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INTRODUCTION TO INCOME TAX POLICY FORMULATION: CANADA 1972-76

By A. B. C. DRACHE*

A. INTRODUCTION

The decade ending on December 31, 1971 saw the most intensive discussion of tax policy and theory which has ever taken place in Canada, or perhaps any country. On January 1, 1972, the "reformed" *Income Tax Act* became effective, bringing to an end the debate initiated by the Carter Royal Commission, and continued by the White Paper and the Parliamentary debates. Yet it is arguable that the period since 1971 has produced more change in the *Income Tax Act* than did the reform period. Much of this, critics charge, was an undoing of reform. Others suggest that the most significant reforms, including tax indexing, took place after 1971. Whatever one's philosophical view of the changes, it is unarguable that the volume of post-1971 changes is immense and that the amendments were very often fundamental.

The purpose of this article is not to examine the nature of the changes which took place during this period, but rather to consider the inputs involved in making the changes. These inputs are significant since, in contrast to the openness of the tax reform decade, they are mostly hidden from view. A brief review of the criteria considered in enacting statutory amendments and the various groups, in both the public and the private sectors, which have input into the decision-making process will provide a useful starting point from which to consider the other articles in this issue dealing with specialized areas of tax policy.

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B. AMENDMENT PROCEDURES

Amendments to the *Income Tax Act* are publicly proposed in the Budget address and the Ways and Means motion which accompanies the Budget. The decisions which go into amending the Act are made anywhere from several months to a few days before the Budget is presented. The largest group of amendments are nonbudgetary or technical. The process of dealing with these begins soon after the previous Budget has been announced. It is primarily an internal operation within the Department of Finance: most of the decisions are made by officials rather than the Minister. In the vast majority of cases, ministerial approval is *pro forma*.

The second group of amendments are the budgetary changes, the high profile amendments which highlight any Budget.¹ The budgetary items are usually dealt with in the period between the announcement of the Budget and the delivery of the Budget Address. These items tend to involve much more input from the senior officials and from the Minister of Finance and his colleagues.

While work on the Budget ranges over many branches of the Department of Finance, the vast majority of the work done on the *Income Tax Act* is done by the Tax Policy and Federal-Provincial Relations Branch. Three divisions of this Branch have been primarily responsible for amendments to the Act: the Business and Corporations Division, the International Division and the Personal Tax and Quantitative Analysis Division.² The personnel of these divisions consisted primarily of lawyers and accountants, although a few economists were added to do quantitative analysis. During the period 1973-75, lawyers and accountants were evenly represented; recently, however, a number of lawyers have left, and most of the replacements have been accountants.

The usual practice is to allocate an area of specialization to each officer so that there is at least one person familiar with its problems. This has resulted in individual officers having a considerable amount of influence in their area. Thus the key person behind any nonbudgetary change may be a junior officer who nevertheless commands the confidence of his seniors. For most of the technical amendments, the officer in charge will prepare a memorandum which sets out the problem, his analysis and a recommendation. These memoranda are compiled in a single volume, "The Black Book." Prior to a Budget, the Black Book recommendations are reviewed at a meeting attended by the officer in charge, his superiors, and the Assistant Deputy Minister. Each memorandum is examined and a decision is made as to whether to proceed with a statutory amendment.

At a later stage, all the recommended changes are brought together into a "Budget Black Book" for presentation to the Minister. This presentation will usually be made by the Assistant Deputy Minister, who may or may not be accompanied by some of the other officers in the Department. If the Minister

¹ These terms are used internally in the Department of Finance but it should be noted that the distinction is not always clear-cut.

² Over the years, these divisions have been reshuffled and undergone various name changes.

approves, as he does of more than ninety-five percent of the technical changes, the officer in charge is then required to prepare a draft of the legislation. Ultimately, this draft becomes the working draft which is submitted to the Department of Justice for the final drafting of the Bill, along with the original memorandum and any other notes which the officer thinks the Justice draftsman should have. After the Justice draft has been completed, it is reviewed at a meeting of the Justice draftsman, the officer from Finance in charge of the amendment, and representatives from Revenue Canada who will have the task of translating the legislation into practice.

C. CRITERIA APPLIED TO STATUTORY AMENDMENTS

1. *Objectives of the Tax System*

Because of the nature of the decision-making process, the criteria which are applied will differ from situation to situation. The classic objectives of a taxation system include equity, neutrality, administrative feasibility, and maximization of revenue yield. The weighting of these elements will vary from individual to individual; when a superior overrules a subordinate, it is often because he has given a different priority to one factor.

(a) *Equity*

Despite what the cynics might claim, in the vast majority of issues considered, equity is a major factor in the determination of the result. However, equity is rarely discussed in an abstract manner; rather, the discussions are approached in the light of "fairness," "discrimination" and the possibility of conferring undue advantage.

No amendments are made without some discussion of these factors, but the question of tax equity is itself a subjective matter, and therefore the application of equity as a criterion does not of itself resolve problems.

For instance, the original deduction under section 110.1 was for up to \$1,000 of interest income.³ It was designed, in part, to protect a modest amount of capital from the effects of inflation. That is to say, it was assumed that if one had \$10,000 of capital yielding ten percent and the rate of inflation was ten percent, it would be "inequitable" to tax the yield. Of course, there were those who argued that the deduction itself was "inequitable" because it gave no relief to those who did not have the capital to protect, that it was a rich man's deduction. When the deduction was introduced for a second time in November, 1974, it included \$1,000 of "grossed-up" dividends. This change again was made for reasons of "equity." First, it was held to be "unfair" to give relief only to those who held debt, as opposed to those who held equity for investment purposes. Second, the amendment was equitable in that it would reduce the incentive to invest in debt (rather than equity) which had been created by the original proposal, and was thus "fairer" to the equity markets. There is room for argument as to whether equity was served or destroyed by the original deduction and by the extension.⁴

³ This proposal was announced in the May 1974 Budget, effective retroactively to January 1, 1974.

⁴ For fuller discussion of this provision, see M. A. Cohen, *Tax Simplification* (1975), 27 Can. Tax Foundation Tax Conference 7 at 7.

Issues of equity were not limited to major amendments such as the interest dividend deduction. Most of the technical amendments dealing with "anomalies" really represented the elimination of situations in which tax was exigible if a transaction occurred in one manner as opposed to another, although the economic or social effect might be identical. This differential treatment was considered "unfair" and the Act was amended scores of times to eliminate such anomalies. Such amendments as the changes in the taxation of "deemed residents," usually service personnel overseas, were based on equitable considerations. Prior to the amendment, deemed residents, who were taxed as if they were resident, were precluded from taking certain deductions because the expenses were not incurred in Canada.

The major obstacle to achieving equity is the fact that full equity means a highly complex Act. Most of the arcane provisions of the Act result from the attempt to achieve fairness. The Act often starts off with a broad rule, in many instances a harsh rule, and then provides exceptions to it on the grounds of fairness. As more and more situations appear to be analogous to those for which an exception has been granted, more exceptions are made. The end result is that the provision becomes complex in the extreme.⁵ The officers are thus faced with the task of fulfilling the equity goal at the cost of simplification or, conversely, abandoning changes which might be desirable in policy terms but are too complex to administer. At least one major change to the child care expense deduction, which was approved at all levels on policy grounds, was abandoned because the required legislation would be so complicated as to defy understanding.

(b) *Administrative Considerations*

The ability of Revenue Canada to administer a provision, and of taxpayers to comply with it, must be considered. Revenue Canada frequently objected to a provision on administrative grounds, and, in many cases, Revenue's objection was enough to kill a proposal for a technical or low-level budgetary change. However, Finance was often sceptical of this type of objection from Revenue because it was felt that, as a bureaucracy, Revenue would almost invariably react negatively to changed procedures. From time to time, changes were forced through which Revenue said could not be handled administratively, but with which it subsequently managed to cope.⁶

Taxpayers' complaints about their inability to comply with a provision carried little weight, though occasionally such complaints were heeded. The problem in this area was often that large organizations could cope with changes, while smaller ones claimed they could not.

⁵ *Id.* at 9. For example, the Act states that when a person dies there is a deemed realization of his capital assets, resulting in a capital gain or loss. Then a special rule creates an exception when the property is left outright to the deceased's spouse. This in turn requires rules which govern the tax consequences on the death of the spouse. A parallel set of rules must be applied in cases where the property is left in trust for the spouse. This necessitates exceptions to the normal trust rules for spousal trusts and the application of different rules when the spousal trust property is distributed. So starting from a basic rule, we arrive at a battery of provisions designed to recognize the fairness of not taxing property when it passes to a spouse.

⁶ This was particularly true of the two sets of proposals in 1974.

(c) *Cost*

Most of the amendments which are made to the *Income Tax Act* are essentially costless since they deal primarily with technical matters and the ultimate cost, if any, is so remote as to be unmeasurable. For example, a particular change may delay the imposition of a tax from the date of a taxpayer's death until the date of the death of his wife. The cost of such a change cannot, in practical terms, be computed.

Yet clearly there are situations in which cost is a factor. One of the roles of the quantitative analysis unit is to try to determine the cost of a proposal. The estimates are often sheer guess work, simply because no estimate can be made of public reaction to a new programme.⁷ In other cases, the unit can estimate the cost with total accuracy. Normally, major cost items are treated as budgetary matters. Interestingly enough, the fiscal stance of the Budget dictates whether cost is a negative or positive factor in deciding whether a change should be made. In some years, the government must, to use Departmental jargon, "give away" hundreds of millions of dollars. In such a case, the fact that a particular amendment might be high cost, i.e., the government will forego substantial revenues, will be an attractive feature. In other years, when there is a need to raise taxes, high cost items are abandoned and technical changes which have the effect of raising revenues are welcomed by the Department.

It should, however, be pointed out that often even technical changes may have a high cost. For instance, it was once proposed that the personal deduction of immigrants and emigrants no longer be prorated by the number of days they were resident in Canada.⁸ This was viewed as a minor simplification of the tax returns. When the proposal was costed, as are all proposals which may have a cost factor, it was found that this simplification would cost tens of millions of dollars in a year of belt tightening. The suggestion was dropped.

2. *Political Considerations*

In dealing with technical amendments, little consideration was given to political ramifications, primarily because such amendments have little impact on the public at large and also because politicians are rarely in a position to assess the consequences of technical amendments. Political considerations did come into play to the extent that almost every amendment, technical or otherwise, was assessed from the point of view of who would benefit and who would bear the burden. The timing of the amendments, even technical changes, was also viewed in the context of political considerations, which is why so-called relieving amendments are often put into effect retroactively, while tightening amendments never come into effect before Budget Day. It should be pointed out that the officials looked at the effect on individuals, not so

⁷ For instance, nobody could accurately predict what percentage of those taxpayers who were *eligible* would make a contribution to a registered home ownership savings plan, nor how many who did contribute would make the maximum deduction. Indeed, there was no way to accurately determine how many were eligible for the plan.

⁸ That is, immigrants and emigrants would be treated in the same manner as a couple who marry in the year or who have children born in the year.

much from the point of view of generating votes, or the possibility of losing them, but rather in regard to the equities of the situation. The Minister will rarely turn down a technical amendment for "political" reasons.

The one general exception to the nonpolitical approach to technical amendments arose during the period between the end of October, 1972 and May, 1974, when the government was in a minority position. At this time, the officials were very conscious of technical amendments which might offend the philosophy of the New Democratic Party, who held the balance of power. In preparing assessments of proposed tax changes, officials felt constrained, although it was a self-imposed constraint, to point out any particular change which might produce a negative reaction from the NDP. Many modifications were made to draft proposals to avoid unnecessarily offending the opposition throughout this period.

Budgetary changes, of course, were viewed in an entirely different context. Such changes were usually instituted "from the top," and therefore the lower echelon officials had little to do with the decision-making, other than making technical assessments. Budgetary proposals were assessed in terms of their economic and political impact. Where the changes were relieving in nature, or were likely to produce a positive public reaction, they were highlighted in the Budget speech and in the supplementary materials provided to the press, and were put at the beginning of the Ways and Means motion. Normally, the Ways and Means motion roughly follows the order of the provisions of the Act, but high profile items are usually placed near the beginning.

A classic example of the effect of political considerations on budgetary proposals was the Budget of May, 1974, which was defeated, leading to the July, 1974 election and the return of majority government. Probably no Budget document in recent years contained more attractive provisions for the majority of Canadian taxpayers. The government was fortunate in its timing in that, as a matter of fiscal policy, it wanted to reduce taxes and encourage savings. This Budget introduced such items as the interest income deduction, the registered home ownership savings plan, the spousal registered retirement savings plan, and a host of other taxpayer benefits. The government expected the Budget to be the basis of its election campaign, and these provisions were drafted as broadly as possible. It is not surprising, therefore, that by 1977, each of these three major provisions has had to be substantially revised to close up "loopholes" which the original draftsmen knew were present, but were instructed to retain.⁹

When the November, 1974 Budget was being drawn up, the orders were, in effect, to retain everything from the defeated Budget but to liberalize certain provisions. Thus, for instance, the interest deduction was extended to cover dividends. This approach was taken in the belief that, since the campaign had been waged in part on the aborted Budget, it would be unconscionable to retreat from the provisions which had *de facto* become part of the campaign platform.

⁹ In the 1977 Budget, each of these three 1974 amendments were significantly tightened up, leading some observers to believe that there would be no election before at least a "mini-Budget" was presented.

3. Federal-Provincial Factors

Bearing in mind that nine provinces base their income tax on Federal tax, it is interesting to note that, for the most part, amendments were considered without taking into account the provincial ramifications. Even fundamental changes, such as the indexing of the tax system, were in fact imposed upon the provinces without consultation; this led to a number of public confrontations.¹⁰ The most significant situations in which provincial factors were considered were those in which amendments were made to combat provincial actions, most notably in the celebrated fight over resource revenues between Ottawa and the Western provinces. It should be pointed out that there were a number of other occasions when Ottawa refused to give taxpayer deductions for costs imposed unilaterally by a particular province, on the ground that taxpayers across Canada should not be forced to share the costs of programmes, the benefits of which would accrue to only one province.¹¹

The Department was faced with another technical difficulty which arose from the fact that provincial law varied. A provision based on the law of Ontario would not have the same effect in some of the other provinces. For instance, under the various provincial statutes governing the disposition of property on death, a direction in an RRSP contract that, in the event of the death of the annuitant, the property pass to his spouse, was accorded different treatment than a similar testamentary disposition. In some provinces the contractual provision was valid, in others it was void. When such discrepancies were identified, and officials at Finance were satisfied that there was no alternative, the provisions of the *Income Tax Act* would be amended.

The lack of formal federal-provincial coordination on tax policy could be rationalized in two ways. First, the concept of Budget secrecy demanded that there be no consultation with respect to most issues. Second, even if consultation could take place, it would probably have been impossible to obtain a consensus on all changes. There was, however, a fair amount of general discussion between Ottawa and the provinces at all levels on various tax policy issues, and it cannot be said that Ottawa was unaware of the probable provincial reaction to proposed changes. There was regular informal contact between lower level officials throughout the year, so it is fair to say that, in the context of major issues, Ottawa was quite aware of the provincial positions, even if the province's position was not adopted. In the context of conflict between federal and provincial legislation, it became clear that Finance did not have enough lawyers versed in areas of the law other than tax law, and that too few of the provinces were represented. Most of the Finance lawyers were educated in Ontario, Quebec, and Manitoba, and had no general legal experience outside the tax area.

¹⁰ See, for example, the contrasting views presented by officials of the federal and Ontario governments in J. R. Allen *et al.*, *Indexing the Personal Income Tax: A Federal Perspective* (1974), 22 Can. Tax J. 355.

¹¹ Typical of such a case would be a situation in which a particular province would impose a levy in some form, either directly or indirectly, on a group within the province and the group would ask for a tax deduction. In all cases, such deductions were denied unless they fell within general existing provisions of the Act.

Finally, there were conflicts both within the Act itself and in relation to other federal statutes. For instance, a Canada Savings Bond was a qualified investment for a registered retirement savings plan, but prior to 1975, could not be owned by a trust.¹² In this case, the rules relating to the holding of bonds, rather than the tax rules, were changed.¹³

D. POLICY FORMULATION

1. *Sources of Input into Nonbudgetary Amendments*

By far the majority of nonbudgetary changes originate from within the Tax Policy Branch itself and from Revenue Canada. The tax policy officers are more aware of the intricacies of the Act as it applies to their own specialties than any other single group in Canada, and a substantial portion of their time is spent considering what changes may have to be made in their areas. This process is complicated by the fact that changes in approach in one area often necessitate changes in other areas, either to keep the overall approach of the Act consistent or because a technical change will create problems in another area. For instance, once it was decided to introduce the \$1,000 interest/dividend deduction, consideration had to be given to the degree of "flow-through" of these types of income from trusts, partnerships, mutual fund corporations and employee profit sharing plans. These changes are usually termed "consequential" in that they do not reflect a significant change in approach *per se*, but rather are consequential upon a decision having been made in an unrelated area.

Revenue Canada, of course, deals directly with the taxpayers and is therefore aware of administrative difficulties, assessment problems and the latest "schemes" of taxpayers. This department also receives many of the complaints made by taxpayers, which are passed along to Finance. The officers in Revenue's Current Amendments Division (formerly known as Tax Base Research) and Finance's Tax Policy Branch are in touch with each other on a daily basis. While Revenue has many more officers working in the area of tax policy than does Finance, the organization is similar, with areas of responsibility being given to specific officers. As a result, the tax policy officers can identify their counterparts at Revenue, and discuss problems with them. It should be stressed that, for the most part, Revenue does not take part in policy decisions. Revenue will set out the problem, whether it be administrative or otherwise, leaving it to the Finance officials to do an assessment and make the final recommendation. However, Revenue's desire for a change in the law is a factor in determining whether a particular change will be made.

Occasionally, when it is agreed that a change is urgently needed, one of two procedures may be adopted. A formal press release may be issued by Finance indicating that a change will be made in the next Budget effective on a certain day, usually the date of the press release.¹⁴ More often, however,

¹² Under the rules relating to bond sales this limitation was imposed to prevent one trustee from "dumping" large quantities of C.S.B.'s at one time.

¹³ But the changes were limited to allow only deferred income trusts to hold the bonds, and even then, under strict rules.

Finance may simply assure Revenue that a particular change will be made in the next Budget, retroactively, and Revenue will instruct its officials to act as though the change had already been made.

Interpretation Bulletins issued by Revenue are usually sent to Finance for clearance, but it would appear that Revenue does not consider itself bound by Finance in its interpretation of the law; occasionally it will even issue such a Bulletin without Finance's concurrence. This may be one of the reasons that Bulletins are issued which, immediately after the next Budget, are inaccurate.¹⁵

There is a constant input of ideas from other government departments, usually relating to their own projects. One of the most common methods for any department of obtaining public acceptance of a project is to grant tax concessions. Proposed tax concessions were usually rejected by Finance unless there was a Cabinet directive to the contrary. Such a directive was itself rare because the Minister of Finance would usually oppose such a measure in Cabinet, and would seldom be overruled.

The Secretary of State, however, successfully requested major changes to the Act concerning aid to the Canadian film industry and restrictions on the solicitation of advertising by foreign media. Finance officials opposed these concessions but were ultimately overruled. The same Secretary of State was nevertheless able to enlist key Finance support for the tax concession given with respect to the disposition of Heritage properties, and was able to enlist the aid of Finance personnel in the drafting of the provisions in a nontax Bill.

As a general proposition, however, Finance officials resented the attempts of other departments to use the *Income Tax Act* for their own purposes.¹⁶

Parliamentary input into the policy-making process was minimal, primarily because few members of Parliament had the requisite technical knowledge to make useful suggestions in other than budgetary areas, and the budgetary areas were essentially reserved for the Minister himself. Letters from M.P.'s and Senators were always graciously answered, but carried little weight with the officials. Opposition questions in Parliament, and remarks during Budget debates, were always monitored so that the Minister could reply to them, but for the most part they were not given significant weight in evaluating amendments (except to a limited degree during the period of the minority government from 1972-74).

On the other hand, the Senate Committee on Banking, Trade and Com-

¹⁴ This is most common where the changes are to the Regulations.

¹⁵ See for instance, Interpretation Bulletin IT-178R. Paragraph 11 states that no deduction may be claimed for new home purchase expenses. Bill C-56 proposes to change that, retroactive to January 1, 1977. The Bill was tabled on June 15, 1977. The Bulletin is dated July 4, 1977.

¹⁶ Other departments may also have an input through so-called inter-departmental committees which are often set up to study specific problems of broad interest. The reports of such committees are, however, not binding on Finance unless backed up by some Cabinet directive.

merce was accorded respect, as much for its experience as for its status. Senators like Salter Hayden and Laz Phillips were acknowledged as having expertise, and the committee usually had counsel with the resources of a top-notch law firm behind them. Committee counsel always consulted with Finance officials before the hearings took place, so that there was no risk of mutual embarrassment. On a number of occasions, so as not to delay the Bill currently under discussion, Finance officials would undertake that a particular amendment would be made in the future, and such undertakings were always recorded and honoured. Among most of the officials, the Senate committee was held in greater respect than any other Parliamentary body, both for its capabilities and for its impartiality.

Most backbenchers, whether part of the government or in oppositions, played no role in policy formation. However, the government caucus did have the power to force through amendments in the Act. The power of the caucus was illustrated during the second reading of the November, 1974 Budget Tax Bill in January, 1975. The Bill contained the interest/dividend deduction, which was structured so that the deduction applied only to net interest/dividend income, i.e., net after interest charges had been deducted. This was intended to ensure that one could not borrow money to generate the interest, which would be tax-free, but deduct the interest on the borrowed money. During internal discussions, Revenue indicated that this approach was necessary from an administrative point of view because they could not determine how the proceeds of any particular loan were used, except in the most simple cases. The Minister at the time, the Honourable John Turner, concurred.

Once the Bill became widely known, however, he came under sharp attack in his own caucus, particularly from those members representing rural ridings, since farmers, who were for the most part unincorporated, often had a heavy interest burden in respect of their farm operations which would eliminate any benefit under the new deduction. Turner capitulated and the deduction became a gross deduction, leading to an increase in borrowing in order to generate tax deductions.

Tax officials were amazed at his capitulation. One ventured that Turner must be on his way out if he could not muster the strength to beat back a few dissidents in caucus on a matter of such fiscal importance. Though Turner did present one more Budget, he did in fact leave within ten months of the incident.

The Cabinet itself had relatively little input into tax policy. While the Minister consulted the Prime Minister in advance of the Budget, the Cabinet would learn of the contents just a short time before Budget Day, usually when there was little time for change. Occasionally, a Cabinet colleague would convince the Minister of the need for a particular change in the Act of a technical nature. For instance, some of the partnership changes relating to retired partners were made primarily because the Minister of Justice was having trouble getting senior lawyers to accept judgeships because of the tax consequences of leaving a practice.¹⁷ But even this sort of change was ap-

¹⁷ Most notably, sections 96(1.1) and 98.1.

proved by Finance officials from a technical point of view, and it was more common for the Minister of Finance to send a sympathetic letter to a colleague about a recommended change, without committing himself. Happily for him, the tradition of Budget secrecy could be relied upon to ensure that no formal commitment had to be made.

A significant source of outside input into tax policy was the series of annual meetings between various interest groups and either officials or the Minister. Typical of these are the annual meetings with the Chamber of Commerce, the Canadian Labour Congress, and most importantly, the Joint Taxation Committee of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. Where the meeting is well organized, the written brief will be submitted to the department sometime in advance, so that the specific proposals can be assessed and appropriate responses prepared for the Minister.

The annual session with the Joint Committee is the most important of these meetings for a number of reasons. The proposals are usually very technical and it is in this area that a change is most likely to be made. All officials, down to the most junior level, attend the meeting to discuss mutual problems. The Committee itself is usually made up of genuine experts, not merely the titular heads of the two organizations, and the continuity of membership on the Committee helps in dealing with recurring problems.

In addition to annual meetings, delegations are often sent by various industries or interest groups to discuss particular problems. Groups representing the insurance industry, trust companies and investment dealers often meet with officials. These groups have apparently recognized that in terms of both technical changes and budgetary changes, the key element in success is convincing the officials of the merit of their position. Meeting the Minister does not necessarily produce results, except in terms of mutual public relations.

Tax policy officials carefully follow all published material about the tax system. Periodicals from Canada and abroad are closely read and widely circulated. In addition, Revenue Canada has a newspaper clipping service, and the clippings are circulated within the Tax Policy Branch. The foreign publications are primarily of interest to those dealing with international taxation, although ideas from abroad are occasionally considered for possible application in the domestic system. Canadian articles are very closely read, but are seldom helpful, either because the author is unaware of the ramifications of his recommendations, or because his ideas have already been drawn by Finance from some other source.

Speeches at various tax conferences, notably those given at the Canadian Tax Foundation annual conference, also receive careful attention. Primarily this is because the speakers are of an extremely high calibre, and because the speeches tend to be highly technical. In practical terms, a forty minute address on "tax simplification" is of little use, while a forty minute address which indicates that one paragraph of the Act does not mesh perfectly in all circumstances with another subsection may be extremely useful. Accordingly, Finance assigns one of the attendees at the Tax Conference to get copies of every address at the time of the conference, rather than wait six or eight months until the report is published.

A few words relating to the influence of case law on amendments may be appropriate. The lawyers in Tax Policy follow the reported cases and will occasionally react to a major decision. A decision which seems contrary to policy may be pushed aside as an anomaly based on its specific facts. Only when such a decision relates to the drafting of the statute and appears to have wide ramifications will amendments be made. Classic examples of such changes were the statutory amendments made as a result of the *Wipf*¹⁸ and *Quinn*¹⁹ cases. Revenue is careful to bring significant unreported decisions to the attention of Finance. Occasionally, Finance may even be consulted as to whether a particular case should be appealed, although there is no evidence that Finance's views on the subject will necessarily be followed.

As has been stated, Revenue is the Department which has the most direct contact with the public, but there is a large flow of correspondence from the public directed to the Minister of Finance, and occasionally to the Department, dealing with tax matters. These letters cover everything from proposing major changes in the tax system to small technical problems. The vast majority of these letters are answered by the "letter writing unit" of the Information Services Division. However, a significant percentage of the "tax" letters are technical in nature and are answered by the Tax Policy Officers. Indeed, one of the most onerous aspects of the officer's work is the drafting of replies. Many letters deal with the same questions, and at one time a book of form answers was produced dealing with about fifty recurring issues, such as making Canada Savings Bond interest tax free, doing away with the life annuity requirement of registered retirement savings plans, making employee expenses deductible on an itemized basis and so forth.

Rarely is a letter from a member of the public instrumental in bringing about a change in the law. Letter writing campaigns are for the most part counter-productive, because they have the effect of irritating everyone involved without convincing them that there is a real commitment to change among a substantial number of taxpayers. Occasionally, however, a letter raises a new issue which does in fact go into the Black Book. A point may arise out of a recent change to the Act which has had an unexpectedly negative effect in some obscure situation.

One of the most important sources of public input is the result of a relatively new technique which is being employed by Finance: the solicitation of response to a paper issued by Finance. The solicitation may be made in a number of different ways, such as a Green Paper, the issuance of a press release or a private request. In the past few years, this approach has been taken with charities reform, the capital cost allowance system, the sales tax system, and every new treaty negotiation. In each case, Finance has had its own views on what should be done, but wanted a better idea of what was actually going on "in the real world." It should be stressed that these are not

¹⁸ *The Queen v. Wipf* (1976), 30 D.T.C. 6059, affirmed by the Supreme Court of Canada without reasons in [1976] C.T.C. 57. This led to the enactment of section 143 of the Act, dealing with the taxation of Hutterite Colonies.

¹⁹ *The Queen v. Quinn* (1973), 27 D.T.C. 5215; [1973] C.T.C. 258 led to the passage of section 146.1 of the Act dealing with registered education savings plans.

simply public relations exercises, but rather attempts to get input from those parts of the public which will be most directly affected by the proposed changes and which have the most intimate knowledge of how they themselves operate. The procedure which led up to the major revisions in the Act relating to charities may be instructive.

The study began as routine departmental work arising out of a commitment by the former Minister of Finance, the Honourable E. J. Benson, at the time of tax reform, to look into a new definition of charity. The work was carried on internally and a report was prepared on the subject. The report raised many issues relating to charities and their taxation, dealing primarily with vagaries of the law, possibilities for tax avoidance, etc. At about the same time, there had been widespread newspaper reports of extremely high fund-raising expenses in charities. On the basis of the Departmental report, officers were asked to go into the subject in more depth in order to recommend changes in the Act. At this stage, a year-long internal study was undertaken, culminating in another report with recommendations.

The officers involved were concerned that they did not have enough knowledge of the day to day operations of many types of charities, and were afraid that the changes proposed might interfere significantly with the work of charities without achieving significant policy objectives. It was therefore decided to issue a "Green Paper";²⁰ this format is designed to put forward tentative conclusions but not commit the government. Indeed, a Green Paper was particularly appropriate because the paper represented extreme positions which, in fact, were not strongly supported. The expectation was that those who were most affected would respond quickly and vehemently, and this proved to be correct.

There were several hundred written responses and meetings were set up between officials and those who wished to make representations. In point of fact, a great deal of new information was obtained during these meetings, some of it reinforcing beliefs already held by the officials about abuses by the charities, some of it requiring a revision of views.

The legislation resulting from this exercise was tabled less than a year after the issuance of the Green Paper; the proposed reforms received, for the most part, genuine acceptance. There is no doubt that the "public" in this case had a very significant input into tax legislation as it was ultimately enacted.

2. *Sources of Input into Budgetary Changes*

Both the process and the inputs relating to budgetary changes are very different from those relating to the so-called technical changes. The two major factors in the budgetary decisions are the government's fiscal objectives and the politics of change, although the latter is subordinate to the former. The determination of the fiscal stance of the government at any given time is the primary task of the Fiscal Policy and Economics Analysis Branch at Finance, which is composed almost entirely of economists. The divisions of this Branch

²⁰ The Green Paper was issued with the Budget of June 23, 1975.

monitor the economy prior to any Budget and report their views as to what would be the appropriate fiscal stance. Those of their specific recommendations which relate to the *Income Tax Act* are often a source of friction between Fiscal and Tax Policy officials.

The political element comes into play in determining what tax changes should be made, if any, to implement the fiscal policy, and to get the best political mileage, or to minimize political damage. It should be pointed out that, for the most part, fiscal changes which take place through tax amendments tend to have a much higher profile than those which, for instance, are implemented through a change in expenditure programmes or monetary policy. For example, a programme such as the registered home ownership savings plan has great political value, while a programme attempting to curb house prices by making direct grants to municipalities, in order to encourage the servicing of raw land, has little immediate appeal to most taxpayers.

The role of the public in the budgetary changes is minimal. Letters from the public, for instance, generally ask for tax cuts and rarely try to put such requests into any sort of fiscal framework. Requests from the more formal interest groups tend to reflect self-interest; while their readings of the economy are of some interest, they rarely have much effect on the decision-making process. One of the reasons for this, undoubtedly, is that there is rarely any sort of consensus between such groups as to the appropriate measures which should be taken, and this lack of consensus tends to make all the analyses suspect.

A similar lack of consensus, however, is apparent among the Finance economists who assess the situation in the first place. Rarely is there total agreement on the appropriate fiscal stance; even when a decision is ultimately made, it is even more difficult to agree on the steps which should be taken to implement the proposals.

Once the goals have been determined, broad outlines of strategy are laid out for most of the staff (except the fairly junior members), and they are requested to come up with suggestions for implementation. At least once during the pre-Budget period there will be a meeting between the economists and the tax policy officials at which various income tax options are discussed and cost estimates prepared. These are usually forwarded to a group, consisting of the senior officials of the Branches in question, which rejects some of the options, while ear-marking others for further study.

Detailed assessments are then prepared of the proposals, and a preliminary draft is done of the most likely ones. This is necessary because of the time constraints. Many of the meetings referred to above will have taken place after the date of the Budget has been announced, and there is tremendous time pressure. At about this time, the technical provisions are also being "cleaned up," and usually these will be ready before the budgetary measures. During this immediate pre-Budget period, working days of fourteen to sixteen hours are not uncommon.

The final decision in all budgetary proposals lies with the Minister, al-

though naturally the advice of senior advisers will be of prime importance. The Cabinet *per se* plays little role in this process. When a particular budgetary proposal impinges on the operation of another department, however, there may be some discreet discussions which take place at the top civil service level or between Ministers.

The key meeting between the Minister of Finance and the Prime Minister takes place ten days to two weeks before the Budget Speech. This meeting, attended by senior advisers from both Ministers' staffs, consists of the Minister of Finance's presentation of the contents and rationale of his proposed Budget. The Prime Minister has a *de facto* veto power over the budgetary measures at this meeting. It seems clear that the relationship between the two Ministers is of prime importance at this meeting. If the Prime Minister has a lot of confidence in his Minister of Finance, all the proposals will be accepted. If, as has happened in recent years, the relationship is less than cordial, the meeting may be akin to a negotiation between sovereign states—formal, polite, but characterized by a certain degree of suspicion. The approval of the Prime Minister is the major hurdle which must be overcome. From the point of view of Finance officials, this meeting presents a problem in that the Prime Minister's staff does not have the technical expertise to challenge the proposals by Finance on tax grounds. So the challenges may be based on political considerations which are alien to Finance, or on grounds which are economically or technically unsound. As a general proposition, however, the Minister of Finance must either be successful in obtaining the Prime Minister's approval, or recognize that the Prime Minister lacks confidence in his ability. The imposition of wage and price controls immediately following the departure of John Turner, only a few months after his last Budget, is perhaps an illustration of such a situation.

The Cabinet itself does not see the Budget until the last week before the Speech. Because the Prime Minister has by this time already approved the contents, it is unusual for any change to be taken as a result of Cabinet deliberations, although changes have been made up to seventy-two hours before the Budget.²¹

The final, yet crucial, source of input into the budgetary process is the draftsman. It is the nature of budgetary decision-making that broad instructions are issued with regard to the proposals. These instructions set out the gist of the required changes, and the cost constraints, but leave it to the "experts" to implement them. Because the implementation must be part of the Ways and Means motion tabled on Budget night, this requires that a virtually complete draft be ready four to five days before the Budget. It should be pointed out that since senior officials are almost always engaged in meetings during this period, the draftsmen have to make their own decisions on the technicalities of the measure without further advice or instruction. In drafting a proposal such as the registered home ownership saving plan, literally dozens

²¹ The printing of the Budget is a practical constraint on Cabinet amendment prior to the Speech, since the Budget package must be printed and distributed nation-wide before the Minister delivers his address in the House.

of technical decisions had to be made by the draftsmen without any direction from their superiors, and these decisions ultimately shaped the nature of the plan as first presented.

The importance of the role of the draftsman can be seen when one considers that his draft is the basis of the Ways and Means motion, to the extent that the contents of the Bill, as ultimately presented, cannot be any more restrictive than the motion. So-called "relieving" changes can be made on second reading in the House of Commons, and in recent years it has not been uncommon to see a score or more of such second reading amendments made, although the Minister and the officials are reluctant to make such changes. Any tightening of a particular provision of the Bill usually has to wait for a subsequent Budget.

For the most part, neither the backbenchers nor the Senate have a significant role in amending budgetary provisions. A change is occasionally made in a technical area if it can be characterized as something essentially within the area of officialdom, but a change in a budgetary amendment is a direct challenge to the Minister's own decision, and few Ministers would be prepared to publicly admit an error in judgment.²²

E. CONCLUSION

Lawyers, like most segments of society, have their own complaints about the *Income Tax Act*, which range from the burden of taxation to the complexity of the provisions. But lawyers also have the task of advocating changes on behalf of their clients. The purpose of this article has been to explain the nature of the process of amending the *Income Tax Act*; with an understanding of the process, lawyers are better equipped to participate effectively.

In advocating any proposal, the lawyer should first assess it to determine who would benefit and who would bear the burden if it were adopted, and recognize that a host of inequities may result from any proposed change. Second, the financial and administrative cost to the government of any proposed change should be considered. Third, the request for change must be made to the proper official. If one has contacts within the Department, they should not be used as advocates, but rather to provide an introduction to the person whom one must convince, the anonymous official who effectively controls the area in which the change falls.

Lawyers work most effectively through the Joint Committee of the Bar Association and the CICA. No other group gets a more respectful hearing from the officials and the approval of this Committee can only help the cause.

²² Walter Gordon was forced to abandon some of the key proposals of his first Budget and as a result, seriously impaired his credibility as Minister of Finance, ultimately giving way to Mitchell Sharp. The experience was often cited as a horrible example of politics interfering with sound proposals. It is noteworthy that in that first Budget, the key proposals were prepared without consultation with the top officials of Finance and Revenue. Peter C. Newman's book on the period, *The Distemper of Our Times*, was recommended reading for new recruits at Finance.

Finally, one should know one's limitations. Suggestions for an across-the-board tax cut, a long-term deferral of taxes for an entire industry, or a change which will benefit only one's largest client are probably unrealistic. On the other hand, the Department recognizes its lack of expertise in many areas and is willing to hear about legal problems with which a lawyer and his clients may be faced. The officers are not always familiar with the legislation of the various provinces and its relationship with the tax provisions, and would welcome assistance from lawyers in this area. The Bar has a major and important role to play in tax changes and this role will be effective only if the lawyer understands the rules and abides by them. By so doing, he may well aid not only his client but also, ideally, the Department.

