MINISTERIAL DISCRETION RESURRECTED

P. N. Thorsteinsson *

The 1963 amendments to the Income Tax Act[1] introduce two provisions that are of more than routine interest to the legal community. They are contained in the new section 138A, and involve the resurrection of the all but dead phenomenon of ministerial discretion, whereby the Minister of National Revenue is vested with powers of determination that are, if reasonably exercised, for practical purposes finally determinative and not appealable to the courts.

The particular amendments are designed to deal with what were thought to be tax loopholes existing in the areas of dividend stripping and multiple companies.[2] The new section provides (italics added):

> "138A. (1) Where a taxpayer has received an amount in a taxation year,
>
> (a) as consideration for the sale or other disposition of any shares of a corporation or of any interest in such shares,
>
> (b) in consequence of a corporation having
>
> (i) redeemed or acquired any of its shares or reduced its capital stock, or
>
> (ii) converted any of its shares into shares of another class or into an obligation of the corporation, or
>
> (c) otherwise, as a payment that would, but for this section, be exempt income,
>
> which amount was received by the taxpayer as part of a transaction effected or to be effected after June 13, 1963 or as part of a series of transactions each of which was or is to be effected after that day, one of the purposes of which, *in the opinion of the Minister*, was or is to effect a substantial reduction of, or disappearance of, the assets of a corporation in such a manner that the whole or any part of any tax that might otherwise have been or become payable under this Act in consequence of any distribution of income of a corporation has been or will be avoided, the amount so received by the taxpayer or such part thereof as may be specified by the Minister shall, *if the Minister so directs*,

---

* Of the Montreal Bar.

[1] S.C. 1963 c.21.

[2] Dividend stripping refers to the various procedures that had recently come into widespread use whereby retained earnings of certain corporations could be distributed free of the tax normally attaching to dividends paid; multiple companies refers to the practice of carrying on a business through the medium of a number of separate companies, whose share structure would be carefully arranged so that all of them could enjoy the low rate of tax on the first $35,000 of taxable income provided by section 39 of the Income Tax Act.

(d) be included in computing the income of the taxpayer for that taxation year, and

(e) in the case of a taxpayer who is an individual, be deemed to have been received by him as a dividend described in paragraph (a) of subsection (1) of section 38.

(2) Where, in the case of two or more corporations, *the Minister is satisfied*

(a) that the separate existence of those corporations in a taxation year is not solely for the purpose of carrying out the business of those corporations in the most effective manner, and

(b) that one of the main reasons for such separate existence in the year is to reduce the amount of taxes that would otherwise be payable under this Act

tbe two or more corporations shall, *if the Minister so directs*, be deemed to be associated with each other in the year.

(3) On an appeal from an assessment made pursuant to a direction under this section, the Tax Appeal Board or the Exchequer Court may

(a) confirm the direction;

(b) vacate the direction if

(i) in the case of a direction under subsection (1), it determines that none of the purposes of the transaction or series of transactions referred to in subsection (1) was or is to effect a substantial reduction of, or disappearance of, the assets of a corporation in such a manner that the whole or any part of any tax that might otherwise have been or become payable under this Act in consequence of any distribution of income of a corporation has been or will be avoided; or

(ii) in the case of a direction under subsection (2), it determines that none of the main reasons for the separate existence of the two or more corporations is to reduce the amount of tax that would otherwise be payable under this Act; or

(c) vary the direction and refer the matter back to the Minister for reassessment."

The words italicized in subsection (1) and (2) quite clearly confer on the Minister a discretionary power to levy tax on what he considers to be dividend stripping transactions and artificial multiple company arrangements. When first introduced on June 13, 1963, the original budget resolution that is implemented in section 138A made no provision for appeal. Vigorous representations from outside groups, including the Canadian Bar Association, resulted in the addition of subsection (3), and also in the narrowing of the Minister's discretionary power to its present form from the rather broader form in which it was expressed in the Amending Bill at the time of the first reading.

The Income War Tax Act, which was replaced in 1949 by the predecessor of the present Income Tax Act, contained a number of

provisions conferring taxable discretion on the Minister, and a considerable body of jurisprudence developed under that statute.[3]

In response to widespread and strong public pressure, ministerial discretion was largely abolished with the implementation in 1949 of the 1948 Income Tax Act. The introduction of two new and important ministerial discretions makes worthwhile a short review of the principles to be evolved from the decided cases on the subject — which cases had otherwise all but reached the stage of being able largely to be ignored by today's tax practitioner.

What then are the basic rules governing the exercise of ministerial discretion?

It is well established in early United Kingdom jurisprudence that where a function is by statute delegated to the discretion of an administrative tribunal or administrator, the exercise of the discretion will not be interfered with by a court merely because the court, on the same facts, would have decided the question differently. At the same time, the court will intervene if the discretion has been exercised arbitrarily or upon wrong legal principles.[4]

The theory behind the first proposition is that the court is not, by substituting its view of the facts, to usurp the function of deciding that which the Legislature, which is of course supreme, has seen fit to delegate to another named person or body. The justification for the

[3] The leading cases in Canada are: *Pioneer Laundry and Dry Cleaners Ltd.* v. *M.N.R.*, 1938-39 C.T.C. 411; *Pure Spring Co. Ltd.* v. *M.N.R.*, 1946 C.T.C. 169; *M.N.R.* v. *Wright's Canadian Ropes Ltd.*, 1947 C.T.C. 1; *M.N.R.* v. *T. E. McColl Ltd.*, 1949 C.T.C. 395; *Burns & Jackson Logging Co. Ltd.* v. *M.N.R.*, 1945 C.T.C. 343; *W. J. McCart & Co. Ltd.* v. *The King*, 1938-39 C.T.C. 220; *The King* v. *Noxzema Chemical Co. of Canada Ltd.*, 1942 C.T.C. 21; *National Petroleum Corp. Ltd.* v. *M.N.R.*, 1942 C.T.C. 121; *Walkerville Brewery Ltd.* v. *M.N.R.*, 1942 C.T.C. 147; *The King* v. *Weddel Ltd.*, 1945 C.T.C. 245; *Joggins Coal Co. Ltd.* v. *M.N.R.*, 1950 C.T.C. 149; *Nicholson Ltd.* v. *M.N.R.*, 1945 C.T.C. 263; *Ross* v. *M.N.R.*, 1950 C.T.C. 169; *Davidson* v. *The King*, 1945 C.T.C. 189; *D. R. Fraser & Co. Ltd.* v. *M.N.R.*, 1948 C.T.C. 297; *J. R. Moodie Co. Ltd.* v. *M.N.R.*, 1950 C.T.C. 61; *Bond* v. *M.N.R.*, 1946 C.T.C. 281; *In Re Saskatchewan Land Titles Act* v. *Minister of Finance of British Columbia*, 1938-39 C.T.C. 332.

[4] *The Queen* v. *Vestry of St. Pancras*, (1890) 24 Q.B.D. 371; *Gardner* v. *Jay*, 29 Ch. D. 50; *Bell* v. *Crane*, (1873) 8 Q.B. 481; *In Re Durham* (1881) 16 Ch. D. 623; *Allcroft* v. *Lord Bishop of London*, 1891 A.C. 666; *Julius* v. *Bishop of Oxford*, (1880) 5 App. Cas. 214; *R.* v. *London County Council*, (1915) 2 K.B. 466; *R.* v. *Board of Education*, 1911 A.C. 179; *Roberts* v. *Hopwood*, 1925 A.C. 578; *Hayman* v. *Governors of Rugby School*, (1874) L.R. Eq. 28; *Point of Ayr Collieries Ltd.* v. *Lloyd-George*, (1943) 2 All E.R. 546; *Sharp* v. *Wakefield*, (1891) A.C. 173; *The Queen* v. *Governors of Darlington School* (1844) 6 Q.B. 682; *Spackman* v. *Plumstead District Board of Works* (1885) 10 App. Cas. 229; *Local Government Board* v. *Arlidge*, (1915) A.C. 120.

second proposition is that if the discretion can be seen to have been exercised arbitrarily or without regard to proper legal principles, then the proper discretion that the Legislature intended *delegatus* to exercise has not been exercised at all, and what was done in purported exercise must be put to right.

Decisions in the highest Canadian courts further defined these concepts in dealing with instances of exercise of ministerial discretion under the Income War Tax Act.

In *Pioneer Laundry and Dry Cleaners Ltd.* v. *M.N.R.*, 1938-39 C.T.C. 411, Lord Thankerton of the Privy Council said, at page 416:

> "Their Lordships are unable to agree with these views, and they agree with the opinion of Davis J. in which the Chief Justice concurred, and in which he states:
>
> "The appellant was entitled to an exemption or deduction in 'such reasonable amount as the Minister, in his discretion, may allow for depreciation.' That involved, in my opinion, an administrative duty of a quasi-judicial character — a discretion to be exercised on proper legal principles."
>
> In their Lordships' opinion, the taxpayer has a statutory right to an allowance in respect of depreciation during the accounting year on which the assessment in dispute is based. The minister has a duty to fix a reasonable amount in respect of that allowance and, so far from the decision of the minister being purely administrative and final, a right of appeal is conferred on a dissatisfied taxpayer; but it is equally clear that the Court would not interfere with the decision, unless — as Davis J. states — 'It was manifestly against sound and fundamental principles.' "

The question then arose, as a practical matter, as to how the taxpayer in a given case would be able to demonstrate that the minister had exercised his discretion in a way that was "manifestly against sound and fundamental principles." In the nature of things arising under the Income War Tax Act, the taxpayer, while he might have ample cause for grievious *dissatisfaction* with the minister's decision, obviously would in many cases not know what that official's reasons for it were, and he therefore in practical terms faced an impossible situation in trying to demonstrate to the court that the minister had not exercised his discretion on proper legal principles. The question whether the Minister of National Revenue, in exercising a discretion under the Income War Tax Act, had to disclose his reasons came up in *Pure Spring Company Limited* v. *M.N.R.*, 1946 C.T.C. 169. In that case Thorson, P., cited an impressive list of United Kingdom authorities and came to the conclusion that the minister need not disclose his reasons for a given exercise of his discretion, and that a presumption existed in favour of its due exercise until displaced by the taxpayer, whose onus it was to show impropriety. He said at page 210:

> "These authorities lead me to the opinion that where the appellant has not shown that the Minister has not applied proper legal principles in arriving at his discretionary determination under section 6(2) and the Minister has not given any reasons for it, the Court should assume that he acted properly; that the presumption of proper exercise of his statutory power should be applied in his favour until rebutted by clear proof to the contrary; that the onus of showing that the Minister did not apply proper legal principles is on the appellant taxpayer and that if he does not discharge it his appeal must be dismissed. No assumption that the Minister acted arhitrarily or improperly should be drawn from the fact that he did not give reasons. He is not required to do so. Since parliament has seen fit to trust the Minister with such extensive discretionary powers of a legislative nature, there is no reason, in my view, why the court should mistrust him and assume, without clear proof, that he has acted arbitrarily or otherwise abused the trust that parliament reposed in him.

This result left the taxpayer virtually defenceless against the exercise of discretion by the Minister of National Revenue, but the situation was drastically changed by the Privy Council the next year in *M.N.R.* v. *Wright's Canadian Ropes Limited,* 1947 C.T.C. 1; where Lord Greene, M.R. concluded that while the Minister may not be required by the stature to give reasons, yet he could not defeat the taxpayer's appeal merely by keeping silent. He said at page 14:

> "Their Lordships find nothing in the language of the Act or in the general law which would compel the Minister to state his reasons for taking action under sec. 6(2). But this does not necessarily mean that the Minister by keeping silence can defeat the taxpayer's appeal. To hold otherwise would mean that the Minister could in every case or at least the great majority of cases render the right of appeal given by the statute completely nugatory. The Court is, in their Lordships' opinion, always entitled to examine the facts which are shown by evidence to have been before the Minister when he made his determination. If those facts are in the opinion of the Court insufficient in law to support it the determination cannot stand. In such a case the determination can only have been an arbitrary one. If, on the other hand, there is in the facts shown to have been before the Minister sufficient material to support his determination the Court is not at liberty to overrule it merely because it would itself on those facts have come to a different conclusion."

The reason for exercise of the Minister's decision being known, the case of *D.R. Fraser & Co. Ltd.* v. *M.N.R.*, 1948 C.T.C. 297 exemplifies proper exercise: Lord MacMillan said in that case at page 305:

> "In their Lordships' opinion the Minister was entitled in exercising his discretion to proceed upon this view of the circumstances. It was an intelligible view which was both tenable and admissible and in adopting it the Minister cannot be said to have transgressed the hounds of his discretion so as to justify any interference with his decision. The criteria by which the exercise of a statutory discretion must be judged have been defined in many authoritative cases, and it is well settled that if the discretion has been exercised *bona fide,* uninfluenced by irrelevant considerations and not arbi-

trarily or illegally, no Court is entitled to interfere even if the Court, had the discretion been theirs, might have exercised it otherwise."

An example of an exercise of discretion being exercised on wrong legal principles is *Joggins Coal Co. Ltd* v. *M.N.R.*, 1950 C.T.C. 149, where the Supreme Court of Canada reversed the Exchequer Court and allowed an appeal from assessments in which the Minister had dealt with depletion allowance claimed by the taxpayer on the basis of a "complete misapprehension" of the taxpayer's position as lessee of a certain coal mine.

Despite some hopeful suggestions that the appeal provisions in section 138A(3) may in effect nullify the Minister's discretions contained in subsections (1) and (2),[5] there is widespread and fundamental opposition to the ministerial discretion that has been re-introduced into the Income Tax Act — even on the basis of its presumed temporary nature.[6]

Ministerial discretion as a taxing device obviously offers the administrative advantage of quick efficiency, and if the jurisdiction of the courts is excluded, some businessmen may regard that as no bad thing, because the costs and delays of litigation will then not arise. What then are the reasons for the opposition to ministerial discretion in the Income Tax Act?

The Canadian Bar Association brief submitted on January 11, 1964 to the Carter Royal Commission on Taxation states them this way:

"The technique of granting ministerial discretion was thoroughly discredited between 1917 and 1948 under the Income War Tax Act and should not now be condoned even on a temporary basis. The objections to discretion are as valid now as they were then. These objections may be summarized as follows:

(1) Taxpayers are unable to know what rule will be applied. Uncertainty as to tax treatment will often inhibit any action being taken with respect to a transaction even though the transaction may have a perfectly legitimate objective. It is difficult for taxpayers to plan or arrange their affairs and business activity is unnecessarily inhibited.

(2) A discretion may not be exercised in the same way for one taxpayer as for another. The knowledge or suspicion that this is the case results in a sense of dissatisfaction on the part of taxpayers against whom the discretion is exercised.

(3) The existence of ministerial discretion confers undue power on Departmental officials. Such power can be exercised against the taxpayer for reasons not related directly to the merits of the matter in respect of

---

[5] Canadian Tax Foundation Report of the 1963 Annual Tax Conference: Gwyneth McGregor at page 364, Stuart D. Thom, Q.C. at page 378.

[6] The Minister of Finance has repeatedly stated that the Government regards section 138A as a temporary provision, inserted as a stopgap measure pending the report of the Carter Royal Commission on Taxation.

> which the discretion is exercised. Such an indirect motive may influence Departmental officials either consciously or unconciously or may be suspected even if it does not exist. This creates a sense of grievance on the part of taxpayers.
>
> (4) The existence of ministerial discretion deprives persons of effective recourse to the courts except in extreme cases. The right of such recourse is the bulwark of our system of government.
>
> In the opinion of this Association these objections to ministerial discretion are valid no matter how able and well intentioned the Departmental officials are."

Objection No. (3) assumes more serious proportions when it is realized that the "discretion" is of course not exercised in fact by the Minister of National Revenue but instead by various officials within the Department who initiate assessing action. The discretion thus is not really that of the individual who happens to be the Minister of National Revenue: rather it is the discretion of the assessor at the local level who (subject of course to internal review and supervision) starts the chain of events that leads to the issuance of a discretionary assessment.

The fourth objection listed by the Canadian Bar Association is perhaps the most fundamental of all: it involves the proposition, fundamental to all aspects of law in Canada, that a man should not be judge in his own cause. The Minister of National Revenue and all his officials are tax collectors, and all of us as citizens want and expect them to behave as such — as indeed they do. But to the extent that ministerial discretion seeks to substitute the tax collector's judgment for the test of judicial review, we have one party to a taxation issue in a position also to judge that issue. That is fundamentally wrong, and if complacency exists in other circles in society, it all the more behooves the legal profession vigorously to oppose this kind of legislation.

The most pressing question that needs to be asked about section 138A is this: why was it thought necessary to insert ministerial discretion into the section at all?

Given the purpose and intent behind this kind of subjective legislation, a fair reading of the text of subsections (1) and (2) *deleting* the words underlined above seems to lead inescapably to the conclusion that the section would be fully effective without the offending words. And, even if that is wrong, and the courts in the course of normal appeal procedure disagreed with the Department and vacated a few assessments made under the section, is that such an untoward injury to the fisc as justifies this kind of departure from legal principle?