90 The explanation [as to why the tax reform package was divided into two stages] is probably political. With the Conservatives trailing in the polls and an election due within two years, many observers feel the government can't afford to introduce a new sales tax system. The Conservatives might prefer to approach the electorate on the strength of personal tax cuts rather than a potentially unpopular new sales tax.


91 "Two-Stage Tax Reform May Become a Political Coup for Wilson", supra, note 88. Finance Minister, Michael Wilson, justified the division of the tax reform package on the basis that the sales tax required more study because "[its] a fundamental change that means replacing one system with a totally new one". This would involve consulting widely with the provinces and interested parties. Wilson stressed the importance of understanding clearly the impact of the new tax before proceeding. J. Ferguson, "Wilson Faces Bay St. Crowd on Tax Reform" Toronto Star (25 June 1987) E1 & E8 at E8.

92 Supra, note 58 at 182.

93 M. Drohan, "Standing Firm on Tax Reform" (14 September 1987) 100 Macleans's 28. Mind you, one possible explanation advanced for the business sector's concern was that the division of the tax reform package, together with only scanty information on the timetabling of Stage Two, reduced their scope for bargaining with the Finance Minister for changes to his proposed tax regime: Fife, supra, note 90.
tax reform package to consist of two Stages, was not seeking to promote other objectives, such as pacifying the business sector or improving the economic conditions prevalent at the time.

The splitting of the tax reform package into two stages had a marginal effect on the GAAR. In particular, the division meant that both parts of the package had to make some attempt to be "fiscally neutral" in their own right. This meant that Stage One of the reform package could not rely on a new sales tax to meet this objective. Therefore, revenue had to be found to pay for the income tax cuts (both at the personal and corporate

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94 For a more detailed discussion on the "fiscal neutrality" of Stage One, see Chapter IV "Economic Context", note 17 and accompanying text. As regards Stage Two, the Finance Minister committed himself to producing a "fiscally neutral" package [J. Kohut, "Tories Find Tax Tables Turned as Reform Becomes Issue in Vote" The Globe and Mail (24 October 1988) B1 & B5 at B5] due to the stirring of political waters by the Opposition Parties in claiming that the government was intending to use Stage Two as a tax grab: "The Context of Tax Reform" supra, note 34.

95 If the two stages had been integrated it is likely that they would have been offset against each other financially. Evidence of this proposition is the promise that Finance Minister, Michael Wilson made that further personal income tax rate cuts would be made on implementation of Stage Two: A. Drache, "Two Opposing Views: Committee's Report Only Tinkers ..." Financial Post (23 November 1987) 6 and L. Whittington, "Wilson Tries to Ease Criticism of Tax Reform Plan" Calgary Herald (23 June 1987) A3. The implication is that if the two stages had been combined the increases from Stage Two would have been used to reduce further the personal income tax cuts in Stage One. The government obviously perceived that the benefits of further income tax cuts did not exceed the political costs of introducing a new extended sales tax before the federal election.
level). This is where the GAAR enters the scene. The increased revenue which the GAAR was estimated to generate\(^6\) assisted in meeting the "fiscal neutrality" of Stage One.\(^7\)

Further evidence of the government's electioneering (although not the promotion of fairness) was the fact that the government did not put tax reform on its legislative priority list.\(^8\) It was thus able to foster the view that unless it was re-elected, taxpayers would lose their tax savings (and the rebate) which the tax reforms had generated.\(^9\)

\(^6\) $2240 million in the period 1988-92: supra, note 74 and accompanying text.

\(^7\) It should be noted that the increased revenue generated by section 245 was arguably insignificant when compared with the changes to the federal sales tax and the acceleration of tax payments: see supra, note 79 and accompanying text. However, it is submitted that every amount (however small) was important to assist the government in "balancing its books". The GAAR did make a contribution to the "fiscal neutrality" of Stage One, particularly considering that it was the most financially lucrative proposal of all the corporate base-broadening measures.

Furthermore, this pressure to achieve "fiscal neutrality" may have influenced the calculations of the estimated revenue increases generated by the GAAR: supra, note 46 and accompanying text.

\(^8\) "Tories Could Use Tax Bill to 'Buy' Votes", supra, note 65.

\(^9\) "[I]t [the government] may be holding back so it can dangle the carrot of tax-reform rebate in front of voters in an election [citing Allan Maslove, Professor of Public Administration, Carleton University]": ibid.
This delay meant that section 245 was not enacted within a short space of time after its initial introduction. The result was that further specific anti-avoidance measures had to be introduced in the interim period. It was claimed, rather hopefully, that these measures dealt a blow to the GAAR: if many more shady business tax transactions were outlawed before the provision was introduced, then it could have reduced the applicability of the rule and called into question the need for it in the first place. However, rather than harming the argument for the GAAR, it would appear that the press releases corroborated the allegations of its necessity. By disallowing abusive transactions before the introduction of the provision, the Department of Finance was effectively reinforcing that such transactions continued to exist after the tax reform exercise, thereby disputing any claims that there were no loopholes left to exploit.

100 Finance Minister, Michael Wilson, outlawed two schemes by press release. One scheme involved the transfer of "capital dividend accounts" from taxpayers who could not benefit them to taxpayers who could. The other concerned the payment of special dividends to effect refunds of the "refundable dividend tax on hand": Beach, supra, note 44.

101 DeMont, supra, note 44.

102 In that most avoidance transactions have emanated from the abuse of so-called preference provisions under the Act, which have now either been repealed or are recommended to be repealed under the White Paper, why is a general anti-avoidance [sic] necessary at this time - has not the barn door been closed?

To conclude, it is submitted that the government embarked upon the tax reform exercise with the desire, inter alia, of bolstering its support with the electorate in the face of a looming federal election. In furtherance of this objective, it sought to present the package as achieving a fairer system. In particular, it attempted to create the image of reducing the tax burden of the lower and middle-classes at the expense of the corporate sector and high income-earning individuals. In pursuing this aim, the GAAR greatly assisted the government. The introduction and inclusion of the provision within the tax reform package helped create this image of fairness, both conceptually (ie. the GAAR, by itself and as part of the corporate base-broadening measures assisted in the presentation of the illusion that the tax burden of the corporate sector had been substantially increased) and financially (ie. section 245 aided the verification of the "significant" increase in the corporate tax burden by the increases in revenues it was supposed to generate). The utilisation of the provision in this way was influential. In particular, it was an impetus for the introduction of the proposal and its inclusion within the tax reform package. Furthermore, it arguably affected the calculation of the revenue increases which the rule was supposed to generate. Finally, it is submitted that political considerations influenced the alteration of the proposal in its passage through the parliamentary process. It is to this latter proposition that we now turn.
(iii) Modification of the Proposed GAAR

The GAAR, as initially proposed in the June 1987 tax reform package, underwent some alteration during its passage through the parliamentary process. However, as previously discussed, these changes did not substantially modify the basic structure and substance of the rule. Initially, this may seem surprising in light of the furore which the proposal generated in the business and professional communities. One may have expected such political pressure to result in the significant modification of the proposal, if not its withdrawal. However, the government took a firm stance and only "tinkered inconclusively" with the provision. It is suggested that this was predominantly due to two factors - political appeal and economic conditions. The latter is discussed in detail later in this thesis.

The prevailing political conditions at the time of the tax reform exercise meant that the government could not afford politically to have the package unravelled. Traditionally, discrepancies between white papers and resultant legislation are

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103 Chapter II, notes 41-8 and accompanying text.

104 P. DeMont, "Political Turns in Tax Reforms: Smoother Ride for Drivers, but Banks Hit" Financial Times (21 December 1987) 1 & 18 at 1.

105 Infra, chapter IV, "Economic Context".
supposedly embarrassing for the government.\(^{106}\) This was more pronounced for the government at the time of the 1987 tax reforms. To explain, the only persons who were complaining about the proposed section 245 were business persons and their tax representatives. If the government had substantially altered the proposal under their pressure it would have been seen as placating the corporate sector and high-earning individuals. This was the very impression the government was trying not to give in relation to its tax reform. This can all be traced back to the attempt by the government to make the tax reform package as politically appealing as possible to the electorate in the hope of bolstering its support in light of the looming federal election.

This proposition is further supported by the changes made to the tax reform proposals, including the GAAR, in response to the Report of the House of Commons Committee on Finance and Economic Affairs.\(^{107}\) This Committee held public hearings\(^{108}\) on the tax reform package and tabled its report in the House of Commons on the 16 November, 1987. Overall, it agreed with the "stated

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\(^{106}\) Beach, supra, note 44.

\(^{107}\) Supra, note 58.

\(^{108}\) A detailed account of the Committee's preliminary work on the tax system in general, and the white paper proposals in particular, is outlined in the Report, ibid. at 25-29. Briefly, in relation to the latter, it consisted of briefs being received (over 550), public hearings (with 174 witnesses) and numerous in camera working meetings.
objective and thrust of tax reform". In total, the report made eighty-one recommendations. In particular, the set of recommendations which received the most media coverage were those that advocated an extra $225 million be given to Canadian families. These (and other recommendations) were going to be funded primarily by a minimum tax being imposed on financial institutions. The government was initially unenthusiastic about the idea of this minimum tax. However, it nevertheless altered the tax reform proposals to incorporate these

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109 Ibid. at 28. This may not be surprising considering that the thirteen-member committee had a Tory majority: W. Johnson, "Conservatives Look Poised to Bring Off Tax Reform" Montreal Gazette (18 November 1987) B3. Consequently, it was stated that the report only "tinkers with the proposed tax system, providing technical responses to the original proposals...": Drache, supra, note 95. However, note commentary to the effect that the "committee neither rubber stamps government proposals, nor blindly endorses pleas for change even by powerful interest groups. Rather it takes, a critical look at each proposal and makes recommendations Ottawa may not be able to ignore." S. Poddar, "Two Opposing Views...A Critical Look Wilson Can't Ignore" Financial Post (23 November 1987) 6.

110 Supra, note 58 at 3-11.

111 For example, J. Douglas, "MPs Propose $225 Million in Tax Breaks" Winnipeg Free Press (17 November 1987) 1. These savings were to be in the form of enhanced child benefits, taxation of family allowances and increases in dependants' net income threshold: Blenkarn Report, ibid. at 42-52.

112 For a list of the revenue impact of the recommendations, see Blenkarn Report, ibid. at 15, Table 1. The Committee applied the principle of revenue neutrality so that its recommendations would not differ from the overall revenue projections in the white paper documents: ibid. at 13-5.

recommendations, albeit in a diluted form.\(^{114}\) It is generally accepted that these modifications were motivated by political factors. In particular, it is suggested that the government, in trying to bolster its support with the electorate, felt that it had to make some attempt to implement the recommendations, especially in light of their populist nature in giving more money to Canadian families. Rejecting the Blenkarn Report would have been politically costly. For example, if it had ignored the recommendations, it may have been seen as contradicting its white paper message of helping the lower and middle-classes at the expense of the corporate sector.\(^{115}\) Also, if the Finance Minister had merely shelved the Report, it could have been interpreted as ignoring the committee process.\(^{116}\) Furthermore, it was suggested that the Committee could delay the progress of

\(^{114}\) The Committee recommended $225 million be given in extra family and child benefits. As a result of the December 1987 changes, the government effectively promised to deliver $156 million: D. Hatter, "Tax Changes Strike Right Political Note" Financial Post (21 December 1987) 3. This was to be financed by "what amounts to, in everything but name, a minimum tax [on financial institutions]": DeMont, supra, note 104.

\(^{115}\) "The rational behind this byzantine twist [ie. the imposition of the tax on financial institutions] is political officials at the Finance Department concede. If banks pay tax each year, the average person is more likely to view the new tax system as fair." DeMont, supra, note 104.

\(^{116}\) "If he ignores [the Blenkarn Report] ... 'he's really thumbing his nose at all the taxpayers and companies and interest groups who took the trouble to put their views to the committee' [quoting Michael Cassidy, New Democratic Party's finance critic and member of the House of Commons Finance Committee]." "Wilson Risks His Credibility over Tax Plan, Cassidy Says" Toronto Star (25 November 1987) F6. See also, DeMont, supra, note 76.
the Bill implementing the tax reform proposals through Parliament as it was to be the first body to analyze the Bill. 117

This hypothesis is reflected in the changes made to the GAAR. Although, the Blenkarn Report endorsed the need for a general anti-avoidance rule, 118 it made several recommendations as to the format of the proposal. 119 Indeed, it proposed a new draft of section 245 which reflected its recommendations. 120 The government incorporated a few of the recommendations, although it mostly integrated them into its version of the rule rather than adopting the draft proposed by the Committee. 121 The government was under great pressure from the corporate and professional communities to either withdraw or substantially modify the rule. It was apparently set on the basic concept of

117 DeMont, ibid.

118 Supra, note 58 at 200-1.

119 Ibid. at 200-7.

120 Ibid. at 205-7.

121 For example, of the seven recommendations, the government incorporated three of them. These included dropping the "significant" from the definition of avoidance; eliminating the business purpose test (a non-tax purpose test was substituted) and eliminating the phrase "notwithstanding any other provision of the Act" (the rule was changed to be a provision of last resort). Furthermore, the Report recommended that the government not proceed with the imposition of a penalty which it had suggested in the white paper: Tax Reform 1987, supra, note 34 at 143. The final version of section 245 did not contain any provision which imposed penalties.
a GAAR,\footnote{DeMont, supra, note 44 at 6 [citing a Department of Finance official].} although it was open to change the exact shape of the rule.\footnote{Ibid. See, also, Dodge, supra, note 25 ("Tax Reform and the Anti-Avoidance Proposals) at 19: "[W]e will welcome all thoughtful suggestions designed to improve the proposed rule."} It is felt that the Blenkarn Report offered a convenient compromise for the government. The Report validated the necessity of the rule,\footnote{Contra, Canada, Senate, Tax Reform '87: Report of the Standing Senate Committee on Banking, Trade and Commerce, tabled on December 1, 1987 (Don Mills: Richard De Boo, 1987) at 55, paragraph 6.106-8.} and suggested alterations which did not result in excessive modification of the rule. By incorporating some of the Blenkarn Report recommendations relating to the GAAR, the government was showing the business community that it was prepared to be reasonable and make some changes to placate the business and professional communities. However, it would also be able to repudiate any claims that it was furthering the interests of the corporate sector. The government could argue that it was merely acting in accordance with the wishes of the Committee.\footnote{However, the government did make other alterations which were not suggested by the Blenkarn Report. For example, it introduced a measure providing for recourse to explanatory notes. This subsection was later deleted in response to strong criticism by the legal professional.}
These conclusions regarding the influence of the political environment are verified by the treatment of the Senate Committee Report.\textsuperscript{126} This Report scathingly attacked the GAAR,\textsuperscript{127} and concluded that it should not be proceeded with.\textsuperscript{128} However, to state the obvious, these recommendations were not implemented. Various reasons can be suggested for this phenomenon. First, the government did not support the conclusions reached.\textsuperscript{129} Second, this Committee Report did not have as much political clout as the Blenkarn Report.\textsuperscript{130} Third,\textsuperscript{126}

\textit{Supra,} note 124.

\textsuperscript{127} "With good reason, not a single voice was heard in support of this proposal." \textit{Ibid.} at 44, paragraph 6.106.

\textsuperscript{128} \textit{Ibid.} at 55-6, paragraph 6.108.

\textsuperscript{129} It was committed to the concept of a GAAR, \textit{supra,} note 129.

\textsuperscript{130} This is perhaps due to the underlying political structure. For example, the members of the House of Commons are elected whereas the members of the Senate are not. Quaere whether this will still be the situation in light of the current Constitutional debate regarding the Triple-E Senate proposals.

This disparity in the political influence of the two institutions is reflected in the varying amount of media coverage each committee attracted: the Blenkarn Report was released to the accompaniment of a fanfare (for example, an advance announcement of the release date, a press lock-up and briefing: D. Beach, "Wilson Has Opportunity to Open Doors on Tax Policy" \textit{Financial Times} (16 November 1987) 25) and received extensive media coverage [for example, E. Beauchesne, "Pressure Conflict on Tax Reforms" \textit{Calgary Herald} (12 September 1987) F6; G. Brett, Wilson Risks His Credibility Over Tax Plan, Cassidy Says" \textit{Toronto Star} (25 November 1987) F6; "Bugs Noted in Tax Package" \textit{Halifax Chronicle Herald} (1 July 1987) 4; P. Cook, "A Fairer Tax System is No Easy Thing to Sell" \textit{The Globe and Mail} (4 September 1987) B2; B. Costello, "Watch as 'Vultures' Move in on Tax Reform" \textit{Calgary Herald} (8 August 1987) D1; DeMont, \textit{supra,} note 76; Douglas, \textit{supra,} note 111; Drache, \textit{supra,} note 95;
doubts have been expressed as to the neutrality of Senate Committee members\textsuperscript{131} which the government could have exposed as justifying its lack of implementation of the Report's recommendations.\textsuperscript{132}

To conclude, it is submitted that the limited nature of the changes made to the proposed GAAR in its passage through the parliamentary process can be traced to the political and economic conditions prevalent at the time. In particular, the political conditions (for example, the looming election, the

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\textsuperscript{131} For example, the Senate Banking Committee comprises of lawyers, executives and stockholders. Furthermore, their ties with the financial and investment world are closer than might appear at first glance. Although no evidence is offered for the committee in 1987, information relating to composition of the committee at the time of the hearings on the 1970 government's tax proposals provides a good illustration. At that time, almost all of the thirty-three members of the committee held at least one corporate directorship and many of them sat on numerous corporate boards. Between them they held 211 directorships, including directorships of some of the largest and most powerful Canadian companies. McQuaig, \textit{supra}, note 2 at 169.

\textsuperscript{132} However, whether the government would actually expose this is another matter. The important point is that it all adds up to reduce the political pressure which the committee can exert on the government to change the law in line with their recommendations.
government's poor electoral support) meant that the government was trying to bolster its ratings with the electorate. Therefore, the government wished to promote the image of creating a fairer tax system. Consequently, it held a firm stance against the pressure exerted by the business sector. Further, it implemented, albeit in a diluted form, the populist recommendations made by the House of Commons Committee on Finance and Economic Affairs.

These political influences were also reflected in the modifications to the GAAR. In particular, the government remained committed to the concept of the rule, despite the furore created by the business and professional communities. It did make some modifications - but nothing that changed the substance of the rule. Furthermore, the majority of these changes were in response to the recommendations of Blenkarn Report. This reinforces the proposition that the government was wishing to appear to be acting in the interests of the electorate and not the business community. The underlying motivation was the desire of the government to bolster its support with the electorate in the face of a looming election.
(iv) Special Interest Groups

Two strands comprise the assumption that underlies this thesis that governments want to retain office. The first part consists of governments wishing to maximize votes with the electorate to ensure its re-election. This has been discussed above in relation to the tax reform package in general and section 245 in particular. The second element is that governments wish to placate special interest groups.\textsuperscript{133} It is submitted that this factor played an important role in the formulation of the tax reform package, and specifically, the GAAR.

The placation of the business community may not be evident at first sight. This is due to the attempts of the government to sell the tax reform package as promoting a fairer system. Consequently, for example, the media concentrated on the criticism by business of the tax reforms in allegedly imposing too great a burden on the corporate sector.\textsuperscript{134} However, in reality, the government tried to pacify the business and professional communities in two ways: these communities were

\textsuperscript{133} In relation to this section, special interest groups are generally taken to be the corporate sector and high-earning individuals. Although special interest groups are not limited to these taxpayers, it is felt that in the context of the 1987 reforms, these two groups are the most relevant. To amplify, it was these groups that the government singled out in its white papers as not paying their full burden of tax. Furthermore, these taxpayers (in particular, the corporate sector) were most vocal about the effects of the tax reforms.

\textsuperscript{134} \textit{Supra,} note 56.
involved quite heavily in the preparatory stages of the reforms and consequently, the structure of the tax reform proposals were weighted in favour of the corporate sector, or at least, were not as harsh as they could have been.

In relation to the former, the government involved the business and tax communities quite extensively in the preparation of the tax reform proposals. These communities lobby the government all year round, particularly in the run-up to the federal budget. However, this lobbying and consultation process was increased for the tax reform exercise. The usual round of formal and informal meetings with special interest groups were

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135 There are a number of advantages for adopting a consultative process. First, it actively builds in many opportunities for voter feedback as the views of the government are formed into legislation. In particular, the government can utilise the process of feedback to gauge the strength of opposition to and support for proposed changes. Furthermore, extensive consultation carries with it the potential for benefit as those who stand to gain are made aware of the fact and political opposition is consequently reduced. W.I. Gillespie, "Tax Reform: The Battlefield, the Strategies, the Spoils" (1983) 26 Canadian Public Administration 182 at 193.

136 Christmas may be over but 35 or so major organizations are still clinging to their annual wish lists, itemized accounts of what they would like to see included in the next federal budget.

The groups have whispered their wishes to Finance Minister Michael Wilson or his junior partner, Tom Hockin, in a series of consultations which finished recently. D. Oxtoby, "Business Consultations Offer Rare Opportunity: Door Open to Business Lobbyists to Influence Federal Tax Reform" Financial Times (12 January 1987) 8.
held. Furthermore, an elite group of tax specialists was formed to give advice to the government regarding the tax reform proposals. This invitation-only group was formed in November 1986 and met monthly to act as a sounding board for the Department of Finance. The involvement of the legal professional in this way has been strongly criticised. The media focused on the invaluable insider's perspective the members of the group would have gained. More fundamentally, the input of such professionals was attacked on the basis that their biases towards the corporate sector influenced the consultation process. This was aptly captured by one


138 The exact number of this group varies depending on the source. Therefore, it has been claimed to be twenty [E. Beauchesne, "Review Fracas: Opposition Says Wilson Breached Privileges" Halifax Chronicle Herald (18 June 1987) 1 & 24 and J. Wong, "Elite Group of 20 Gets Early Peak at Tax Paper" The Globe and Mail (17 June 1987) B1 & B2] or thirty-six [McQuaig, supra, note 2 at 100].

139 Note criticism of the selection of the group on the basis that it was purely political: "I know how these people are picked. They're usually the guys who get their name in the paper. It's political. [quoting A. Boulanger, tax principal at Laventhol & Horwath, Toronto, a former Department of Finance employee]." Wong, supra, note 138.

140 Ibid.

141 Ibid.

142 Beauchesne, supra, note 138 & Wong, ibid.

143 What is questionable is the extent to which Ottawa has chosen to ignore these connections [ie. between the tax and business communities], treating tax practitioners as independent experts rather than as the technical arm of the
commentator who stated that "[l]etting the tax community shape tax legislation is a bit like getting the fox to build a safer henhouse". Therefore, in light of this extensive consultation process with the business and professional communities, it is of no surprise that the tax reform proposals were weighted in favour of the corporate sector.

The placation of the business sector is reflected in the structure of the tax reform proposals which did not hit the business sector and high income-earning individuals as hard as the government claimed. The government ostensibly created an image of fairness whereby the tax burden on lower and middle classes was to be significantly reduced, seemingly at the expense of the corporate sector. However, as previously discussed, in financial terms, this image was illusory. Moreover, the tax reform package was unfair in other respects. In addition to the measures already mentioned in this paper, other proposals reinforced the favourable treatment of the corporate sector and high income-earners. For example, the top rate of income tax was reduced; not all tax breaks were removed; rates were reduced in 1988, but many tax breaks

business and investment community. McQuaig, supra, note 2 at 102.

144 McQuaig, ibid. at 99.

145 "We didn't arrive at a perfectly level playing field. There are still incentives left which, in theory, did not have to remain and could be called unfair. But on balance we worked
slated for removal were not phased out until 1991; those tax breaks that were removed were not ones important to the corporate sector and high income-earners, but to the middle class (eg. employment expense deduction and interest and dividend deduction); the deductions utilised by the corporate sector were not converted to credits and were not cut, they were merely trimmed (eg. the lifetime capital gains exemption). This list of favourable measures was primarily a result of the placation of the business sector. It has been suggested that no alternative viable reasons exist for these measures.

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146 See, generally Brooks & McQuaig, supra, note 54 and McQuaig, supra, note 2 at chapter 12.

147 "The most important objective was to avoid a general uprising by business, which could easily undermine the entire exercise, weaken if not destroy Wilson's credibility and, through him, sink Brian Mulroney's government." Solomon, supra, note 41.

148 For a discussion as to the lack of reasonable justification for these proposals, see generally Brooks & McQuaig, supra, note 54 and McQuaig, supra, note 2, chapter 12.
However, this is not entirely true. In particular, the U.S. reforms necessitated a reduction in the Canadian corporate tax rates.

The pacification of the corporate sector is verified by the low-key reaction which the tax reforms received. In total, the response was quite favourable, at least when compared with the furore that accompanied previous attempts at tax reform. There were the expected complaints from business that its tax burden had been increased excessively and the new sales tax had not been outlined in any great detail. However, within two weeks the major newspapers had virtually lost interest in the tax reform proposals. This has been interpreted as reflecting the benign nature of the tax reform proposals towards the powerful interest groups, the corporate sector and the high

149 It is arguably accurate in respect of some of the measures. For example, there would seem to be no good reason for the continuance of special incentives in light of the evidence which questions their effectiveness in achieving the socio-economic purpose that they are supposedly meant to promote. See supra, note 22.

150 This is discussed in greater detail later: infra, notes 170-83 and accompanying text.


152 For a more detailed discussion, see Chapter V, "Historical Context", Social and Political Historical Background.

153 McQuaig, supra, note 2 at xxxvi.
income-earning individuals.\textsuperscript{154} To explain, because the 1987 tax reforms were favourable, these taxpayers did not feel the need to manipulate the media to gain maximum exposure of their point of view with the objective of exerting political pressure on the government to alter its proposals.

However, it would appear at first glance that the situation of the GAAR was slightly different to the one described above. Admittedly, the tax community was involved in the preparation of the rule.\textsuperscript{155} However, the rule did not favour the corporate sector as it was directed specifically against this sector and high-earning individuals.\textsuperscript{156} Nevertheless, despite this limitation, it is submitted that the government did make efforts to placate the business community. For example, arguably it

\textsuperscript{154} Ibid.

\textsuperscript{155} "The tax community, working mainly through the joint tax committee of the CICA and the Canadian Bar Association, has been meeting with the Finance Department bureaucrats to work out a compromise on the wording of the rule." DeMont, supra, note 44.

This raises the same concerns that were previously discussed (\textit{supra}, notes 142-4 and accompanying text) in relation to the involvement of the tax community in the formation of tax legislation. Furthermore, in particular, the CICA/CBA Joint Committee has been criticised for unashamedly calling for changes that will aid the business and investment community, whose members they tend to represent: McQuaig, \textit{supra}, note 2 at 100-1.

\textsuperscript{156} These are the taxpayers who predominantly make use of artificial tax avoidance schemes to reduce their income. This is due to a variety of factors, for example, the costs in retaining tax professionals and the value of the investment required to make the return financially viable (when offset against the fees of the tax professionals etc.).
initially indicated that it was not committed to the rule,\textsuperscript{157} or at least to its original format;\textsuperscript{158} it modified the rule in response to criticism\textsuperscript{159} and produced interpretative aids, for example, explanatory notes,\textsuperscript{160} to assuage fears of uncertainty. Therefore, it would appear that the government, although introducing a measure contrary to the interests of the corporate sector, did everything it could within the circumstances to pacify the business community.

\textsuperscript{157} This is implied from the absence of an implementation date in the initial format of the rule. It was speculated that this "suggests that the Government is willing to accept other ways of solving the tax avoidance problem. 'If they were satisfied with it, they would have said it's effective now' [quoting R. Couzin, Stikeman, Elliot]." B. Little, "Accountants, Lawyers Say Plug Too Big for Tax Gaps" The Globe and Mail (20 June 1987) B1 & B4. Also, McQuaig, supra, note 2 at 342. However, note comments to the contrary that the government was committed to the concept of the rule, supra, note 122.

\textsuperscript{158} Little, ibid. Note also the comments made by one Department of Finance official that the government was open to suggestions as to the content of the rule: supra, note 123.

\textsuperscript{159} For example, it added subsection (10) to the December 1987 draft providing for recourse to explanatory notes. This was later deleted when the provision was severely attacked, notably by the Joint Committee of CBA/CICA: "Comments on the GAAR - Re: Recommendations on the General Anti-Avoidance Rule of December 1987" reprinted in V. Krishna, Tax Avoidance: The General Anti-Avoidance Rule, (Toronto: Carswell, 1990), Appendix A.5 at 123-4.

\textsuperscript{160} Canada, Department of Finance, Explanatory Notes to Legislation Relating to Income Tax (Ottawa: the Department, April 1988).
To conclude, it is evident from the above that the government was attempting to placate the business and professional communities in relation to the introduction of the tax reform proposals, and the GAAR in particular. Although the government was restrained by other considerations, for example, a desire to appeal to the electorate, it still managed to produce a package that was heavily weighted in favour of these communities. It reconciled these two conflicting objectives by some very astute political manoeuvring. In particular, it produced a package whose underlying structure was favourable towards the corporate sector, yet was presented to appear to be promoting a fairer system. The success of these political antics is evidenced by the fact that the government was able to enact the package without having to completely unravel it. Such a consequence would have been costly to the government both politically and financially. This whole scenario exposes how the tax system is a direct result of the political process. Furthermore, it highlights the influence that external factors, such as a looming election, can have on the tax structure.

161 "Dressed up in the lingo of social justice, the proposals threaten in the long run to shift the burden significantly—off the backs of corporations and the rich. What is going on isn't tax reform at all, it's the hijacking of tax reform." McQuaig, supra, note 2 at 346.
C. SECTION 245 AS PART OF THE TAX REFORM PACKAGE

The GAAR was proposed as an integral part of the tax reforms presented in June 1987. The overall thrust was to present a package that was appealing to the electorate, whilst simultaneously, placating the business community.

However, the issue is whether the inclusion of the GAAR in the tax reform package had any impact on its development. Although it is conceded that such questions cannot be answered conclusively (due to the absence of a comparable standard, eg. the presentation of the rule in isolation), it is submitted that viable arguments can be made that the presentation of the GAAR as part of the tax reform package did have an influential effect on the rule.

The inclusion of the proposal within the tax reforms perhaps provided an impetus for its introduction. The government wished to present an image of fairness to the electorate to bolster its flailing support. The GAAR was an important element in the creation of such an image, both conceptually and financially. This perhaps motivated the government to introduce the GAAR.

Furthermore, the government maybe would not have introduced the rule if it had not been part of the tax reform package. Introducing the GAAR in isolation may have resulted in the business community's venom being directed exclusively at the
rule. By including it in the tax reform package, the government was essentially able to deflect some of the focus from the rule, as obviously other measures within the package would attract some degree of attention.

The inclusion of the GAAR within the tax reform package also subjected it to the trade-offs and compromises which are inherent in structuring any tax reforms. Without proffering any substantive evidence, it is suggested that the inclusion of the rule may have influenced its development. For example, perhaps the government only introduced the rule because it perceived that it was politically safe to do so in light of the other measures that were favourable to the corporate sector. Maybe the introduction of the rule motivated the government to structure the other measures to be favourable. Perhaps if the response of the corporate sector to the tax reforms had been stronger, the government may have withdrawn or substantially

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162 This process was aptly captured by one commentator in his submissions to the Standing Senate Committee on Banking, Trade and Commerce: "The tax reform package was put together with finely balanced trade-offs between economic rationality and political expediency, between immediate patching and long-term reform, between the competitive need to bring down personal and corporate tax rates and the obscene revenue requirements of the bulging government deficit and between different means of numerous pressure groups. Overall, the package stands as an excellent example of the possible" [Robert D. Brown, "The Effects of Tax Reform on Business", in Tax Reform: Perspectives on the White Paper, Submission by the C.D. Howe Institute, October 1987] and the Committee's response: "Tax reform will always be thus": Report, supra, note 124 at 14.
altered the proposed GAAR to pacify the business community.\textsuperscript{163} Although this is all hypothetical, it serves to illustrate the compromises and trade-offs that exist in putting together a package of tax reforms. By including the GAAR within the 1987 tax reform proposals, the government was exposing it to this process.

A final major influence of the inclusion of section 245 within the tax reform package was the presentation of the rule as part of white paper documents, rather than a Bill. Gillespie has argued that the process which the government adopts - whether it be the consultative\textsuperscript{164} or budget process\textsuperscript{165} - is determined by the information it has regarding the political costs and

\textsuperscript{163} The withdrawal or alteration of the rule would have been a good way to placate all sectors of the business community at the same time as tax avoidance is not specific to any one sector.

\textsuperscript{164} A stylized description of such a process might be as follows: the government selects from a variety of choices and publishes them as a white paper discussion. It then calls for briefs and representations and may conduct public meetings. It sometimes prepares draft legislation which is submitted to Parliament for consideration. Also, it may be channelled to special committees of Parliament for study, review and comments. \textit{Supra}, note 135 at 193-4.

\textsuperscript{165} This process discourages voter feedback, minimizes the time available to potential losers to marshall their resources in an all-out attack on the government's proposals and strives to translate the proposals into legislation with minimal alteration. This process may entail the government introducing the proposals as part of the budget speech. Legislation will follow shortly thereafter. It closely resembles the initial proposals, except perhaps for a few technical adjustments. \textit{Ibid.} at 194.
benefits. In particular, it depends on whether it is certain about the extent of the winners and losers from the proposals, whether the winners are clearly identified and, in terms of political support, outweigh the losers and whether the losers are located in different sectors of the economy and have few, if any, prior links to the proposals (and are thus unable to mount a unified attack).

The 1987 tax reform proposals were introduced as white paper documents - thus reflecting the consultative process. This is further corroborated by other strategies the government adopted in formulating the package - the pre-consultation with interested parties; the referral of the package to the House of Commons Finance Committee and the Senate Committee on Banking, Trade and Commerce (the former holding public hearings which provided a forum for special interest groups); the fairly significant amendments made to the white paper proposals, in particular, to incorporate the recommendations of the House of Commons Finance Committee. These factors verify the proposition

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166 Ibid.
167 Ibid.
168 At one point in time, it was mooted that the proposals may be introduced as a green paper due to dissensions within the government and the Cabinet in particular. L. Whittington, "Tax Paper May Turn Green" Calgary Herald (28 April 1987) A3.
169 Cook, supra, note 130 and Fife, supra, note 90.
that the government was adopting a consultative process and was therefore more willing to accept criticism and suggestions as to the final format of the proposals.

The inclusion of the GAAR within the tax reform package resulted in its presentation as a white paper proposal. This influenced its development by indicating to the business and tax communities that the government was not committed to the format of the rule. This exposed the rule to criticism and ultimately, change. However, bearing this in mind, it is surprising that only limited changes were made, particularly when one considers the extreme pressure the government was put under to withdraw or substantially amend the rule. One possible explanation is that, although the GAAR was presented as a white paper proposal, the government was nonetheless committed to the concept of the rule, and moreover, to the basic format. This proposition is substantiated by the fact that the government included draft legislation of the rule. Compare this with the presentation of the sales tax which only consisted of three options being outlined, with no commitment made to either nor the inclusion of a timetable. This suggests that the government was less hesitant politically about the GAAR than it was about other proposals within the package.
To conclude therefore, the inclusion of the GAAR within the tax reform package was influential, both as regards its introduction and its development. However, as previously mentioned, this is hypothetical as no comparable standard exists against which to judge the proposal. Nevertheless, viable arguments have been advanced illustrating the impact of the inclusion in the tax reform proposals on the rule.

D. TAX REFORM IN THE UNITED STATES

The U.S. exercise reflected a trend in tax reform which was spreading across industrialised nations.170 This trend generally resulted in the reduction of top rates of tax for individuals and corporations, the broadening of the tax base by the elimination or cutting-back of numerous benefits and the shifting of the burden of taxation from individuals to corporations.171 This trend towards more neutral and less interventionist tax systems with lower rates was the result of changes in attitudes regarding taxation theory and practice. For example, there was a growing perception that the appropriate role of the government in fine-tuning economic activity is more limited than previously thought, this philosophy resulting in an increased reliance on markets; the desire to improve economic


performance motivated the reduction in the perverseness of existing tax systems and there was a growing realisation that domestic tax policies must not obstruct international competitiveness.\textsuperscript{172} This worldwide reform put pressure on all industrialised nations to examine and reform their own tax systems.\textsuperscript{173}

\textsuperscript{172} Brown & Morgan, supra, note at 747-8 and R.D. Brown, "The Painful Realities of Tax Reform" (June 1987) 120 CA Magazine 26 at 26-8.

\textsuperscript{173} The Canadian government's recognition of this pressure is illustrated by the following:

It also became evident ... that some of our major trading partners, whose tax systems suffered many of the same deficiencies as Canada's, were moving forward more aggressively and more comprehensively with actions to reform their tax systems, and, in particular, to lower their tax rates. In an increasingly interdependent world, it is important not to allow Canada's tax system to put our traders, businesses, investors and highly skilled individuals at a competitive disadvantage with other countries.

\textit{Tax Reform 1987, supra, note 34 at 21.}
However, it is submitted that the United States reform,\textsuperscript{174} in particular, was influential in Canada.\textsuperscript{175} This influence was both political and financial. As regards the former, the Canadian government was seduced by the political appeal which tax reforms had for American citizens, especially since the U.S. Congress was also facing a looming election at the time.\textsuperscript{176} In relation to the latter, the close connections between the two economies meant that the U.S. tax reform was financially pertinent to Canada. Verification of this was provided by a study done by the C.D. Howe Institute which concluded that unless the U.S. tax reforms were met in Canada, they could pose a threat because they would make most foreign investment by American corporations less attractive.\textsuperscript{177}


\textsuperscript{175} The government's recognition of this is reflected in the following statement: "But we have to be mindful of what is going on [in the U.S.], particularly in tax rates. That's because of the proximity and integration between the two countries and therefore the need to be competitive [quoting Michael Wilson, Finance Minister]." Pitts, supra, note 33.

\textsuperscript{176} Ferguson, supra, note 34.

\textsuperscript{177} "Tax Reform Dilemma: Study Warns We Must Match U.S." Vancouver Sun (22 January 1987) F6.

'With Canada's open economy and with multinationals making up such a large part of the Canadian business community, if corporate tax rates in Canada remain substantially higher than those in the United States, there could be a painful
However, although Canadian tax reform needed to parallel the U.S. exercise, it was accepted from the outset that the former could not replicate the latter. In particular, the Canadian system did not have the same proliferation of tax incentives to choose from and ultimately, eliminate, as the U.S. system had

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erosion of the Canadian tax base and Canadian tax revenue' [quoting R. Brown, vice-chairman of Price Waterhouse, Toronto, author of study].

Ibid.

See, also, the Standing Senate Committee on Banking, Trade and Commerce, Report, supra, note 124 at 12-3 which outlined the possible result of rate disparities (ie. particularly, lower rates in the U.S.) - the shifting, by multinationals, of income to the U.S. and expenses to Canada.

One commentator who does not support the reduction in Canadian corporate tax rates to make our tax system more internationally competitive is Linda McQuaig. First, she does not believe that the disparities in tax rates between Canada and other nations are significant considerations to corporations in choosing their location. She claims that studies have found that tax factors are relatively low on the list of reasons determining where corporations locate themselves. She alleges more important factors include, for example, access to markets, transportation and skilled labour: supra, note 2 at 76. Furthermore, as regards large multinational corporations and the shifting of their profits/expenses to low/highly taxed jurisdictions, she posits that the solution does not lie in reducing rates, but in adopting other measures to effectively deal with this problem, for example, strengthening our laws on tax havens in general: ibid. at 79. It is felt that this view is simplistic. In particular, it ignores the close trading connections between the U.S. and Canada. Canada cannot afford to impose strict laws, especially against the U.S., regarding the operations of multinationals, particularly in light of the present ideology of minimum trade barriers. Furthermore, it does not take account of the political aspect of the disparities. In the current climate of heightened interest in the U.S. economy and its tax system, the Canadian government could ill-afford politically to be seen as not responding to the U.S. reforms, or reacting in a way that was diametrically opposed to their direction.
pre-reform. Also, some of the Canadian incentives, for political reasons, could not be removed. Furthermore, the Canadian system provides more benefits to its citizens, such as publicly financed health and hospital care; greater public financing of post-secondary education and more public financing of the arts. Politically, the government was careful to stress that the Canadian reforms would not duplicate the U.S. exercise. This was accepted by the Canadian electorate. However, despite these differences, there is no doubt that the U.S. reforms did have an influential impact on the Canadian tax system. In fact, it has been claimed that they were the main impetus for the Canadian tax reform exercise.

178 See Hartle, supra, note 7 at 398: "Because the old U.S. system was so rife with loopholes and special concessions, even partial base broadening there could finance large reductions in rates. This easy option was not available in Canada."

179 For example, the lifetime capital gains tax exemption. C. Motherwell, "Politics May Hobble Canadian Tax Reform" The Globe and Mail (16 September 1986) B1 & B8.

180 Brown & Morgan, supra, note 170 at 747. Brooks & McQuaig, supra, note 54 at 17. Although the United States spends more on defence and related activities, it has higher per capita income and accordingly can absorb these higher expenditures whilst still achieving lower tax burdens: Brown & Morgan, ibid.

181 Pitts, supra note 33.

182 A survey concluded that seventy-eight per cent of Canadians agreed with Michael Wilson's assertion that tax rates must be higher than in the United States to finance government benefits. Ferguson, supra, note 38.

183 Hartle, supra note 7 at 401-2. See, also, Worthington, supra, note 28.
However, the impact of the U.S. tax reform on section 245 cannot quite be discerned at first glance, considering that it did not include a general anti-avoidance rule as was present in the Canadian package. Nevertheless, it is submitted that the U.S. tax reforms did indeed exert some degree of influence, both as regards political appeal and financial considerations. In relation to the former, as previously discussed, the government tried to present the tax reforms as promoting a fairer system. However, in creating an image of harming the corporate sector, limitations existed. For example, the Canadian system did not contain as many special incentives as the U.S. system pre-reform, and furthermore, some of the special incentives were untouchable. Therefore, on the basis of these limitations, the government may have decided to introduce the GAAR to enable it to present a more complete picture of fairness. For example, the rule would prevent abuses of the remaining incentives (an added justification for their continuance) and would preclude abuses of future incentives introduces.\textsuperscript{184} Overall, therefore, the provision greatly contributed to the creation of this image. In relation to the financial considerations, for reasons stated above, the Canadian government was unable to eliminate/reduce as many special incentives as the U.S. system. This meant that to

\textsuperscript{184} The Canadian system does not have a judicial business purpose test as the U.S. does. Therefore, existing anti-avoidance measures were advocated by the government as being inadequate. \textit{Tax Reform 1987: Income Tax Reform, supra}, note 24 at 130.
substantiate its image of fairness it had to increase the projected revenues of its base-broadening measures using other measures. Enter the GAAR.

To conclude therefore, it is clear that the U.S. tax reform experience had an influential affect on the Canadian tax system. In particular, it provided an impetus for the reforms and then dictated to a large extent, the direction of these reforms - the lowering of rates, the broadening of the base and the shifting of the tax burden from individuals to corporations. In relation to the GAAR, the U.S. reforms provided an impetus for its introduction as part of the Canadian tax reforms. Although the U.S. package did not contain a parallel provision, the Canadian reforms were hindered by limitations regarding the extent of special incentives that could be eliminated/reduced. Therefore, the rule contributed in making up the short-fall, both conceptually and financially.

E. CONCLUSION

To conclude, it has been shown that the political and social context had an influential role in the introduction, formulation and presentation of the tax reform package, and the GAAR in particular. For example, the looming federal election at the time of the 1987 tax reforms, together with the government's poor electoral support were manifested in the government's self-interest in seeking re-election. This involved two elements
being promoted simultaneously - the government trying to maximize votes with the electorate and the placation of the special interest groups, in particular, the corporate sector and high-earning individuals. The former premise resulted in, inter alia, the government presenting the tax reform proposals as ostensibly promoting a fairer system. In particular, it sought to give the impression that the tax burden was being shifted from low and middle-class taxpayers to the corporate sector and high-earning individuals. The GAAR was an integral component in the creation of this image. It greatly contributed to the concept of fairness - in its own right, as part of a plethora of other base-broadening measures and in substantiating economically the claim of fairness. These factors in turn influenced the rule. For example, they provided an impetus for the introduction of section 245, for its inclusion within the tax reform package, and arguably, influenced the calculation of the revenue the rule was estimated to generate.

However, it has also been shown that this image of fairness was illusory. In particular, the reduction of the tax rates was not financed by an increase in the corporate tax burden as the government tried to make out. Instead this reduction was funded primarily by increases in the federal sales tax and acceleration of tax payments. The corporate sector was also pacified in other ways by the tax proposals. For example, corporate tax rates were reduced; not all special incentives were
eliminated/trimmed and those that were removed were not the important ones primarily relied upon by the corporate sector. These favourable measures are perhaps not that surprising when one considers the extensive involvement of the corporate sector and their tax representatives in the preparatory stages of the tax reform proposals. This is indicative of the desire of the government to placate the special interest groups, and in particular, the corporate sector.

In relation to the GAAR, it would appear at first glance that the government was not pacifying the business community as the rule was effectively directed against this group. However, although this is true to some extent, the government still attempted to minimise the harm that it would do. For example, it involved the tax professional in the preparation of the proposal, and furthermore, amended it in response to their criticism.

Overall, it is fair to say that the tax reform package, and the GAAR in particular, reflects the conflicting strands of the government's self-interest in seeking re-election. This objective was pertinent at the time of the 1987 tax reform exercise due to a looming election which was due to be held by the fall of 1989 and was generally expected to be called sometime in 1988.
Other aspects of the political and social environment also had an impact on the tax reform exercise, and the GAAR in particular. For example, the inclusion of the provision within the tax reform package was perhaps an impetus for its introduction - to contribute to the image of fairness the government sought to present or, to reduce the excessive political costs involved in introducing the rule in isolation. Furthermore, the rule was subjected to the compromises and trade-offs that are inherent in the formulation of any tax reform package. Finally, its inclusion in the package necessitated the presentation of section 245 as part of white paper documents. This arguably exposed the proposal to increased pressure regarding its alteration, than if, for example, it had been introduced as part of a set of budget measures.

The last major political and social consideration which influenced the tax reform exercise was the reform that had occurred in the United States. For financial and political reasons, this exercise was an impetus for the Canadian reform and to a large extent, determined the direction such reform would take. As regards the GAAR, although no parallel provision was included in the U.S. reform package, the latter still had an impact on the rule. For example, it was a motivation for the introduction of the proposal due to the decreased number of special incentives which could be eliminated/reduced in the
Canadian tax system. Therefore, to make up this short-fall to present an image of fairness and economic verification, the government introduced the proposed section 245.

In summary, it can be seen that the political and social context within which the tax reform measures, and in particular, the GAAR, was formulated was very influential in determining the introduction, structure and presentation of the package.
CHAPTER IV

ECONOMIC CONTEXT

A. ECONOMIC CONDITIONS

At the time of the introduction of section 245 the Canadian economy was in a precarious position. It was still in a state of recovery from the recession of the early 1980s which had been caused by the western-world oil crisis and the policy responses thereto. By 1987 the economy had improved somewhat from the low reached in 1984/5 when the deficit (measured by debt-to-GDP ratio) peaked at $38.3 billion.¹ However, this does not imply that the Canadian economy was anywhere near to being regarded as healthy by the time of the tax reform package in June 1987 - as evidenced by the following "sobering figures":² federal deficit ($29.3 billion), public debt ($293.8 billion), annual federal debt charges ($28.5 billion) and GDP ($537.8 billion).³ The significance of these figures can be understood if explained in lay-man's terms, namely, that the state was basically in the position of being "mortgaged to the hilt"⁴ (with the public debt being three times budgetary revenues) and had a deficit that was

¹ Canada, Department of Finance, Tax Reform 1987: Economic & Fiscal Outlook (Ottawa: the Department, June 18, 1987) at 40-1 (Chart 5.2).
³ Figures contained within Tax Reform 1987: Economic and Fiscal Outlook, supra, note 1.
⁴ Stikeman, supra, note 2 at 1.
substantially larger than the U.S. deficit, in fact, probably twice as great if the provinces and states were taken into the comparison. ^5 However, despite such factors, the government still attempted to paint a bright overview of the state of the Canadian economy, with even more enthusiastic projections being advocated regarding its future performance. ^6 However, the business world was not to be convinced of this rosy picture, as instead it received the government's comments with scepticism and reservation. ^7

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^5 This observation was made by the Standing Senate Committee on Banking, Trade and Commerce: Canada, Senate, Tax Reform '87: Report of the Standing Committee on Banking, Trade and Commerce, tabled December 1, 1987 (Don Mills: Richard De Boo, 1987) at 31.

^6 Although, even the government had to admit that the pace of deficit reduction had slowed down by 1986/7, although, of course, it attributed this to external, international factors: Tax Reform 1987: The Economic and Fiscal Outlook, supra note 1, at 35-36.

^7 See for example, observations made by the Standing Committee on Finance and Economic Affairs: Canada, House of Commons, Tax Reform '87: Report of the Standing Committee on Finance and Economic Affairs tabled in the House of Commons on November 16, 1987 (Don Mills: Richard De Boo, 1987) ["Blenkarn Report"] at 32-3:

[t]hey [i.e. some economic research groups] were concerned that the economic projections presented in the White Paper may be too optimistic, and that the deficit could turn out to be larger if the economy performs worse than projected. It was noted that the yield from base-broadening measures is uncertain, and could be lower than projected. The concern about the projected size of the federal deficit was shared by a number of representatives of the business community.

See also comments made by the Standing Senate Committee on Banking, Trade and Commerce, Report, supra, note 5 at 31.

For a more detailed discussion on the economic background, see D. Hartle, The Expenditure Budget Process of the Government of Canada: a Public-Choice Rent-Seeking Perspective, Canadian Tax
Against this background, it is proposed that section 245 be considered to determine the influence, if any, that such prevailing conditions may have had on the enactment of the provision.

B. INFLUENCE ON SECTION 245

An important effect of the adverse economic conditions may have been the garnering of public animosity against tax avoidance schemes. At times of large deficits and high interest rates there is an increasing social view that artificial tax planning imposes undeserved costs on other Canadians. This is perhaps related to the increase in tax avoidance which adverse economic conditions may cause. Obviously taxpayers (notably profitable corporations and high-earning individuals who can afford the fees of tax professionals and whose attempts at mitigation of their tax bills are financially viable) are more likely to exercise caution over their expenditure (eg. seeking ways to minimize their tax liabilities) in times of economic hardship. However, it must be stated that there is no means available to prove such an hypothesis empirically as the extent, in revenue

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terms, of tax avoidance cannot be estimated with any degree of accuracy, nor can it be proven whether it is more prevalent at any time compared with the past.\(^9\)

However, in respect of section 245, support for such a proposition can be gleaned from several comments made by the government to the effect that tax avoidance was rampant in the immediate years prior to 1987.\(^{10}\) In other words, it would appear that the increase in aggressive tax planning in the 1980s coincided with harsh economic conditions. However, even if one was to accept the government's statements as being accurate (arguably, unlikely, bearing in mind the motives of the government in alleging such abuse, namely to justify the enactment of section 245), one should be extremely cautious in drawing any conclusions, as such linkage is perhaps only fortuitous, with other factors being more important in determining the propensity to avoid tax. Nevertheless, if one

\(^9\) B.J. Arnold & J.R. Wilson, "The General Anti-Avoidance Rule--Part 2" (1988) 36 Canadian Tax Journal 1123 at 1128. Furthermore, it has been stated that empirical data detailing losses in revenue are "far too sketchy to support any convincing conclusions": ibid.

\(^{10}\) See for example, comments made by Mr. Jim Wilson before the Standing Committee on Finance and Economic Affairs, supra, note 7 at 128: "...over the last couple of years ... taxpayers are becoming a bit more aggressive than they have been historically" and D.A. Dodge, "Tax Reform and the Anti-Avoidance Proposals" 1987 British Columbia Tax Conference, tab 4 at 2-3: "Within the Canadian commercial community there has developed a profusion of sophisticated tax-motivated strategies involving various technical provisions that yield unintended and significant tax advantages."
supports the theory that such a correlation could exist between tax avoidance and the economy, then this may assist in explaining why the government felt the need to introduce section 245. In other words, the incidence of tax avoidance increased, due perhaps to adverse economic conditions, which together with the prevailing socio-political environment, forced the government to take corrective action and introduce section 245.

To reiterate, one result of this possible increase in tax avoidance was a growing public resentment against such tax-mitigation schemes. Generally, this is particularly prevalent in times of harsh economic conditions. If the majority of taxpayers are subjected to reduced spending and higher taxes in an attempt to improve the economy, it is fair to assume that they do not look favourably upon those who do not suffer in a like manner and who instead find ways to minimize their tax liabilities, thus adding to the tax burden of everyone else. Evidence that these attitudes were fostered during the harsh economic conditions of the 1980s was the increased publicity which tax avoiders attracted during this period. For example, the media repeatedly highlighted the vast number of taxpayers who avoided paying tax. This culminated in a general public

view that the tax system was unfair. Consequently, this put pressure on the government to take action to rectify this perceived unfairness. It prompted the government to produce a tax reform package which was presented and structured to be politically appealing to the electorate. In particular, the government sought to present the package as promoting a fairer system, especially, the shifting of the tax burden from low and middle-class taxpayers to the corporate sector and high-earning individuals. Section 245 was an important element in the achievement of these objectives. It contributed both conceptually (i.e. the provision in its own right and as part of the plethora of corporate base-broadening measures) and economically (i.e. assisting in the financial verification of the claim of an increased corporate tax burden) in the formulation of this image of fairness. The utilisation of the rule in this way contributed to a favourable political climate being created for the enactment of section 245. Thus, the prevailing economic and political environment provided an impetus for the introduction of the rule. Furthermore, they encouraged the government to take a firm stance and deflect the pressure that

12 Polls conducted concluded that Canadians believed that the tax system should be more fair: seventy-six per cent of those surveyed thought the system was unfair: "Poll Spelled Trouble for Tax-Reform Plans" Montreal Gazette (25 July 1987). Another survey revealed that seventy per cent of those questioned perceived that large corporations did not pay their fair share and seventy-six per cent thought the rich were undertaxed: J. Ferguson, "Most Canadians Oppose Tax Reform Proposals" Calgary Herald (21 March 1987) A3.
was exerted by the tax profession and business community to withdraw/substantially alter the rule during the Parliamentary legislative process.

Related to the impact on public attitudes of tax mitigation is the influence of the economic environment on the interpretation of section 245. To amplify, Revenue Canada, in its administration of the rule, and the judiciary, in interpreting the provision, may be affected by the economic setting. Thus, adverse economic conditions may explain Revenue Canada's apparent aggressive attitude to tax planning and consequent reliance on the rule to defeat tax-minimization transactions. As regards the latter, although the provision has not yet been judicially considered, it is foreseeable that the economic surroundings will influence the interpretation given to section 245.

Another potential impact of the adverse economic conditions was the influence they may have had in determining the means available for effecting "legal" avoidance through special tax incentives. However, it is submitted that the linkage between adverse conditions and the prevalence of tax expenditures is at a best a tenuous one as other factors seem to play a major role.
So, for example, it would appear that the proliferation of tax incentives in the early 1970s was traceable to other factors, notably political and social considerations.\(^{13}\)

The final possible influence of the economy on tax avoidance, and in particular, section 245, was the political pressure exerted on the government not to use the exercise as a means of increasing total revenues. With business repeatedly expressing its concern over the level of the deficit,\(^{14}\) and Canadian taxpayers believing the deficit should be reduced,\(^{15}\) the government was put in a difficult position. In light of the looming federal election, it wished to structure the tax reform proposals to be appealing to the electorate to bolster its flailing support.\(^{16}\) A relatively easy way of achieving this objective would be to give tax-savings to the electorate. However, due to the pressure discussed above, it could not

\(^{13}\) For example, arguably it was an attempt to placate some of the business community's outrage over what it regarded as the Trudeau government's growing commitment to state intervention in the economy: D.A. Wolfe, "Politics, the Deficit and Tax Reform" (1988) 26 Osgoode Hall Law Journal 347 at 364.


\(^{15}\) Seventy-five per cent of those surveyed thought that the government's top economic priority should be getting the deficit under control: "Poll Spelled Trouble for Tax-Reform Plans" supra, note 12.

\(^{16}\) See generally, Chapter III, "Political and Social Context" and in particular, section (ii) The Looming Election.
implement this aim in a way that would increase the already bulging deficit. The government perceived this would involve political costs which would outweigh the benefits of any tax-savings. Therefore, it committed itself to produce a fiscally neutral tax reform package. Furthermore, the tax reform package was divided into two distinct stages, each one being fiscally neutral within its own right. In relation to Stage One, the GAAR played an important part in the achievement of this objective. This was primarily due to the increased revenue the provision was estimated to generate: $2,240 million over the period 1988-92. This increase was undoubtedly the highest overall and markedly the greatest during the first two years (thereafter, it was estimated that the revenue gained in the reduction of Capital Cost Allowance would increase and finally overtake the gains under GAAR) of the corporate base-broadening measures. However, these figures pale into significance somewhat when one considers the increases that were projected

17 The white paper proposals were claimed to be fiscally neutral: "The cumulative impact of the tax reform and related measures on the deficit and net debt over the 1988-89 and 1991-92 period is negligible." Canada, Department of Finance, Tax Reform 1987 (Ottawa: the Department, June 18, 1987) at 73. However, in reality, the overall package was not neutral (or the impact negligible): in 1988-89, the reforms generated over $1 billion extra revenue. In 1989-90, there was a short-fall of over $1 billion - this amount adding to the already large deficit.


19 For qualification of these figures, see Chapter III, notes 75-6 and accompanying text.
from changes to the federal sales tax and acceleration of tax payments.\textsuperscript{20} However, it is submitted that the GAAR still made an important contribution as $2 billion is certainly not an insignificant amount to be passed over lightly. Therefore, as a result of these measures (ie. base-broadening proposals and changes to the federal sales tax and acceleration of tax payments) the government was able to finance the reduction in the rates of the personal and corporate income taxes, and be in an improved net fiscal position.\textsuperscript{21}

\textbf{C. CONCLUSION}

To conclude therefore, the economic environment played an influential role in the introduction, structure and presentation of the tax reform package, and the GAAR in particular. The most notable example was the affect of adverse economic conditions on public attitudes. In particular, the economic environment perhaps caused the incidence of tax avoidance to increase. Enhanced media coverage regarding this increase arguably fostered a growth in public animosity towards would-be avoiders. This resulted in a general public attitude that the tax system was unfair and, in particular, the belief that high-earning individuals and large corporations should pay more tax. This

\textsuperscript{20} Totalling $2,705 million in 1988-89 alone and $7,485 million over the period 1988-92: Tax Reform 1987, supra, note 17 at 75.

\textsuperscript{21} For example, in 1988-89, the net overall impact of the tax reforms was an added $1 billion raised: supra, note 17.
exerted pressure on the government to rectify the situation. The government was vulnerable to such political pressure at the time of the 1987 tax reforms due to its desire to bolster its appeal with the electorate in light of a looming election. Thus, the government was prompted to produce a tax reform package which it presented to the electorate as promoting a fairer system. The GAAR was an integral part in the presentation of such an image, both conceptually and financially.

However, it should be exemplified that the influence of the economic context in the above scenario was largely indirect. The adverse economic conditions alone did not cause the introduction of the tax reform package, including the GAAR. To explain, the economic context had an impact on public perceptions, which in turn affected public attitudes. The socio-political context (e.g. the looming election, the government's flailing support) meant that the government felt the need to respond to the political pressure exerted by the electorate. If the socio-political context had been different, for example, the government was newly elected and/or was electorally popular, then it perhaps would not have been quite so vulnerable to public pressure. Consequently, in these circumstances, it may not have felt the need to introduce a tax reform package which was geared to be electorally appealing.
Therefore, it can be said that the economic conditions indirectly provided an impetus for the tax reform package through the socio-political environment.

Other influences of the economic conditions include the limitations imposed on the government in producing a tax package that promoted fairness. In particular, for political reasons it had to produce a fiscally neutral tax reform package - it could not finance the rate reductions by adding to the deficit. Such a move would have incurred political costs exceeding the benefits from the tax savings. Moreover, the government divided the tax reform package into two distinct parts. Both of these had to be independently fiscally neutral. In relation to Stage One, the GAAR played an important role in the achievement of this objective, particularly as regards the increased revenue it was estimated to generate. Again it should be noted that the influence of the economic context appears to be indirect. The government could have increased the tax savings and added to the deficit in the practical sense. However, it was because of the socio-political environment that this option was unattractive. In particular, this environment meant that the government was vulnerable to political pressure. Consequently, due to adverse political reaction to increasing the deficit, the government chose to implement diminished tax savings and not add to the
deficit. This balancing of political costs and benefits is reflective of the process undertaken by governments to maximize their political support.

Overall, it is submitted that these economic conditions influenced the proposed section 245. As discussed above, the economic environment indirectly provided an impetus for the introduction of the tax reform package and its presentation as promoting a fairer system. The GAAR was an integral part of this package, especially its contribution to the fulfilment of the objectives of the tax reform exercise.
CHAPTER V

HISTORICAL CONTEXT

A. INTRODUCTION

It is proposed that the historical context be briefly considered in the analysis of section 245. In particular, two aspects of this context should be discussed. First, the legal background to the enactment of section 245 should be highlighted. This will involve tracing the development of anti-avoidance measures. Briefly, various attempts have been made in Canada, both at the legislative and judicial level, to curb what is now termed "abusive" avoidance. Analyzing the precursors to section 245 should reveal the influence of such factors in relation to, for example, the introduction and format of the rule.

The second component is the social and political background. In particular, it is proposed that previous attempts at tax reform in Canada be discussed. It is felt that these experiences influenced the 1987 tax reform exercise, particularly the strategy adopted by the government in formulating and structuring the tax reform package.
B. LEGAL BACKGROUND

The Income Tax Act contains a wide array of anti-avoidance provisions, of both a specific\(^1\) and general\(^2\) nature. It is the


The government cited minimizing the need for the enactment of specific anti-avoidance rules as a factor supporting the introduction of the GAAR. It claimed that the objective of counteracting each unforeseen transaction with specific, prompt legislative responses was practically unattainable. Furthermore, it alleged that such rules result in complexity; increase detail; diminish flexibility; create additional unintended loopholes; do not deal with transactions completed before amendments become effective; undermine taxpayer morale and often adversely affect legitimate transactions: Canada, Department of Finance, Tax Reform 1987: Income Tax Reform (Ottawa: the Department, June 18, 1987) at 129 and D.A. Dodge, "Tax Reform and the Anti-Avoidance Proposals" 1987 British Columbia Tax Conference, tab 4 at 3-4.


The demerits identified by the Carter Commission Report are mirrored in the government's reasoning outlined above. Consequently, it would appear that the government had a strong case for seeking to discontinue its reliance on specific anti-avoidance rules, thus reinforcing the necessity of the GAAR. However, a caveat should perhaps be added as it would appear that an additional reason for the inadequacy of specific rules is lack of governmental activity in enacting these rules, even after identification of abuses. One example is the Scientific and Research Tax Credit which was only officially in place for ten months in 1984. However, during this short period of time, the program managed to drain $2.8 billion from the federal treasury: L. McQuaig, Behind Closed Doors: How the Rich Won Control of Canada's Tax System ... And Ended Up Richer (Markham, Ont.: Viking, 1987) at 265. Moreover, the Liberal Government knew about these abuses within three to four months of the program being introduced: *ibid.* at 267-8. However, it chose to do nothing about them, primarily for political reasons. In particular, with a federal election looming that fall, the
latter that are of greater significance in relation to the new GAAR, for reasons given below. It should be noted that the new section 245 repealed a number of general rules, namely subsection 55(1) dealing with artificial or undue reductions in capital gains or additions to capital losses; subsections 245(1) and 245(1.1) dealing with artificial transactions and subsection 247(1) dealing with dividend stripping. Despite their repeal, it is submitted that such provisions can be of assistance in the analysis of the new section 245. For example, guidance may be obtained from their substance (particularly if analogous concepts are used in the new GAAR), application, administration, interpretation and process of development. But a word of caution in using these provisions for the purposes of furthering our understanding of the new section 245 - these rules were also influenced by, and therefore should be interpreted in light of, the external conditions prevalent at the relevant time. It is not proposed that these general anti-avoidance rules, and in particular, their relevance to the new section 245, be discussed

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2 The most notable being section 245, the provision forming the subject matter of this paper.

government did not want to risk the wrath of the business community by withdrawing or limiting the program, especially since it had only been introduced a few months earlier: ibid. at 269. Consequently, the government's arguments regarding the inadequacy of specific rules are not as clear-cut as it makes out. In particular, the issue is clouded by external factors, such as political and social conditions.
in this thesis due to space constraints. A great deal of literature has been written on these sections, and it is to these that the reader is directed.³

In addition, various judicial doctrines have developed over the years to curb certain tax avoidance schemes. The most notable are the ineffective transactions doctrine, the sham transaction doctrine, the substance over form doctrine, the step transaction doctrine, the business purpose test and, more recently, the \textit{Stubart}⁴ interpretive guidelines.⁵ Moreover, these doctrines, unless judicially overruled,⁶ continue to have the force of law - they have not been supplanted by section 245. It is therefore feasible that they may be argued in tandem with the provision if a case regarding its application ever reaches the courts. The


⁵ For a general discussion of these various doctrines, see, for example, Arnold & Wilson, \textit{supra}, note 3 at 852-69 and Kellough, \textit{supra}, note 1 at 40-52.

⁶ In relation to the rejection of the business purpose test in the \textit{Stubart} case, see \textit{infra}, note 7 and accompanying text. The substance over form doctrine was omitted from the \textit{Stubart} guidelines and thus also implicitly rejected (notwithstanding the subsequent decision of \textit{R. v. Bronfman Trust [1987]} 1 S.C.R. 32).
main value of these doctrines in relation to section 245 is their reflection of the trend of judicial attitudes towards tax avoidance.

However, although these judicial tests are not discussed in detail, it is proposed that the business purpose test merits analysis in greater depth. The singling out of this test is justified on the basis that the *Stubart* case (which, it is widely accepted, rejected a business purpose test of general application) was identified by the government as an impetus for the introduction of the GAAR. Accordingly, it incorporated the business purpose test within section 245, albeit, in a diluted form as a bona fide purpose test. However, doubts as to the validity of this apparent verification of the necessity of

7 "I would therefore reject the proposition that a transaction may be disregarded for tax purposes solely on the basis that it was entered into by a taxpayer without an independent or *bona fide* business purpose." Estey, J. at 6322.


9 Paragraph 245(3)(a)

10 The original version contained a business purpose test, paragraph 245(2)(a), but this was changed to a non-tax purpose test in the December 1987 amendments. The reason for this alteration was to exclude transactions which were not carried out for "business" purposes, yet were not primarily tax motivated either: Canada, Department of Finance, *Supplementary Information Relating to Tax Reform Measures* (Ottawa: the Department, 16 December, 1987). However, the bona fide purposes test is essentially the business purpose test in all other respects, except for this small technical amendment: D.A. Dodge, "A New and More Coherent Approach to Tax Avoidance" (1988) 36 *Canadian Tax Journal* 1 at 18-9.
section 245 exist. First, it is unclear that a business purpose test did not exist in some sense pre-GAAR.11 Furthermore, if the government was that concerned about the rejection of the business purpose test, why did it wait so long to introduce one in the shape of section 245? To explain, the Stubart decision was released by the Supreme Court of Canada on 7 June 1984. However, the government did not introduce the GAAR until some three years later as part of the 1987 tax reform package. Allowing for consultation and formulation of the rule, this time

11 Commentary questioned the rejection of the business purpose test in Canada after the Stubart decision. It is clear from the interpretative guidelines laid down by Estey, J. that the test would be relevant in determining the application of the former section 245. Other uses of the business purpose test have also been mooted. For example, its application to other purpose-related sections (in addition to section 245) has been advocated and also its application in a series of transactions occurring in the course of complex corporate reorganizations: D.Y. Timbrell, "Planning After the Stubart Decision: the Business Purpose Test" in Report of Proceedings of the Thirty-Sixth Conference, 1984 Conference Report (Toronto: Canadian Tax Foundation, 1987) 89 at 102-5.

Governmental recognition of the possible continued existence of the business purpose test is evidenced by statements made by one Department of Finance official: Dodge, supra, note 1 at 13.

period still seems excessive. Furthermore, it may be questioned whether the business purpose test is the most appropriate anti-avoidance mechanism to be incorporated in the GAAR. Overall, these factors cast doubts on the proposition that the rejection of a business purpose test in Stubart and the consequent incorporation of such a test within the GAAR was a valid justification for the introduction of the rule.

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12 However, one may argue that it was not the Stubart case itself that the government objected to, but the proliferation of tax avoidance that occurred as a direct result of the judgment. This latter proposition may explain the delay between Stubart and the GAAR as it involves a greater period of time to determine the effects of the case, rather than just the case itself.

13 See, for example, D.A. Ward & M.C. Cullity, "Abuse of Rights and the Business Purpose Test" (1981) 29 Canadian Tax Journal 451 at 473:

The introduction of the business purpose test would inevitably create a significant degree of uncertainty and unpredictability in the application of the Canadian income tax law .... As almost 50 years of litigation in the United States have demonstrated, it is unlikely that this state of uncertainty would be one of short duration. As a legal principle, the business purpose test has nothing to commend it.

[This article was referred to in the Stubart decision by Estey, J. at 6316.]

To conclude, it is submitted that the primary influence of the historical context of section 245 is the fact that these statutory and judicial anti-avoidance measures paved the way for the introduction of the rule. It was thus politically feasible for the government to enact the GAAR as obviously the existence of former section 245 and other general rules meant that it was not such a great step forward for the government to propose the rule, compared with the position, for example, had it countenanced tax avoidance before, and then suddenly, tried to introduce section 245. Moreover, the previously enunciated anti-avoidance measures influenced the format of the rule proposed by the government: against such a backdrop, the government was able to decide which concepts and terminology would be most appropriate in the achievement of its desired aims. Finally, the government cited the rejection of the business purpose case in the Stubart case as providing an impetus for the introduction of the rule. However, doubts have been cast on this proposition, primarily for the following reasons: it is not clear that such a test did not exist in some sense pre-GAAR; the delay between the case and the introduction of the provision and the appropriateness of the business purpose test as an anti-avoidance mechanism.
C. SOCIAL AND POLITICAL HISTORICAL BACKGROUND

The most recent tax reform experiences which influenced the 1987 exercise were the tax reform legislation of 1971 (which culminated nine years of debate and was based on the Carter Commission Report) and the changes proposed by Allan MacEachen, former Finance Minister, in 1981. Both these tax reform exercises involved significant dilution of the original measures when compared with the format which was finally enacted. This dilution has generally been recognised as a direct result of the political pressure exerted on the government by powerful special interest groups. Consequently, tax reform has long been regarded as a politically dangerous issue -- one that governments take on at their peril.  

It is submitted that the government in 1987 was influenced by these tax reform experiences, particularly in relation to the strategy it adopted and, ultimately, to some extent, the structure of the package.  


15 For example, Michael Wilson referred to the tax reform attempts of Allan MacEachen: G. Pitts, "'We Need All Tax Elements on Same Track': Interview with Michael Wilson" Financial Post (2 August 1986) 4. In particular, he identified MacEachen's problems as being surprise and the inadequacy of transitional elements. He committed himself to not repeating these mistakes: ibid.
The first major tax reform exercise that should be discussed is the Carter Commission Report and its implementing legislation. A synopsis of the events which surrounded this process is briefly given. The Conservative government appointed the Royal Commission on Taxation under the chairmanship of Kenneth Le M. Carter in August 1962. The impetus for the establishment of the Commission was mostly political and narrowly based. Notably, in the run-up to the June 1962 election, a promise to set up a review body was extracted from the Progressive Conservatives by a prominent businessman, the late Senator Wallace McCutcheon, who the party wished to have on their Cabinet. McCutcheon's reason for seeking this promise was the pressure exerted on him by the tax professional and business community. This pressure related to various issues, for example, high rates of tax and the "surplus-stripping" schemes then being touted (in particular, tax professionals felt their personal reputations and their future incomes were being jeopardised as a result of such schemes). The business and professional communities

16 Material relevant to this section include W.I. Gillespie, "Tax Reform: The Battlefield, the Strategies, the Spoils" (1986) 26 Canadian Public Administration 182 at 195-7; Gillies, supra, note 14; D.G. Hartle, "Some Analytical, Political and Normative Lessons From Carter", in The Quest for Tax Reform, ibid. at 397; J.G. Head, "The Carter Legacy: An International Perspective", ibid. at 367; D.K. Huggett, "An Apocalyptic Apocalypse?", ibid. at 381; L. MacDonald, "Why the Carter Commission Had to be Stopped", ibid. at 351; P.R. McDaniel, "The Impact of the Tax Expenditure Concept on Tax Reform", ibid. at 387; L. McQuaig, Behind Closed Doors: How The Rich Won Control of Canada's Tax System ... And Ended Up Richer (Markham, Ont.: Viking, 1987) chs. 5-7.

17 Hartle, ibid. at 401 and McQuaig, ibid. at 131.
favoured an independent, technically qualified instrument to reform the tax system, addressing the above issues in particular. A Royal Commission appeared to be the answer. The composition of the Commission reassured these communities as all the members were connected with business one way or another.\textsuperscript{18}

However, despite this, the Commission did not come up with the results it was expected to. Instead, its report, released in February 1967, advocated a system which would work directly against the interests of business. In particular, it adopted the guiding principle of a comprehensive income base. It stated that the primary objective of the tax system was to "share the burden of the state fairly among all individuals and families".\textsuperscript{19} This would have entailed eliminating special privileges that permeated the tax system. For example, special tax rates that had applied to different forms of income - from capital gains to dividends to inheritances - were to be removed. Furthermore, by eliminating key deductions, the Commission sought to make the tax burden more consistent throughout industry. (Previously, great disparities in the level of tax burdens between different sectors prevailed.) Overall, the recommendations would have achieved greater vertical equity making the system fairer in its treatment of different levels of

\textsuperscript{18} MacDonal\textsuperscript{d}, supra, note 16 at 353 and McQuaig, ibid. at 139.

\textsuperscript{19} Carter Commission Report, supra, note 1 at 4.
income and different social classes. Therefore, it would have reduced taxes (by at least 5 per cent) for about 64 per cent of Canadian taxpayers. However, those adversely affected would mostly have been wealthy Canadian residents\(^{20}\) and the corporate sector\(^{21}\) - two powerful groups of taxpayers.

Initially the response to the Report was mostly both extensive and favourable - *The Globe and Mail* being the prominent exception.\(^{22}\) Thereafter, coverage shifted to the business pages where it remained for years.\(^{23}\) However, the reaction soon turned to anger - newspapers daily ran articles about how the Carter recommendations would lead to ruination, albeit from a business perspective.\(^{24}\) Harvey Perry (Commission member) was quoted as saying, "It wasn't so much the reaction [that surprised me]. It was the violence and virulence of it."\(^{25}\)

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\(^{20}\) For example, for the estimated 633 individuals receiving 1964 comprehensive income in excess of $300,000 the recommendations would have resulted in them paying, on average, an additional $67,000 a year in taxes. MacDonald, *supra*, note 16 at 360.

\(^{21}\) The business community would have paid about 28 per cent more tax as a result of the Carter recommendations. MacDonald, *ibid.*, at 339.

\(^{22}\) Hartle, *supra*, note 16 at 412 and McQuaig, *supra*, note 16 at 150.

\(^{23}\) Hartle, *ibid*.

\(^{24}\) McQuaig, *supra*, note 16 at 151.

\(^{25}\) Quoted in McQuaig, *ibid*.
This put the government\textsuperscript{26} in a difficult position – the issue of tax reform was clearly a volatile one. It cautiously responded by asking for submissions from interested groups and individuals\textsuperscript{27}. It received some nine hundred briefs\textsuperscript{28}. Ultimately, this resulted in a white paper being produced which greatly diluted the Carter recommendations\textsuperscript{29}. However, rather than pacifying the special interest groups, the white paper was met with screams of anguish and dismay\textsuperscript{30}. The Carter report could be dismissed on the basis that it was only wild suggestions of Commissioners who were unrealistic and unrepresentative. However, the same could not be said of the government.

Parliamentary hearings were held on the white paper which were utilised as forums for special interest groups. In June 1971, Finance Minister Edgar Benson tabled, as an appendix to this budget statement, a draft of the proposed legislation which had

\textsuperscript{26} During the period of research and formulation of the Report, the government changed: the Progressive Conservatives lost office and the Liberals took over.

\textsuperscript{27} Gillespie, \textit{supra}, note 16 at 195.

\textsuperscript{28} McQuaig, \textit{supra}, note 16 at 157-8.

\textsuperscript{29} For example, it did propose that capital gains be taxed and that for resident shareholders there should be full credit given for corporate taxes paid. However, a multitude of other recommendations were not implemented, for example the treatment of the family as a taxable unit and that transfers within the unit not be taxable. Hartle, \textit{supra}, note 16 at 412. See, also, McQuaig, \textit{ibid.} at 159-63.

\textsuperscript{30} Hartle, \textit{ibid.} at 413.
incorporated the Department's response to the submissions received in respect of the white paper. This legislation constituted a major retreat from the white paper, which in turn, had been a massive retreat from the Carter Report.\(^3\) In all, the failed implementation of the Carter recommendations was generally attributed to the power of the special interest groups who pressurized the government into repeatedly retreating on both the Carter Report and the white paper proposals.\(^4\)

The government again attempted to reform the tax system in 1981. At that time there was a general feeling within the Liberal government that tax expenditures had to be curbed.\(^5\) This perception originated in a document, "Tax Expenditure Account", produced by the Conservative government in 1979 which detailed the amount of revenue being lost through various tax breaks - some $32 billion.\(^6\) Restricting tax expenditures seemed like an attractive option to raising revenues - this was preferable to cutting back on spending plans. Moreover, the government did

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\(^3\) Hartle, \textit{ibid.} at 413.

\(^4\) Gillies, \textit{supra}, note 14 at 343. However, the limitations of the Report itself have also been identified as contributing to its lack of implementation. For example, the Commission ignored the issue of the overall level of taxation in Canada and the problem of inflation and it proceeded on the assumption that the Canadian economy was a closed economy in considering personal-corporate tax integration: Hartle, \textit{ibid.} at 405-12.

\(^5\) McQuaig, \textit{supra}, note 16 at 217.

\(^6\) McQuaig, \textit{ibid.} at 216.
not think that the reaction from business would be that intense. Consequently, Allan MacEachen, then Finance Minister, introduced, as part of the federal budget, a number of proposals designed to eliminate tax breaks that were utilised by high-earning individuals and corporations.

However, the proposals were not well received. In fact, the assault by a furious business community, an aggressive press and a reinvigorated Tory opposition began almost immediately. Furthermore, the situation was exacerbated by the deterioration of economic conditions which was claimed to be a direct result of the 1981 proposals. The extent of the backlash finally caused the government to retreat somewhat and to retain many of the crucial tax incentives which it had sought to remove. Again, a tax reform attempt had been thwarted by special interest groups.

35 McQuaig, *ibid.* at 217.

36 McQuaig, *ibid.* at 221-3. For example, it was proposed that the deductibility of interest on money borrowed to make investments be restricted; important "corporate reorganization" tax breaks be eliminated and restrictions on charitable foundations be tightened.

37 McQuaig, *ibid.* at 223.

38 McQuaig, *ibid.* at 231-2.
It is submitted that both these tax reform exercises influenced the 1987 tax reform proposals. In particular, they had an impact on the strategy the government adopted which ultimately determined the structure of the tax reform package to a certain extent.

One major influence of these two experiences was the extent to which the government obtained the input of special interest groups in preparing the initial documents. This is reflected in the structure of the various documents. For example, the Carter Commission, although it did receive business briefs, was not so susceptible to external pressure as governments, being isolated from the political process. Therefore, the Report did not per se take the interests of business into account, indeed, it positively went against them. The same is true of the 1981

39 For example, note the following comments: "The 1981 fiasco was very much on the minds of strategists when they sat down to plot the course of Tax Reform 1987." H. Solomon, "Wilson Learned from MacEachen's Fiasco" Financial Post (22 June 1987) 9.

40 For a discussion of other factors contributing to the non-implementation of Carter compared with the 1987 reforms, see Gillies, supra, note 14 at 345-9. For example, he identifies the political base for reform (at the time of Carter there was no widespread popular demand for tax reform); the changes made to the way in which public policy is made (both administratively and legislatively); the need of the government for additional revenue (it was claimed that the government required more revenue in 1987 compared with in the 1970s. This is reflected in the 1987 tax reform package (at least Stage One) which although was claimed to be fiscally neutral, did increase total revenues somewhat in the first year. Thereafter, the revenues decreased before levelling out to a neutral position a few years later. Overall, the government perceived that the political costs of significantly increasing total revenues would outweigh
budget proposals. Although presumably the government listened to special interest groups, it obviously did not succumb to pressure as it produced a package which was not weighted in their favour. Compare this with the 1987 reform proposals. The government consulted widely before-hand and incorporated the interests of the business sector and high-income earners. In essence, the white papers constituted a compromise package.\(^1\) Consequently, the likelihood of business not accepting the initial proposals was greatly reduced.\(^2\)

The previous tax reform exercises, and in particular, the 1981 proposals, had an impact on the presentation of the 1987 tax reforms. In particular, they prompted the government to present its proposals as white paper documents. For example, as regards the Carter Report, the government's response was to introduce a white paper as a means of continuing discussion. In contrast, the 1981 proposals were introduced as part of the federal budget measures. According to Gillespie's theory, this indicated that

^1 Solomon, supra, note 39.

^2 These propositions are supported by McQuaig who claims the primary reason why the 1987 tax reforms were not changed dramatically was that the other tax reform exercises (Carter and MacEachen in particular) had been genuinely progressive. The 1987 tax reforms were structured to be favourable to the corporate sector and high-earning individuals. McQuaig, supra, note 16 at xxxvi.
the government wished to keep discussion to a minimum.\textsuperscript{43} Both
documents were substantially revised before implementing
legislation was introduced. However, the alteration of the 1981
proposals was more politically embarrassing for the government.
The retreat from definite legislative proposals involves greater
political costs for the government (for example, in terms of
perceived strength of the government to stand up to special
interest groups) compared with changes to white paper proposals,
which are theoretically only discussion points in the first
place. Consequently, the government in 1987 was encouraged to
introduce its tax reform proposals in the form of white papers.
It did so despite the extensive consultation that had already
taken place and the definite and precise nature of the proposals
in Stage One.

These previous tax reform attempts also influenced the method of
introduction of the 1987 package. Both the initial documents of
the previous tax reform experiences were formulated and
presented in secrecy. Therefore, taxpayers (including special
interest groups) were not given any opportunity to gradually get
accustomed to the new proposals. Moreover, this precluded any
receipt of advance feedback on the proposals. In contrast, the

\textsuperscript{43} Gillespie, supra, note 16 at 194.
government in 1987 was careful not to avoid creating any surprises in the 1987 exercise. For example, it let details of the proposals dribble out in advance.

A final influence specific to the 1981 proposals relates to the transitional measures for the introduction of the measures. It was claimed that the transitional elements relating to MacEachen's proposals were not sufficiently thought out and equitable. Consequently, the 1987 measures contained a great many transitional provisions. For example, reductions in the personal income tax rates were not effective until July 1988 to enable employers to get used to them and many corporate base-broadening measures were phased-in gradually over a period of months, if not years.

In summary, it is submitted that the two most recent attempts at tax reform, the Carter Commission Report and its subsequent legislation and the measures proposed by Allan MacEachen as part of the 1981 federal budget, influenced the 1987 tax reform exercise. In particular, these experiences had an impact on the strategy adopted by the government, and ultimately, on the structure of the tax reform package. These past reform
exercises prompted the government to consult widely with interested groups and to include their concerns, to a certain extent, in the preparation and formulation of the 1987 package. This influenced the eventual structure of the tax reforms as such consultation and incorporation resulted in the 1987 proposals being weighted in favour of the corporate sector and high-earning individuals. Furthermore, these tax reform experiences may have induced the government to introduce the reforms as white paper documents. Even though the government had consulted widely beforehand (so presumably had some idea about the political costs involved) and incorporated some of these concerns, it still opted for the presentation of the proposals as white papers. It is felt that the government was proceeding as cautiously as possible. It was perhaps discouraged by the past tax reform attempts which had resulted in major revision of the initial (and even subsequent, in the case of the Carter Report, namely, the white paper released in November 1969) documents. Substantial alteration of white papers is politically less costly than significant changes to definite legislative drafts such as budget measures. Therefore, the government decided to proceed with the most politically safe method and consequently opted for the white paper mechanism. Finally, the 1981 budget proposal influenced the 1987 tax reforms by encouraging the government to introduce adequate transitional provisions.
Overall, it is fair to say that these two recent tax reform experiences exerted a degree of influence over the 1987 tax reform exercise. This manifested itself in the strategy the government adopted in formulating the package and, ultimately, to some extent, the structuring of these measures.
CHAPTER VI

CONCLUSION

The central theme of this paper has been the analysis of section 245 of the Income Tax Act. This provision introduced an extended general anti-avoidance rule into Canadian tax law. Exclusive focus on this section is justified when one considers that it has been claimed to be the most significant change to the Act since income tax was first imposed in 1917.¹

It was felt that the methodology adopted in the analysis of this rule should go beyond the traditional means employed in considering technical tax policy provisions. This approach usually consists of applying one of the normative standards - equity, efficiency and simplicity. However, such tools have been discredited in recent times, primarily on the basis that they do not take account of the political aspect of taxation. Consequently, the methodology employed in this thesis is grounded in the politicization of tax. Support for adopting such an approach can be found in existing literature. In particular, a body of literature has developed within the discipline of economics, generally known as the political economy of taxation. It is felt that this theory is relevant to this paper due to its inclusion of the political element. More

specifically, reliance is placed on a model developed by Hettich and Winer. This model was considered to be the most useful because of its incorporation of the political 'voice' and its assumption that the tax system is a natural outcome of self-interested decision making. The model integrates a number of factors, including this self-interest behavioural element, which give rise to an equilibrium of political costs and benefits. The structure of the tax system, at any given time, reflects this equilibrium.

Moreover, the model can assist in explaining the incidence of tax reform. In particular, tax reform is the result of shocks to the system which necessitate re-establishing the equilibrium by the adjustment of revenue instruments. Therefore, it is fair to say that government's utilise tax reform as a means of attempting to retain office. This model and its application to tax reform constitute the foundation of the methodology adopted in this paper. In particular, its fundamental concepts that taxation is a political process and it is the equilibrium outcome of self-interested behaviour of the government are followed. It is against this background that the 1987 tax reform package, of which section 245 was an integral part, is analyzed. In particular, the factors causing its introduction are identified and explained. Furthermore, an attempt has been made to isolate those factors which were specific to section 245. In summary, the tax reform package, and the rule in
particular, were analyzed within their relevant contexts to identify the factors which were most influential in prompting their introduction and determining their presentation and structure.

However, before going on to outline these factors, it is proposed that the assumptions underlying this paper first be discussed. The two main assumptions are first, that tax is a political process and second, that governments are acting in their own self-interest - not according to general and social criteria such as efficiency and equity. The former is fairly self-explanatory. In democratic states statutes are the creation of legislative bodies. Tax is purely a creature of statute and therefore is a product of this political process.

As regards the latter premise, its basic thrust is that governments are seeking to retain office. This involves two strands: maximizing its support with the electorate and placating special interest groups. Governments usually attempt to promote these two components simultaneously. The weight accorded to each depends on the external conditions, for example, the socio-political and economic environment. The tax reform package and the GAAR in particular are good illustrations of these two competing components. For example, the tax reform
package was presented as being fair to be electorally appealing, yet was structured in a way to favour special interest groups, especially the corporate sector and high-earning individuals.

It is now proposed that the different contexts be briefly discussed to illustrate their influence on the tax reform exercise, and the introduction of the GAAR in particular.

The socio-political environment played an important role in the introduction, formulation and presentation of the tax reform package and the GAAR. In particular, the tax reform package was effected at a time when the Progressive Conservative Government was facing a federal election sometime within two years. Although this time frame may seem excessive and therefore the influence of the election diminutive, its impact is more viable if one considers the period necessary for implementation of the proposals and the general expectation that the election was going to be called in 1988. Moreover, the government's electoral support was flailing at that time. For example, at the beginning of 1987, it was third in the polls with only twenty-two per cent support. Therefore, the tax reform exercise was regarded by the government as a means of bolstering its public support. Consequently, the government produced and presented the package as promoting a fairer system. Although this concept was stated as comprising a number of facets, the one most heavily relied upon was the premise that the tax burden
would be shifted from low and middle-class individuals to the corporate sector and high-earning individuals. This image was projected through various means.

The first method by which the government promoted the image of shifting the tax burden was in the structure of the tax reform proposals. Primarily, it lowered the tax rates for the majority of taxpayers. These savings were designed to induce feelings of benevolence towards the government. Moreover, they were structured to maximize political appeal. For example, the tax savings were spread thinly over a large volume of taxpayers, namely eighty-five per cent of all taxpayers. Furthermore, the reduction of the rates was timed so that, although they were effective from the beginning of 1988, the savings would not be felt until July of that year - around the time that the federal election was expected. Also, a tax rebate was to be given the following spring, arguably to encourage the voters to re-elect the government to ensure that the rebate would not be lost.

The government also sought to promote an image of fairness by supposedly complementing these tax cuts with a correlating increase in the tax burden of the corporate sector and high-earning individuals. In other words, it presented the tax reform proposals in such a way to foster the impression that the personal income tax savings were being funded by corporate tax increases. For example, the proposals on the reduction in the
tax rates for low and middle-class individuals were presented parallel to the corporate measures and the corporate base-broadening measures were constantly highlighted in the tax reform documents. However, in economic terms the fallaciousness of this image is exposed. The tax reforms did involve some increase in corporate revenues - they rose from 15.6% to 17.2%. However, this was not nearly sufficient to finance the tax savings to ordinary taxpayers. The increase in corporate revenues only amounted to about twenty to twenty-five per cent of the personal income tax reductions. Instead, these reductions were primarily funded by increases to the federal sales tax and acceleration of tax payments. This state of affairs reinforces the proposition stated above that the government was simultaneously promoting two objectives with the tax reform package - maximizing electoral support and placating special interest groups. By presenting the reforms as promoting a fairer system, it was attempting to maximize its votes. However, the underlying structure was essentially unfair and favoured the corporate sector to a great extent. Therefore, with what appears to be some astute political engineering, the tax reform package accommodates both of these contradictory elements.
Where does the GAAR fit in to all of this? The provision played an important role in the creation of this image of fairness that was projected by the government. In particular, it greatly contributed to the illusion that the corporate tax burden was going to be significantly increased. It achieved this in its own right, as part of the plethora of base-broadening measures and assisting in the economic validation of the claim of the increased revenues.

Section 245 assisted in the creation of the image of fairness within its own right. This is inherent in the nature of the rule - namely, those taxpayers against who it is directed. The taxpayers who use artificial tax avoidance schemes to reduce their tax liabilities are those for whom it is financially viable, taking account, for example, of the fees of professional advisors. Consequently, the provision will mostly adversely affect the corporate sector and high-earning individuals. This is supported by the fact that these taxpayers were identified by the government as not paying their fair share of taxes.

The provision also helped to promote a fairer system due to its inclusion within a whole array of corporate base-broadening measures. The rule was an integral part of these measures, both conceptually and financially. As regards the former, the GAAR assisted considerably in creating the image that the tax burden
was being shifted onto the corporate sector. Consequently, the measure was continuously referred to in the tax reform documents.

As regards the financial implications, the GAAR aided the economic validation of the claim that the tax burden of the corporate sector was being increased. In other words, to verify this proposition, the government had to provide facts and figures that the burden was in fact being increased, although, as previously discussed, it was not significant. The section greatly contributed in the achievement of this objective. As regards the projected revenue increases generated by the base-broadening measures, it was the most financially lucrative. Without it, the figures would not have appeared nearly as impressive. For example, in 1989, absent the GAAR, and the projected revenue would have been in the negative - there would have been a decrease in corporate taxes of $30 million.

The use of the provision in the above way to present the image of fairness had, in turn, an influence on the rule. First, it provided an impetus for the introduction of the proposal and its inclusion within the tax reform package. Second, it arguably affected the calculation of the increased revenue that the provision was calculated to generate. Third, it influenced the response of the government to the heated criticism which the proposal was subjected to.
To amplify, the whole social and political background provided an impetus for the introduction of the rule and its inclusion within the tax reforms. It was an integral part of the tax reform package. It assisted greatly, both conceptually and financially, in the government's objective of creating the image of promoting a fairer system. The government sought to give this impression with the intention of bolstering its support with the electorate. These factors help explain the introduction of the section in 1987 as part of the tax reform package. For example, if the government had been that concerned about abusive tax avoidance which was supposedly occurring, then why did not it not introduce the rule at an earlier date? Curbing tax avoidance through "newspaper release" had been prevalent for some time and moreover, the courts had revealed their hesitancy to set down extended limits in this area some years earlier. Yet, the government still held off introducing the rule until it initiated its tax reform measures. Consequently, it is fair to say that socio-political factors prompted the introduction of the GAAR and its inclusion within the tax reform package.

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2 For example, the Supreme Court of Canada rejected a general business purpose test in the *Stubart* case [*Stubart Investments v. The Queen* [1984] C.T.C. 294, 84 D.T.C. 6305 (S.C.C.)] in 1984.
The second influence of these factors on the rule was arguably in relation to the calculation of the estimated revenue increases. The calculation of projected increases has been likened to "witchcraft",³ which does not inspire confidence in the accuracy of the estimated increases. Moreover, in relation to the GAAR, the task was aggravated due to various factors. For example, at least with other base-broadening measures there was a starting point - some special incentive with a value which was being removed or trimmed. With section 245, no such assistance was available. Furthermore, the calculation of the increases in relation to the rule was based on fortuitous circumstances, for example, the extent of future abuses and the frequency of application of the rule. In light of these difficulties, it is arguable that external factors influenced the calculation of the increases relating to the GAAR. For example, it is foreseeable that the socio-political backdrop persuaded the government to shape the calculations to maximize (within reasonable limits) the projected increases to substantiate its claim of fairness. The problem is that there is no way of proving or disproving these figures, and consequently, this proposition.

³ P. DeMont, "Tax Break Proposals Create Deficit Headaches: Economy Could be Savior" Financial Times (23 November 1987) 3.
The final influence of the socio-political context on section 245 is in relation to its amendment during the parliamentary process. In particular, the rule originated as a white paper proposal and was thus more susceptible to change. Furthermore, the provision was subjected to prolonged and heated criticism, primarily from the professional community. However, despite this, the government did not substantially alter the proposal within its passage through Parliament. The changes made did not affect the substance of the rule. It is submitted that exogenous factors influenced this outcome. In particular, the government could not afford, politically or financially, to have the tax reform package unravelled. Politically, to maintain the image of fairness, the government could not be seen to be caving in to special interest groups. Economically, due to adverse economic conditions (and consequently, political pressure), it had to ensure that the package remained more or less financially neutral. Therefore, the government stated that no changes were to be made unless the financial losses were made up elsewhere.

This relates back to the socio-political environment as the government could not afford politically to increase the already bulging deficit.

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5 "'I'm Listening': Thoughts of Michael Wilson [quoting Michael Wilson]" Financial Times (7 September 1987) 14.
The influence of the political factors is further heightened when one considers that the changes which were made to the tax reform package were in direct response to the recommendations of the House of Commons Committee on Finance and Economic Affairs. In particular, these recommendations were of a populist nature. In light of the publicity of the Blenkarn Report and its political influence, it is of no surprise that the government felt compelled to implement some of the recommendations, albeit, in a diluted form.

This proposition was reflected in the GAAR. Despite the adverse reaction of the business and professional communities and the extreme pressure exerted to withdraw/substantially alter the rule, the government stood firm. It only made minor alterations to the provision, and even then, some were in response to the Blenkarn Report and not as a result of pressure from these communities. It is submitted that the government's response was related to the political and social environment discussed above. In particular, it could not afford politically to withdraw/alter the rule as it would have been regarded as pampering the corporate sector - in direct contradiction to its image of fairness which it sought to promote.

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The hypothesis that the tax reform package was "dressed-up" to be electorally appealing is supported by other tactics that were adopted which were not related to the shifting of the tax burden from individuals to the corporate sector. For example, the tax reforms were divided into two distinct parts: Stage One dealt with income tax reform, Stage Two floated the idea of the introduction of a new extended sales tax. It is generally accepted that this division was implemented for political reasons. In particular, the introduction of a new extended sales tax was a volatile issue and not supported by the electorate. The government therefore postponed this new tax indefinitely. However, in the meantime, it proceeded with Stage One to benefit from the political gains of the tax savings. Moreover, concern was expressed regarding the division of the package in this way, notably by the House of Commons Committee on Finance and Economic Affairs. However, the government perceived that the political costs of proceeding with the sales tax would exceed the benefits of acting in accordance with these concerns.

The above reinforces the political aspect of the tax reform. In particular, the government was acting in its own self-interest to promote its chances of re-election. Consequently, it presented and structured the tax reform package to be politically appealing to the electorate. Notably, it sought to present the tax reforms as promoting a fairer tax system. In
particular, it attempted to create the impression that the tax burden was being shifted from low and middle-class individuals to the corporate sector. The GAAR was an integral part of the tax reform package. It played a major role in the creation of this image of fairness. In particular, it greatly assisted the promotion of the impression that the tax burden of the corporate sector had been significantly increased. The utilisation of the rule in this way provided an impetus for its introduction and inclusion within the tax reform package, arguably influenced the calculation of the revenues it was estimated to generate and had an impact on the attitude which the government adopted when the proposal was attacked by the business and professional communities.

However, the above is primarily concerned with only one of the objectives which the government was wishing to promote in seeking re-election. In addition to maximizing votes with the electorate, it was also placating the special interest groups, notably, the corporate sector and high-earning individuals. One means by which this was achieved has been discussed previously. Notably, in financial terms, the corporate sector was not greatly adversely affected by the tax reforms. In particular, its tax burden was not significantly increased. Moreover, this situation is exacerbated when one considers that the corporate tax burden was not restored, by the reforms, to the level it had been when the government had taken office in 1984.
The government adopted other strategies and measures which treated the corporate sector favourably and accordingly are examples of the placation of the business community. For example, the tax professional and corporate sector were extensively involved in the preparatory stages of the tax reform package. Consequently, the tax reform proposals were weighted in favour of business. Structurally, in addition to the financial implications, other proposals reinforce this proposition. For example, the top income tax rate was reduced; not all tax breaks were removed; rates were reduced in 1988, but many tax breaks slated for removal were not phased out until 1991 and those breaks that were removed were not ones important to the corporate sector. These examples clearly support the claim that the business community was placated by the government in structuring the tax reform proposals.

At first glance, it may be difficult to discern comparable arguments in relation to the GAAR as the latter obviously disadvantaged the corporate sector. This may be so, but nevertheless, the government still did all it could, despite this limitation, to placate the business and tax professional communities. For example, it involved the latter in the preparation of the rule; it modified the rule in response to criticism and produced interpretative aids. This all points to the government attempting to pacify the corporate sector.
In summary therefore, it is submitted that the looming federal election had an important impact on the tax reform package. In particular, the government sought to utilise the exercise as a means of bolstering its appeal with the electorate. Consequently, it produced and presented a package which was designed to appear to be promoting a fairer tax system. However, as shown, any claims to fairness were somewhat illusory. This was primarily due to the other objective of the government in seeking re-election - to placate the business community. This aim was reflected primarily in the structure of the tax reform package. In basic terms, the tax reforms were weighted in favour of the corporate sector. The accommodation of these two contradictory strands is evidence of some clever political manoeuvring by the government.

Other elements of the socio-political environment influenced the tax reform package and the GAAR in particular. For example, for reasons given above, the provision was included in the tax reforms which had an impact on its development. Consequently, the rule was subjected to the trade-offs and compromises which are inherent in structuring any tax reforms. Furthermore, the inclusion of the section within the tax reform measures meant that it was presented as a white paper proposal. Theoretically, this exposed the rule to increased pressure and ultimately, change. However, if this is true, then it is surprising that the proposal was not withdrawn or significantly altered in light
of the heated criticism it generated. It is submitted that the
government conveyed its determination regarding, at the very
least, the concept of the provision by including draft
legislation within the white paper documents.

The final major socio-political factor which greatly influenced
the 1987 tax reform exercise was the tax reform that had
occurred in the United States. For political and economic
reasons, this reform provided an impetus for the Canadian
reforms and dictated, to a large extent, their direction. The
impact of the U.S. reforms on the Canadian GAAR may not be
discerned at first glance considering the U.S. package did not
contain a parallel provision. However, the existence of
limitations concerning the Canadian tax reform influenced the
provision. To explain, the Canadian exercise was hampered by a
number of factors (for example, less special incentives to be
removed/trimmed) which meant that it could not be as wide-
ranging as the U.S. exercise. Therefore, the GAAR was perhaps
introduced to make-up this shortfall. For example, it
substantiated the claim of fairness which the government was
seeking to promote.
Overall, it is clear that the socio-political context had a major influence on the tax reform package and the GAAR in particular. The main elements included the looming election, the inclusion of section 245 in the tax reform package and the U.S. tax reforms. These factors played an important role in providing an impetus for the introduction of the tax reforms (and the GAAR) and for determining their structure and presentation.

However, other contexts also should be considered in the analysis of section 245. For example, the economic conditions prevalent at the time contributed to the creation of an environment conducive to the introduction of the provision. The economy at the time of the tax reform was not in a healthy state. Basically, the country was "mortgaged to the hilt" and had a deficit that was substantially larger than the U.S. deficit. These adverse conditions arguably garnered public animosity against tax avoiders which was perhaps due to an increase in the incidence of tax avoidance. Media attention regarding these tax avoiders precipitated a general attitude that the tax system was unfair. This exerted political pressure on the government to rectify the situation. The government at that time was particularly vulnerable to public pressure due to social and political factors. For example, as discussed above,

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it was seeking to increase its electoral support in the face of a looming federal election. Therefore, a combination of the economic and the socio-political contexts culminated in providing an impetus for tax reform. The GAAR was an integral part of this tax reform package, especially in relation to the creation of an image of fairness which the government sought to promote.

The adverse economic conditions also had an impact on the tax reform package in affecting the scope of the government to use the exercise to increase revenues. These conditions resulted in political pressure being put on the government not to use the tax reform proposals as a means of collecting extra revenues which would have added to the already bulging deficit. Due to the social and political environment the government was susceptible to such pressures and thus produced a tax reform package which it claimed was fiscally neutral. The GAAR played an important role in assisting the government to fulfil this objective. As regards Stage One, the provision was the most lucrative of the corporate base-broadening measures.\(^8\) Although the increased revenue it was projected to generate does not seem quite so significant in light of the increases that the changes to the federal sales tax and acceleration of tax payments were

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\(^8\) It was estimated to generate $2,240 million over the period 1988-92: Canada, Department of Finance, *Tax Reform 1987: Income Tax Reform* (Ottawa: the Department, June 18, 1987) at 67.
estimated to result in,\textsuperscript{9} it is submitted that the GAAR's contribution was still important - an extra $2 billion cannot be easily dismissed.

However, it should be noted that the impact of the economic context was mostly indirect. Its primary influence was in affecting public attitudes - both towards tax avoiders and the size of the deficit. However, it was social and political factors which caused the government to be vulnerable to political pressure manifested by such public attitudes. This pressure provided an impetus for the introduction of the tax reform package and determined to a certain extent the structure and presentation of the reforms. Consequently, it should be reiterated that the economic context played an important role in creating a political climate which was favourable to the introduction of the tax reform package and the enactment of the GAAR.

The economic context also reinforces the extent of the influence of the social and political conditions. It is submitted that the latter were more prominent in determining the introduction, structure and presentation of the tax reform proposals, and the GAAR in particular. For example, if the government had been more concerned with the economic environment, then the tax

\textsuperscript{9} Totalling $2,705 million in 1988-89 alone and $7,485 million over the period 1988-92: Canada, Department of Finance, Tax Reform 1987 (Ottawa: the Department, June 18, 1987) at 75.
reform proposals would probably have addressed the deficit problems. Instead, the government produced a package that was intended to be electorally appealing, yet which circumvented economic issues.\textsuperscript{10}

This proposition is verified by the overall revenue impact of the tax reforms. In particular, the reforms were structured to increase the total revenues by over $1 billion in 1988-89.\textsuperscript{11} An extra $1 billion boost to the economy before the election would help the government create the image that it was making progress in improving the economic difficulties. Moreover, by limiting the increase to $1 billion, the government was still able to maintain that Stage One was fiscally neutral, thus acting in accordance with public sentiment. Therefore, it is arguable that the government intentionally structured the tax reform package to generate these revenue effects in the first year post-reform. This hypothesis may seem a trifle cynical, but if one considers the fiscal implications in the following years,\textsuperscript{12} it reinforces this political manoeuvring of the government.

\textsuperscript{10} "'It is all political. This is not a deficit-controlling package. It is a let's-win-the-next-election policy' [quoting an unnamed senior economist at a Toronto brokerage firm]." M. Janigan, "Cautious Reform" (29 June 1987) 100 Maclean's 34 at 38.

\textsuperscript{11} Tax Reform 1987, supra, note 9 at 75.

\textsuperscript{12} For example, in 1989-90, there was a short-fall of over $1 billion. Thereafter, the overall net position was relatively neutral.
Further evidence of the government's desire to produce a politically sound package is provided by observations made by the Standing Committee on Finance and Economic Affairs to the effect that Stage One may drag on the economy in the longer term because the increase in taxation of investment could slow economic growth. If the government had been concerned with rectifying the economic situation it would not have structured a tax reform package to have this effect.

Overall, from the above, it is clear that the government was utilising the tax reform package to enhance its chances of being re-elected. It could have implemented this objective in a number of ways, for example, improving the economic situation. This would have reflected favourably on its ability to manage the country and perhaps bolstered its electoral support. However, the government perceived that the measures necessary to alleviate the economic problems (for example, tax increases, expenditure cuts) would have entailed incurring political costs exceeding the benefits of an improved economy. Therefore, it opted to circumvent the economic issues and instead produce a tax reform package that was more directly appealing to the electorate (eg. by implementing tax savings). It perceived that the benefits of effecting these proposals would outweigh the costs of not dealing with the economic situation.

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13 Blenkarn Report, supra, note 6 at 31.
However, it should also be noted that the tax reform proposals did not materially worsen the economic conditions. For example, the government could have effected greater reductions in personal income taxes. It perceived that this would be politically dangerous, as the benefits of implementing such measures would outweigh the political costs of significantly adding to the deficit. It therefore chose a balance whereby the overall impact would not be that noticeable - what is a billion dollars here and there when there is a deficit of over $38 billion?

In summary, it would appear that the economic context did not have a direct bearing on the tax reform exercise. The government was more interested in bolstering its electoral support through more direct means than improving the economic situation. It therefore produced a tax reform package which was designed to be politically appealing, for example, by implementing tax savings for the majority of taxpayers.

The final context which is relevant to the tax reform package and section 245 is the historical context. This encompasses two elements - the legal background to the GAAR and the social and political history of Canadian tax reform in general. The former influenced the provision in a number of ways. First, the existence of statutory and judicial anti-avoidance rules paved the way for the introduction of section 245. They helped to
create a favourable environment for the enactment of the provision. For example, it was not such a great step forward for the government to propose the GAAR, compared with the position, for example, had it countenanced tax avoidance before, and then suddenly, attempted to initiate section 245. Moreover, these rules influenced the format of the rule. The government was able to decide which concepts would be most appropriate in the achievement of its desired aims.

The social and political background of tax reform in general influenced the strategy the government adopted with its 1987 package, which in turn affected the structure of the proposals. In particular, two recent attempts at tax reform - the 1971 tax reform legislation (which was based on the Carter Commission Report\(^\text{14}\)) and the budget proposals of Allan MacEachen in 1981, were most relevant. Both these attempts had been thwarted by pressure exerted on the government by special interest groups. Ultimately, the legislation that was enacted differed greatly from the original proposals. This encouraged the government in the 1987 exercise to seek the input of special interest groups, in particular, the business community. Therefore, it consulted widely with the corporate sector in the preparatory stages of

\(^{14}\) Canada, "Report of the Royal Commission on Taxation" (Ottawa: Queen's Printer, 1966).
the tax reform proposals. This input was reflected in the structure of the tax reform package, which as previously discussed, was weighted in favour of business.

The two tax reform experiences also encouraged the government to present the 1987 tax reform proposals as white paper documents. The prior tax reform exercises had resulted in dilution of the original documents. Changes to legislative proposals are more embarrassing for the government than alterations to white paper proposals. Therefore, the government in 1987 was prompted to introduce its proposals as white papers.

In summary, it is suggested that the historical context had an impact on 1987 tax reform exercise, and the GAAR in particular. In particular, the legal background paved the way for the introduction of the provision and determined to a certain extent, the format of the rule. As regards the political and social history, recent tax reform attempts influenced the strategy the government adopted in preparing its tax reform proposals in 1987 and the presentation of the reforms as white paper documents.
To conclude, it is apparent from the above that the whole environmental backdrop, from the socio-political background to the economic conditions to the historical context, influenced the enactment of section 245. By analyzing the context of the provision, we can further our understanding of the rule. In particular, the factors that led to its introduction and its structure can be identified. From this perspective, we can appreciate why the government introduced the rule and why it was able to remain committed to the provision despite the severe criticism which it attracted.

Furthermore, the value of focusing on section 245 is validated when one considers that a parallel provision was enacted in respect of the new Goods and Services Tax which the government introduced in 1989.\textsuperscript{15} Section 245 obviously emboldened the government to introduce this parallel provision. It also forewarned the special interest groups of the futility of their objections. Quaere whether this reflected a trend in Canadian policy making. This raises wider issues concerning the era of democracy - questions which cannot be answered here.

In addition, this paper exposes the political element of tax legislation. Tax laws cannot be divorced from the political process. Consequently, the analysis of tax provisions should not be limited to normative traditions such as equity, efficiency or simplicity. Adopting such tools ignores the political reality of tax law. It is only by looking at this wider context that we can truly understand what goes into the formulation of tax provisions. We can appreciate the political balancing between costs and benefits, the compromises and trade-offs that occur and the accommodation of conflicting interests. The 1987 tax reform package truly represents the outcome of these factors.

Finally, this paper raises wider issues relating to the role of governments in democratic states. In particular, it illustrates that governments are not acting in the public interest or according to some general and social criteria. They are acting in their own self-interest, doing whatever is necessary to ensure their continued stay in office. However, the tax reform exercise also exposes the fallibility of the electorate. The government went to great lengths to produce and promote\textsuperscript{16} a

\textsuperscript{16} The government went all out to sell the tax reforms to the public. For example, the Finance Minister himself travelled the breadth of Canada giving innumerable speeches and interviews: J. Ferguson, "Wilson Faces Bay St. Crowd on Tax Reform" \textit{Toronto Star} (25 June 1987) E1). He even resorted to writing to \textit{The Globe and Mail} ("Tax Reform Lowers Burden for 85%" (Letter to Editor) \textit{The Globe and Mail} (24 August 1988) A7) to ensure maximum exposure of the government's image of fairness.
package which it thought would be appealing to the electorate and therefore bolster its support. However, despite these efforts, the Canadian public still seemed ignorant\textsuperscript{17} and uninterested\textsuperscript{18} in the whole affair. Perhaps it is not the activities of government which we should concentrate on, but the unpredictable nature of the electorate. It seems that in these days of advanced technology, we still do not know how to appeal to human nature!

\textsuperscript{17} For example, despite the selling efforts, the Canadian public did not pick up on the government's message of fairness that it sought to promote: a poll by Angus Reid Associates for Southam News revealed that six out of ten of those surveyed did not believe the government's claim that tax reform would make the system fairer. Only one in ten expected to benefit personally from tax reform: J. O'Neil, "Canadians Skeptical of Tax Reform" \textit{Calgary Herald} (2 February 1988) A3. It is submitted that these results were due to lack of public knowledge of the issue rather than informed decisions. For example, a primary means of public dissemination of knowledge is through the media. But, in the case of the 1987 tax reform exercise, general media attention only lasted for about two weeks. Thereafter, it was relegated to the business pages: L. McQuaig, \textit{Behind Closed Doors: How The Rich Won Control of Canada's Tax System ... And Ended Up Richer} (Markham, Ont.: Viking, 1987) at xxxvi.

\textsuperscript{18} Anecdotal evidence includes one Conservative MP (and member of the Standing Committee on Finance and Economic Affairs), Paul McCrossan who stated that he was not been asked a single question from any constituent on taxation: J. Kohut, "Tories Find Tax Tables Turned as Reform Becomes Issue in Vote" \textit{The Globe and Mail} (24 October 1988) B1.
To conclude, this paper raises many issues, some of which have been left unanswered. In all, it shows that tax analysis does not have to be limited to the technical or the specific. In fact, it should encompass wider topics, for example, the political process and democracy in general.

It is hoped that this analysis of section 245 has verified the validity of adopting a political approach in considering tax laws. By viewing the provision within the contexts prevalent at that time, an attempt has been made to identify the exogenous factors which influenced its introduction and development. This provides a better understanding of the rule, particularly since it is still in a state of limbo, not being considered by the courts. Overall, this thesis reinforces the claim that tax laws should be analyzed in the wider context - they are after all a product of their environment.
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