THE CANADIAN BAR ASSOCIATION
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April 24, 2003

The Honourable John Manley, P.C., M.P.
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Dear Ministers:

Re: Retroactive Legislation – Shifting Tax-Borders

We write to express our concern with the introduction of retroactive tax legislation. The most recent example involves retroactive amendments that were introduced by the federal government in the budget on February 18, 2003 in response to the *Des Chênes* case[1]. We wish to register our strong opposition to the retroactive nature of the amendments, and urge you to cure them of any retroactivity.

In making these comments, we are cognizant of the government's response to the Seventh Report of the Standing Committee on Public Accounts, which was the government's reaction to Chapter 3 of the Auditor General's 1993 Report. We comment more on that response below in the context of the retroactive amendments now being proposed in response to the *Des Chênes* case (the *Des Chênes* amendment).

[1] *Des Chênes (Commission Scolaire)* v. *The Queen*, [2002] G.S.T.C. 11 (F.C.A.).

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A. Importance of the Rule of Law

Canada is governed by the Rule of Law. The Rule of Law is imbedded in our constitution. Substantive adherence to that rule is fundamental to the very fabric of our country. Canada encourages other countries to respect the Rule of Law. We must strive to resist any erosion of this principle.

In matters of taxation, there is always an inevitable tension between the taxpayer and the Crown. The Crown wants to capture as much revenue from the taxpayer as possible.

This inherent tension makes adherence to the Rule of Law all the more important with respect to taxation matters. Taxpayers are liable for tax in accordance with the taxation laws, as they exist from time to time in this country. This obligates taxpayers to read, understand and apply the law as it is at the time of their decision. Taxpayers bear the risk of the courts not agreeing with their interpretation of the law; taxpayers must pay their taxes according to the law as the courts say it is, or was, at the time of the filing.

Similarly, the Crown must adhere to the law in its administration of tax legislation. Respect for the law would be seriously impacted if the taxpayer had to follow the law as it is, but the tax-authority did not. Similarly, respect for the law would be impacted if the tax-authority could rely on *ex post facto* retroactive adjustments to make the law read, retrospectively, as the tax-authority would prefer.

As a community, we must deal with the GST legislation as it reads. This is a dictate of the Rule of Law. We are not given the option to deal with GST legislation (or any other legislation) as we think it should read. We cannot advise clients on the basis of an interpretation that the tax-authority would prefer the legislation to have, or by reference to drafting that might come later through a retroactive amendment.

Adherence to the Rule of Law is all the more important in Canada because of the self-assessing system on which the Canadian tax system relies. In income tax matters, the taxpayer must know what transactions to report and how they will be taxed. In GST matters, both the vendor and the taxpayer/purchaser must know the nature and characterization of the transaction with which they are dealing.

This is particularly important in the GST context because it is a transaction-based tax. The participants in a particular transaction are expected to know the applicable GST implications at the time the supply occurs because that is when a decision must be made to charge and collect the tax.

B. The Challenge Presented by the GST

The GST regime has tested both taxpayers and the Crown for a variety of reasons, three of which are these.

> First, the GST is a relatively new tax. As a consequence, there have inevitably been interpretative challenges to the legislation as drafted.

Second, when the government designed the GST, it chose not to tax everything. Instead, it imposed a legislative framework that included both taxable supplies and exempt supplies. That legislative decision introduced a fundamental distinction into the GST legislation that requires taxpayers to determine whether the GST is to apply to a particular supply or whether the particular supply is exempt — in other words, on what side of the "tax-border" the supply falls.

Third, the GST regime is very complex. That simple reality imposes an added burden.

C. The *Des Chênes* Case

The *Des Chênes* case involved a challenge to a particular tax-border in the GST legislation. The taxpayer in the *Des Chênes* case asserted that the money received, under particular terms, to provide school bus services was received in the context of a "commercial activity", since its supplies were taxable supplies. The taxpayer successfully advanced that argument in the Federal Court of Appeal. As a result, the taxpayer in the *Des Chênes* case was entitled to recover all of the GST that it had incurred on the relevant purchases, rather than just a percentage thereof.

The Department of Finance did not believe that the result in the *Des Chênes* case was appropriate and has proposed the *Des Chênes* amendment. That amendment would displace the judicial finding in the *Des Chênes* case, thereby making the decision irrelevant. Indeed, with very few exceptions, the effect of the *Des Chênes* amendment will make the judicial finding in *Des Chênes* irrelevant both going forward and also on a retroactive basis.

The *Des Chênes* amendment provides that a supply of a service of transporting elementary or secondary school students to or from school that is operated by a school authority is an exempt supply. As a result, the GST incurred on the corresponding purchases (inputs) will not be fully recoverable. **These amendments are stated to be effective December 17, 1990, and are explicitly stipulated to be effective notwithstanding any court case rendered after December 21, 2001.**

The *Des Chênes* case is really a dispute concerning the tax-border that is inherent in the GST framework. The very existence of that tax-border dictates the need to determine the character of a transaction, whether the GST applies to the transaction, and at what rate the tax applies, if any. Coincidently, there is a need to determine whether the maker of the supply in the transaction is entitled to recover the GST incurred in the course of making such supplies.

By introducing the tax-border into the GST framework, the government imposed an interpretive challenge on us all. That tax-border, and all other such borders, will always be a challenge.

The proposed *Des Chênes* amendment is a message to taxpayers that they cannot rely on correct interpretations of the tax-border in the context of the law as written. That message places taxpayers and their advisors in a perfectly untenable position. Are we to ignore the tax-border? Are we to ignore the law? Are we obligated to interpret the actual legislation in accordance with how a government official interprets, or would prefer to interpret, the particular provision? What are we to do if the government's preferred interpretation is not supported by the black letter of the statute or precedent or even a court's final decision on the very point? Should we simply

seek advice and direction from government officials in every circumstance and follow it without question? These are important and relevant questions in the context of the *Des Chênes* case. All of us should prefer negative answers to these questions.

D. Inappropriateness of the Retroactive Nature of the *Des Chênes* Amendment

We have a number of concerns about the *Des Chênes* amendment. While we do not doubt the jurisdictional ability or power of Parliament to make this proposed retroactive amendment, we are persuaded that the policy behind any such retroactivity is deeply flawed and dangerous. Accordingly, we feel compelled to express our strong views on the matter.

First, the *Des Chênes* amendment will interfere with vested rights. That would be a "grave injustice". As noted in *Outremont (City)* v. *Outremont (City) Protestant School Board*[2]:

> [A] vested or accrued right is a claim or interest that cannot be defeated without causing grave injustice; it is something that should be protected because to take it away would be arbitrary or unfair.

In the context of vested rights, we must now consider the prospect of the tax authorities reassessing School Boards and recovering GST that has already been allowed. We are also concerned with the fact that the *Des Chênes* amendment includes an amendment that will invalidate judgments consented to by the Crown before and after the budget of February 18, 2003 was tabled.

Interfering with vested rights is only justifiable in the rarest of circumstances. For reasons touched on throughout this letter, such rare circumstances do not exist in this case. A prospective amendment, if any, should be more than adequate to address the characterization of the narrow category of relevant services.

Second, the *Des Chênes* amendment is troubling because of its origins. Part of the tax authorities' concern in the *Des Chênes* case arose from the fact that the funding for the service in question was government-sourced. The *Des Chênes* amendment would require taxpayers to speculate whether other, specifically tailored, retroactive amendments will be introduced for other goods and services that also are government funded.

Having created a legislative distinction between taxable and exempt supplies that is not always clear, it is not appropriate in our view, when its interpretation is not upheld by the courts, for the government to introduce a retroactive amendment. Since it drafted the rule, the government should shoulder the inherent burden that flows from the legislative structure. If it does not do so in this instance, then we can only assume that future retroactive amendments will be forthcoming when taxpayers explore the legislative boundaries of the tax, or simply rely on a reasonable interpretation of the law as written, and successfully assert positions with which the tax-authority does not agree. That would be an unjustified intrusion of the Rule of Law, and would attack the very foundations on which taxpayers file millions and millions of tax returns in good faith.

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[2] [1951] Que. K.B. 676, at 692; aff'd [1952] 2 S.C.R. 506 (S.C.C.).

Third, the retroactive aspect of the *Des Chênes* amendment violates a fundamental principle of taxation, that is tax certainty. Taxpayers must have stable tax laws in order to be able to arrange their affairs in an appropriate manner. Retroactive amendments are unfair, and they have the additional cost of eroding the ability of a taxpayer to deal with their tax affairs appropriately and eroding general confidence in the tax system as a whole.

The importance of the principle of certainty has been recognized and applied by the Supreme Court of Canada as recently as March 6, 2003 in the *Markevich* case.[3]

E. Measuring the Crown's Response Against its Stated Policy

1. Government Position

We now address the *Des Chênes* amendment in the context of the response made by the government to the Seventh Report of the Standing Committee on Public Accounts. In that document, the government asserted that retroactive tax legislation was appropriate when one or more of the following elements are present:

(a) The amendments reflect a long-standing well-known interpretation of the law by the Department of National Revenue (now the Canada Customs and Revenue Agency (CCRA));

(b) The amendments reflect a policy that is clear from the relevant provisions and that is well-known and understood by taxpayers;

(c) The amendments are intended to prevent a windfall benefit to certain taxpayers;

(d) The amendments are necessary to preserve the stability of the Crown's revenue base; or

(e) The amendments are corrections of ambiguous or deficient provisions that were not in accordance with the objects of the taxing statute.

2. CBA Response

We respond to each of the government's assertions in the order they are listed above.

(a) This criterion ought to be irrelevant. CCRA is not the arbiter of the law, but the enforcer of it. CCRA ought to enforce the law as the courts find it to be and to have been. It should not seek to make judicial decisions irrelevant. In any event, there is no long-standing well-known interpretation of the law in this tax-border area. The simple truth is that it took many years after the introduction of GST for taxpayers and the Crown even to address the specific issues decided in *Des Chênes*.

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[3] *Markevich* v. *Canada*, 2003 S.C.C. 9.

Moreover, the Federal Court of Appeal decision in *Des Chênes* is in accordance with the Technical Notes (May 1990) that were issued in respect of the contested provision.

(b) The policy behind the taxation of grants is not clear. That is why CCRA issued *Technical Interpretation Bulletin* B-067 - "Goods and Services Tax Treatment of Grants and Subsidies" on August 24, 1992. That policy statement goes beyond the black letter law, necessarily inviting a challenge to the premises stated therein. It is a valid question whether taxpayers are obligated to follow the Rule of Law or administrative policy. Further, the direction provided in *Technical Interpretation Bulletin* B-067 is itself very non-specific, creating its own uncertainties.

(c) But for the *Des Chênes* amendment, certain taxpayers would admittedly incur less of a tax burden. We note, however, that the financial benefit that such taxpayers enjoy would be no more than they would be entitled to under the ETA as it read at the relevant time (before the retroactive amendment was introduced).

The primary beneficiaries of the *Des Chênes* case were expected to be public sector bodies. The financial benefit that should have been enjoyed by these public sector bodies as a result of the *Des Chênes* case would likely have been only a modest increase in the GST recovered because a significant component of the GST incurred on purchases (inputs) would already have been recovered. Any such incremental increase in the GST so recovered would have relieved pressure on their budgets, thereby allowing such public sector bodies a few more financial resources to assist them in the delivery of their programs. This is hardly a "windfall".

(d) The results of the *Des Chênes* case (but for the *Des Chênes* amendment) would have been a welcome (*albeit* likely modest) increment to the cash flow demands of a public sector body. It is difficult to imagine that the aggregate financial consequences to the Crown of this narrow issue are significant enough to warrant the retroactive aspect of the *Des Chênes* amendment.

(e) We could debate the issue whether the *Des Chênes* amendments correct ambiguous or deficient provisions of the ETA. The better view is that the *Des Chênes* amendments merely change a very narrow component of the tax-border between exempt supplies and taxable supplies. In any event, all amendments presumably correct ambiguities or deficiencies in the original rule.

F. Conclusion

Given the legislative framework in Part IX of the ETA, there will always be borders and distinctions that must be dealt with by taxpayers and the Crown. By legislating in the manner proposed in the *Des Chênes* amendment, tax certainty has been all but eliminated.

This amendment signals that every time the tax-border is successfully challenged by a taxpayer, we will be subject to the possibility of a retroactive amendment that would destroy vested rights. This is troubling. If poor drafting or unintended and unforeseen tax consequences are to be neutralized through the use of retroactive amendments, the principle of tax certainty can no longer be relied on by taxpayers

If the retroactive aspect of the *Des Chênes* amendment is not removed, it raises the spectre of a substantial tax compliance concern. That retroactive aspect seriously undermines our tax system.

There is no justification for the retroactive nature of the *Des Chênes* amendment, and every reason to consider it highly dangerous to the Canadian tax system, its administration, its competitiveness, and to Canada's attachment to the Rule of Law.

We would welcome the opportunity to meet with both of you to discuss the importance of this matter in greater detail.

Yours truly,

Simon V. Potter