THE McGILL LAW JOURNAL

VOLUME 2 AUTUMN 1955 NUMBER 1

THE CONSTITUTIONAL BACKGROUND OF TAXATION AGREEMENTS

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The financial relations between Ottawa and the provincial governments form one of the most complex and changing aspects of Canadian federalism. Within two years after Confederation the original terms of Union, set out in Sec. 118 of the B.N.A. Act, were varied to accommodate the claims of Nova Scotia, and since then no constitutional provision or political agreement has endured for long, whether it has been declared in the law of the constitution, as in 1867, to be "in full and final settlement", or whether, as in 1907, this firm intention was prudently withdrawn from the text of the amendment, at the request of British Columbia. Indeed, the new form of these financial arrangements that was adopted after World War II, based on the tax rental idea and renewable every five years, was the first serious attempt ever made in Canada to discover a method by which some order and stability might be introduced into a relationship which otherwise changes in an erratic and unplanned manner. The Sirois Report proposed another solution, but this was rejected in 1940. That the recent attempt has been only partially successful is evident from the fact that no general formula was found acceptable to all the provinces.

At a time when new financial terms are being negotiated in Canada, it may be useful to examine the law of the constitution within which any revised arrangements will have to operate. This law could, of course, be changed by constitutional amendment, as in 1907, but it is doubtful if such a course will be followed. Amending the constitution is one of those complexes in the Canadian psyche which we prefer to thrust down deep into our political subconscious, and no sofa has yet been devised on which we seem able to liberate our internal conflicts. Any new tax agreements we adopt are therefore likely to have to be fitted into the old law. This leaves a very wide area where solutions ean be found based on consent, since the legal rules are relatively few. Nevertheless consent cannot be given contrary to the law, nor can it rest on founda-

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tions more secure than those which the federal framework provides. It is to these basic constitutional rules, therefore, that attention will be turned.

TAXING POWERS IN THE B.N.A. ACT

Leaving aside minor variations, the principle ideas in the B.N.A. Act regarding the financial powers and the fiscal relations of the federal and provincial governments may be stated simply. The Parliament of Canada may adopt any mode or system of taxation it chooses, be it direct or indirect, progressive or regressive, fair or discriminatory. The provinces are limited to direct taxation within the province in order to the raising of revenue for provincial purposes, and in addition have a general licensing power for the same purposes. Provinces may also gather the royalties and income from the sale and development of their natural resources (s. 109). All provinces were granted subsidies in 1867, at so much per head of population, calculated at an amount enabling provincial budgets to be balanced with the then existing provincial responsibilities. All provincial debts were assumed by Ottawa so that every provincial government started its federal life debt free. But provinces were given power to borrow on the sole credit of the province (s. 92-3) and no restriction was placed upon the total amount that might be raised in this manner, nor upon the location of the lender. Hence provinces may incur international debts. It was not believed in 1867 that the needs of local government would be great, or that there was any danger of provincial fiscal policies endangering national economic plans. Jurisdiction over credit generally, through banks, currency and the issue of paper money, was in federal hands, along with control of interest. Both Parliament and the legislatures were prohibited from imposing any tax on Crown property (s. 125).

It is clear from these initial provisions of the constitution that the concept of provincial autonomy prevailing at Confederation was subject to two important financial restrictions; first in being limited to direct taxation, and secondly in being dependent on subsidies. On the other hand, the taxing powers of Parliament appeared unlimited. This is the reverse of the situation found in the American constitution, where the States may impose direct or indirect taxes, and where there were limitations on the right of Congress to tax which necessitated the XVIth amendment authorising federal income taxes. The notion of subsidies, substantial in relation to the original provincial budgets, which was basic to the Canadian scheme, is all the more surprising in view of the sound parliamentary tradition with us that the government which spends public money should be compelled to raise it.[1] In the United States as well as in Switzerland and Australia, however, though no subsidies were provided in the constitution, it has since been found necessary for the central government to make voluntary grants to the states in proportions comparable to those paid in Canada under the tax agreements.[2]

[1]See comment Sirois Report, Book II, p. 126.

[2]Wheare, *Federal Govt.* 3rd ed. pp. 115-6.

VARIATIONS IN FINANCIAL STATUS OF PROVINCES

While in general the taxing powers of all provinces are equal, it was found impossible from the first to apply uniform rules across Canada. By s. 124 of the B.N.A. Act New Brunswick was permitted to levy lumber dues not allowed to other provinces. The natural resources of the western provinces were handed back in 1930 subject to limitations from which the other provinces were free. As the Privy Council said in 1953, when holding that Saskatchewan was prevented by its constitution from taxing C.P.R. properties, "There was thus no set pattern of 'a Province' in the Act of 1867",[3] a remark which does not quite square with Mr. St. Laurent's comment at his Reform Club speech in the autumn of 1954 that Quebec was "a province like other provinces". There are very few provinces exactly like other provinces in their constitutional position, though it is true that the taxing powers of the four original provinces were the same with the one exception for New Brunswick already noted.

Thus it is not surprising to find that when the taxation agreements were negotiated in 1942 and 1947 there were two options available, and in 1952 three options, later increased to four to accommodate Quebec's income tax. Perhaps when we reach ten options we shall achieve a truly Canadian unanimity. How far these variations are compatible with the maintenance of something we can call national fiscal policy designed to maintain high employment it is not for the constitutional lawyer to say, but it is clear that the present constitution does not give Ottawa the legal power to implement a policy that controls provincial taxing powers, except with provincial consent.

RESULTS OF CONSTITUTIONAL INTERPRETATIONS

The results of judicial decisions on the tax clauses of the B.N.A. Act may perhaps be summarized without serious inaccuracy by saying that the courts have somewhat reduced the wide taxing powers of Parliament, and have permitted some extensions of the limited powers of the provinces but not enough to keep pace with the vastly increased costs of provincial government.

Federal power has been diminished by the application of the doctrine that particular words override more general ones and operate by way of exception to them. Hence Ottawa cannot impose a direct tax within a province in order to the raising of a revenue for provincial purposes.[4] It can, however, impose a direct tax in order to raise a revenue for a federal purpose. What then is a provincial purpose? Curiously enough this term has never been authoritatively defined by the courts; if it means merely "for the exclusive disposition of the legislature", as Duff C.J. said it meant in the Unemployment Insurance

[3] *A.-G. for Sask.* v. *Canadian Pacific Rly. Co.* [1953] A.C. 594 at p. 613. Saskatchewan and Alberta are compelled by their constitutions to accord the C.P.R. a degree of fiscal respect elsewhere reserved for royalty.

[4] *Caron* v. *The King* [1924] A.C. 999.

Reference,[5] then indeed the Dominion and Provincial powers of taxation are on different planes and cannot come into conflict. However, there was an obscure remark in the Privy Council judgment in the same case indicating that just because the Dominion has collected a fund by means of taxation, it by no means follows that any legislation which disposes of it is necessarily valid. The first unemployment insurance act, which raised such a fund, was unconstitutional, but chiefly on the ground that it interfered with the contract of employment. Obviously, not every federal statute is valid just because it authorizes the expenditure of public funds, which is all the Privy Council has actually said, but the manner of their saying it has raised some doubt as to the validity of social insurance schemes paid for out of federal revenues. It should be noted, however, that the legal doctrine referred to which limits federal powers by excepting from them specific provincial powers, only applies to direct taxes; indirect taxes escape its application, since the provinces cannot impose them at all.

Turning to the provincial taxing powers, it is evident that once the courts had classified sales taxes as direct taxes when they were based on the device of making the vendor a tax collector, a wide new field for taxation was open to provincial governments. This is a strange result in a country where excise taxes are reserved to the central government, since both types of tax have much the same economic effect on consumption. In New Brunswick a man who opens in his own home a package of cigarettes imported from another province is supposed immediately to pay his New Brunswick tax.[6] British Columbia succeeded in imposing a tax on consumers of fuel oil which was in fact being imported free into the province.[7] Thus in effect the provinces can impose a custom barrier around themselves despite the explicit reservation of customs to Ottawa in s. 122 of the constitution. The courts also approved provincial taxes on banks, federal civil servants and judges, thus rejecting for Canada any doctrine of the "immunity of instrumentalities". On the other hand, the courts did not allow provinces to breach the tariff wall by the simple process of taking ownership of the imports in the name of the Crown and claiming exemption under s. 125. Had the reverse ruling obtained, socialism for fiscal purposes might have developed at the provincial level much more rapidly.

Despite these enlarged interpretations of their powers, provinces have had great difficulty in increasing their revenues as fast as their enlarged governmental functions, also due in part to judicial interpretation, have accumulated. This explains why, of the three formal amendments to legislative powers in the B.N.A. Act since 1867, two have concerned costly social insurances, namely

[5] *Unemployment Insurance Reference* [1936] S.C.R. at p. 434.

[6] *Atlantic Smoke Shops* v. *Conlon* [1943] A.C. 550.

[7] *A.-G. for B.C.* v. *Kingcome Navigation Co.* [1934] A.C. 45; see also my comment in (1934), 12 Can. Bar Rev. 303.

unemployment insurance (1940) and old age pensions (1951). (The third was the 1949 addition of the federal amending clause). Health insurance would be another very costly undertaking, and while, it is submitted, it could be established without an amendment, by a system of grants in aid financed through income tax and general revenue, federal administrators would no doubt feel happier with some agreed transfer of jurisdiction.

LEGAL NATURE OF TAXATION AGREEMENTS

The Parliament of Canada and provincial legislatures, being sovereign in their own spheres and incapable of binding their successors, cannot place taxation schemes on any but a "gentlemen's agreement" basis. Despite the concurrent statutes giving effect to the agreements, nobody is really bound in law to maintain them. Hence no loss of sovereignty takes place when a province enters an agreement, any more than it takes place when a province leases natural resources to an American corporation. The restraint imposed comes from the economics, not the law of the situation. British Columbia was held to be able to impose a tax on the Vancouver Island railway belt even though it had passed a self-denying statute in 1883 as part of a scheme for aiding railway construction.[8] Quebec's acceptance of the Wartime Agreements in 1942 did not prevent her refusing the subsequent ones in 1947 and 1952.

The most startling proof of the purely voluntary nature of taxation agreements, however, was furnished by the federal government itself, when in January, 1945 it suddenly refused to pay to Saskatchewan the monies promised under the Wartime Tax Agreement of 1942 because of an unsettled claim on the seed grain debt, though repayment of that debt by Saskatchewan was never made a condition of the Agreement. It is true that the CCF Party defeated the Liberal Party in Saskatchewan in 1944, but to a constitutional lawyer no significance can be attributed to this event. Yet even to a constitutional lawyer it would seem that gentlemen's agreements ought to be carried out in a gentlemanly way, and that where strict law ends good faith must continue. This is particularly necessary in a federal system as complex and delicate as our own, and it does not seem an adequate answer to say, as did the Arbitration Board appointed to hear the seed grain dispute, that there was nothing illegal in Ottawa's behaviour.[9] Money promised in the Agreement suddenly ceased to be paid, upsetting provincial plans and revealing the tenuous nature of the legal obligations created.

Because taxation agreements are based on consent and not on constitutional obligation, it follows that special deals with particular provinces are legally unassailable. We have no requirement that taxation must be undiscriminatory, or equal as between the provinces. If national policy requires that wealth shall be taken from the richer and given to the poorer regions, the manner of

[8] *A.-G. for B.C.* v. *E. & N. Rly.* [1950] A.C. 87.

[9] The Board was divided in its opinion: see [1946] W.W.R. p. 257.

its distribution is a matter of politics and not of law. Hence the abstention of some provinces does not preclude the possibility of agreements with others, as past practice makes abundantly clear.

THE SPENDING POWER OF GOVERNMENTS

All public monies that fall into the Consolidated Revenue Funds of the federal and provincial governments belong to the Crown. The Crown is a person capable of making gifts or contracts like any other person, to whomsoever it chooses to benefit. The recipient may be another government, or private individuals. The only constitutional requirement for Crown gifts is that they must have the approval of Parliament or legislature. This being obtained the Prince may distribute his largesse at will. Such gifts, of course, do not need to be accepted; the donee is always as free to reject as the donor to offer. Moreover, the Crown may attach conditions to the gift, failure to observe which will cause its discontinuance. These simple but significant powers exist in our constitutional law though no mention of them can be found in the B.N.A. Acts. They derive from doctrines of the Royal Prerogative and the common law. They operate equally for the Crown in right of provinces as well as for the Crown in right of the Dominion. It would be as lawful for provinces to subsidize Ottawa as for Ottawa to subsidize provinces; the only difference is that Ottawa is obliged by the constitution to pay certain statutory sums.

These rules explain several interesting practices inherent in Canadian federalism. They explain why no amendment was necessary to the B.N.A. Act in 1869 when the amount guaranteed to Nova Scotia was increased; if the federal Crown is obliged to give x dollars to a province, it does not violate its promise by giving x plus y dollars. It may excite the cupidity of other provinces by so doing, but that is not a legal matter. So too these rules explain how it has been possible for Ottawa to set in motion a variety of welfare projects, such as family allowances and grants to universities, through the method of the grant in aid. It explains how Canadian Government annuities were established. And not only Ottawa employs this method. The Province of Quebec, which has been most insistent on provincial autonomy in education, does not hesitate to make grants of public money to colleges in other provinces. According to Mason Wade[10] the redoubtable Mercier, as staunch a defender of Quebec's rights as the present premier of Quebec, even gave $10,000 to the University of Toronto after it had suffered in a bad fire. This was indeed a *beau geste*. But what is the difference, one may ask, between giving to a university after a fire and giving annually without regard to conflagrations? If Ottawa's gift to Quebec universities is an invasion of Quebec's rights, why is not Quebec's gift to Toronto, or to the University of Ottawa, an invasion of Ontario's rights? The true answer is that none of these gifts is an invasion of anybody's rights in so far as constitutional law is concerned. Generosity in

[19] *The French Canadians*, p. 428.

Canada is not unconstitutional. If the grants are undesirable, it must be for non-legal reasons.

Making a gift is not the same as making a law. Because one type of government alone has jurisdiction over a class of subject under the B.N.A. Act, does not mean that the other may not make gifts to persons whose activities fall within that class. A province, for example, may not make laws having extra-territorial operation, but it may make gifts having such operation. Quebec made a gift of $35,000.00 for flood relief in Europe in 1953. Gifts from American Foundations to Canadian universities are not 'laws in relation to education'. No more are gifts from the Crown, even though such gifts must be approved in an Appropriation Act before the payment is lawful. Tying all this to taxation agreements, it is quite lawful for Ottawa to entice provinces into agreements by offering to pay them more for surrendering certain taxes than would be received by them through those taxes. Call it a gift or a "tax rental", it is equally within the discretion of the Crown, if Parliament approves.

THE QUESTION OF PRIORITIES

In the recent debate between Ottawa and Quebec regarding income taxes, a claim was put forward in high provincial places, and indeed was written into the preamble of the Quebec statute imposing its income tax,[11] that the Canadian constitution recognized provincial priority in the matter of direct taxation. This part of the statute was repealed after Ottawa agreed to allow certain deductions for the Quebec taxpayers. What is the law on the point?

If by priority is meant that every time a province enters the income tax field the federal government must evacuate it, there is obviously no such priority. As already said, the exclusive provincial jurisdiction over direct taxation is only for the raising of revenues for provincial purposes; direct taxation for federal purposes is exclusively a federal power. As was said by Lord Macmillan in the Forbes case,[12] "Both income taxes (federal and provincial) may co-exist and be enforced without clashing. The Dominion reaps part of the field of the Manitoba citizen's income. The Province reaps another part of it". But what happens if the poor Manitoba citizen is reaped right down to his bare stubble? Suppose the taxpayer has not enough money to pay both taxes, who then is paid first? This is the only case where conflict between the taxes exists in the legal sense.

To this question the Privy Council has already given the answer. In Silver's case,[13] where a bankrupt company owed taxes both to Quebec and to Ottawa, Viscount Dunedin, while holding that on the statutes before him the two claims ranked *pari passu,* went on to say that either under head 21 of 91 (bankruptcy) or under head 3 of 91 (taxation) it would have been competent

[11] 2-3 Eliz. 11, cap. 17.
[12] [1937] A.C. 260.
[13] [1932] A.C. 514.

for Ottawa to have made its claim prevail over that of the province if it so wished:

> The two taxations, Dominion and Provincial, can stand side by side without interfering with each other, but as soon as you come to the concomitant privileges of absolute priority they cannot stand side by side and must clash; consequently the Dominion must prevail.

This is because of the well-established rule that where there is a concurrent field of legislation neither the federal nor the provincial laws are ultra vires if they do not conflict, but once they do the federal law prevails. The only exception to this rule seems to be in regard to the old age pensions amendment of 1951. Prof. K. C. Wheare, in his *Federal Government*,[14] seems to think that this ruling has destroyed the federal principle in Canada in so far as the taxing power is concerned. To which my reply is that the Canadian constitution was never expected to operate on strictly federal principles as the political scientist understands them; we adopted, for what seemed good reasons, a constitution leaning toward a strong central authority whose power might offset in some degree the centrifugal forces which are always present in the body politic.[15] Let it not be forgotten that the first attempt to escape from Confederation was made by Nova Scotia within eight months of the coming into force of the B.N.A. Act.

THE SYMBOLISM OF TAXATION AGREEMENTS

The dry bones of constitutional law are not the living flesh of Canadian politics. The problems involved in taxation agreements reach far beyond the ground covered in an analysis of legal rules. Yet the problems cannot be understood and no satisfactory solution can be worked out unless they proceed from an analysis of the legal norms established in the fundamental law.

It is only too apparent that in Canada one great difficulty is to reach agreement on the kind of federal-provincial relationships that the constitutional rules imply. On many technical points such as have been discussed here, final decisions of the Privy Council or the Supreme Court of Canada give us an answer, but on much more fundamental matters the court decisions are silent or confusing. It is precisely these deeper issues which elevate constitutional discussion in Canada to the plane of philosophical debate and which intrude themselves into every aspect of federal-provincial relations.

The point can be illustrated by asking some simple questions. What is the nature of the B.N.A. Act? Is it a statute or a compact, or, as Père Arrhès holds, both a statute and a compact?[16] Or is it to be explained by the "théorie de l'institution" as Edouard Laurent maintained?[17] If it is a compact, between

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[14] 3rd ed. pp. 110-114.

[15] I have expanded this argument in "The Special Nature of Canadian Federalism", (1947) C.J.E.P.S. pp. 13 ff.

[16] See *La Confédération: Pacte ou Loi*, éditions de L'Action Nationale, 1949, p. 72.

[17] See *Quelle est la nature de l'acte de 1867?* Cahiers de l'Ecole des Sciences Sociales, Laval (n.d).

whom was it made; between the four original provinces, between all the provinces and the Dominion, or simply, as the prevalent theory in Quebec seems to maintain, between races? If it is a compact between races, is it between the French race and all other races in Canada collectively, or between French and English, using English in the Quebec sense of meaning anyone from the British Isles?[18] Again, is the aim of the constitution the retention of what Lord Atkin calls "the watertight compartments",[19] or is it rather, as Lord Sankey once said,[20] "to give the central government those high functions and almost sovereign powers by which uniformity of legislation might be secured on all questions which were of common concern to all the provinces as members of a constituent whole?"

It is unlikely that a single answer will ever be given to these questions by all Canadians. Each will answer according to his basic philosophical approach and according to the ends he has in view. In a bicultural country, the backgrounds, educational systems and political aspirations are too varied to permit of single explanations of constitutional rules. To someone trained in Dicey's *Law of the Constitution,* the B.N.A. Act is simply a statute to be obeyed by our courts because of the ancient doctrine of imperial sovereignty. Is it reasonable to expect so technical a view to be held by a graduate of a classical college in Quebec? Is he not right when he reminds us that the great central facts of Canadian life — the race relationships, the religious guarantees, the bilingualism — cannot be subsumed under narrow legal concepts? Is it surprising that he finds a continuing difficulty in expressing his French realities in the terms of English legalities? The Canadian constitution is not even written in one of the two official languages of this country — his own.

It is unfortunate for the economists who wish Ottawa to adopt a fiscal policy based on Keynsian principles, that taxation arrangements have now become involved in, and perhaps dominated by, Quebec's insistence on the recognition of her status and her rights under the Canadian constitution. It is also unfortunate for the unemployed in Quebec and elsewhere, since battles over status seldom aid in solving economic problems. As a member of the Quebec delegation said after the first sessions of the federal-provincial fiscal conference in April, 1955, "When other provinces come to Ottawa they bring their problems and leave their rights behind. Quebec brings her rights and leaves her problems behind". But few will doubt that Quebec is standing on very strong ground in stressing the non-economic factors in this debate. Quebec's view is based on the theory that the maintenance of Canadian federalism requires that each province, and particularly Quebec, should be able to finance its own functions of government out of its own resources; otherwise it ceases to have any autonomy worth the name. This is claimed as a

[18]The only race mentioned by name in the B.N.A. Act is the Indian race, and Indians were made wards of Ottawa.

[19][1937] A.C. at p. 354.

[20][1932] A.C. at p. 70.

right, not as a privilege or concession. Since taxation agreements as hitherto devised seem to imply an abandonment of this right, their rejection is an act of honour. They become mixed up with feelings of status and prestige, and cease to be merely practical devices for solving common problems. And since Quebec's income tax of 1954 brought these issues vividly to the Quebec public, the income tax itself became, in a sense, a symbol of cultural defence. This explains why there has been so much insistence over deductions for an income tax in Quebec, whereas a far wider group of Quebec taxpayers — including the lowest paid workers — pay a double and sometimes a triple sales tax without any sense that their culture is at stake. Yet why, one may ask, is an income tax more honourable than a sales tax? It affects far fewer people.

The currents of constitutional thinking in Quebec suggest that to-day the identification of the government of Quebec with the whole French-Canadian race is greater than ever before. This identification once assumed as a major premiss, a number of new concepts about Canadian federalism seem to follow. Canada is seen not just as one central government and ten provincial governments, Quebec being merely one of the ten: rather is it looked upon as composed of two races, equal in status, one of which speaks through the government of Quebec and the other through Ottawa. Hence Quebec on this view is one of two governments. The notion of Canada as a dyarchy, or a dual monarchy, is implicit in much of the contemporary discussion on federal-provincial relations.

Fiscal policy in Canada is thus enmeshed in minority rights. When financial arrangements achieve the importance and magnitude of current tax agreements this is scarcely surprising. For the inner conflict in all federal states between growing welfare responsibilities resting on the local governments, and new fiscal responsibilities for promoting overall economic welfare resting on the central government, is difficult enough to resolve even in a homogeneous society. It assumes added complexities in a bicultural society. With us taxation agreements must be understood as achieving two objectives simultaneously: Quebec's autonomy, as well as economic stability. Autonomy for English-speaking provinces is, of course, also a serious factor, but without minority complications. This is no criticism of past agreements; they may have been the best that could be devised. They were not so understood in Quebec, however, and too little attention was paid to the necessity of securing that widespread acceptance of the aims and objectives of the agreements, which is necessary if so significant a change in older constitutional relationships is to rest on some adequate degree of popular consent. In this issue two powerful ideas are contending for recognition — provincial self-government and federal responsibility for overall economic stability. Provincial resistance creates a countervailing power to balance federal control. Too much resistance could create economic chaos, too little might endanger federalism itself. Finding the acceptable mean is the art of Canadian fiscal policy.