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of Neil Brooks*

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Article 5

Tax Law within the Larger Legal System

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Tax Law within the Larger Legal System

Abstract

Tax law may be viewed as occupying its own universe, even though tax funds the implementation of public policies that animate Canadian society. This article reminds us that tax law must respond to basic rule-of-law norms in spite of overarching and well-meaning policy goals. It adopts reference points featured in recent cases. One is the Charter, which limits penalties that can be imposed on non-compliant taxpayers and tax advisers without adhering to due process safeguards. Another is the impact of international arrangements among countries in a global business environment to guide consistent regulatory responses and to identify and share information. No matter how seemingly efficient or well-grounded, international norms still need to be safely grounded in Parliamentary authority to be enforceable in relation to Canadian taxpayers. All practitioners concerned with tax equity, neutrality, and efficiency should remember that tax law exists within a larger legal system and must be so evaluated; occasionally, it must yield to the legal principles underlying that system.

Keywords

Taxation--Law and legislation; Rule of law; Canada

Tax Law within the Larger Legal System

J. SCOTT WILKIE* & PETER W. HOGG**

Tax law may be viewed as occupying its own universe, even though tax funds the implementation of public policies that animate Canadian society. This article reminds us that tax law must respond to basic rule-of-law norms in spite of overarching and well-meaning policy goals. It adopts reference points featured in recent cases. One is the *Charter*, which limits penalties that can be imposed on non-compliant taxpayers and tax advisers without adhering to due process safeguards. Another is the impact of international arrangements among countries in a global business environment to guide consistent regulatory responses and to identify and share information. No matter how seemingly efficient or well-grounded, international norms still need to be safely grounded in Parliamentary authority to be enforceable in relation to Canadian taxpayers. All practitioners concerned with tax equity, neutrality, and efficiency should remember that tax law exists within a larger legal system and must be so evaluated; occasionally, it must yield to the legal principles underlying that system.

Les lois sur la fiscalité semblent occuper leur propre univers même si c'est le produit de la fiscalité qui permet de mettre en œuvre des politiques publiques qui animent la société canadienne. Cet article nous rappelle que les lois sur la fiscalité doivent obéir à des normes juridiques élémentaires malgré la primauté et le caractère bien intentionné des objectifs de ces politiques. Il adopte des balises tirées de causes récentes. L'une de ces balises est la *Charte*, qui limite les pénalités qui peuvent être imposées aux contribuables délinquants et à leurs conseillers fiscaux en l'absence des garanties de l'application régulière de la loi. Une autre est la capacité des ententes commerciales internationales, dans un monde des affaires devenu sans frontière, d'uniformiser les réglementations et d'identifier et partager l'information. Peu importe qu'elles paraissent efficaces et bien fondées, les normes internationales doivent malgré tout être bien enracinées dans l'autorité du Parlement pour qu'il

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soit possible de les appliquer aux contribuables canadiens. Tous ceux qui se soucient d'équité fiscale, de neutralité et d'efficacité ne doivent jamais oublier que les lois sur la fiscalité s'inscrivent dans un système juridique plus vaste et qu'elles doivent être évaluées dans ce contexte. Elles doivent à l'occasion céder le passage aux principes juridiques qui sous-tendent ce système.

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I. THE LAW'S EXPANSE

THIS ARTICLE EXPLORES SOME ASPECTS OF THE RULE OF LAW as it applies to Canada's tax system. Our thinking has been both invigorated and challenged by the writing of Neil Brooks,¹ whose contribution to tax law is the subject of the workshop in which this article was first presented. Our subject challenges, and is challenged by, the confluence of social justice and tax policy that has so interested Neil. However, the admirable idea that tax policy should advance social justice must not lose sight of the legal limits of the tax system against which much of Neil's fiscally-inspired social criticism has strained and to which our comments are directed. We are mindful that Neil's views on socially just tax policy in fact tend to be broadly consistent with our own. Even if they would diverge, however, ours still reflect an abiding awareness of the need to view tax policy and its

1. See *e.g.* Neil Brooks, "The Responsibility of Judges in Interpreting Tax Legislation" in Graeme S Cooper, ed, *Tax Avoidance and the Rule of Law* (Amsterdam: IBFD Publications BV, 1997) 93.

influence on the development and application of the tax law with an eye to social justice, an exercise for which Neil's thinking is both a compass and a conscience.

Tax law is one part—a very important part—of the universe of private and public law, constitutional and international law, all of which influence and sometimes control the norms of the domestic tax system. This observation foreshadows how the system would be protected from outcomes that Neil would criticize as inconsistent with the distributional and other effects that ensure its compatibility with normative measures of social justice. It also, however, implicitly captures the possibility that just outcomes—whether socially, fiscally, or politically just—are only achievable within the context of a legal system. It may be that interpretive principles advocated by Neil throughout his career would be pushed and pulled, even stretched, to accomplish underlying social and related tax policy objectives. But this flexibility would still involve interpreting the law, not the chaotic or capricious, even though possibly well-intentioned, imposition of exogenous outcomes lacking the authority supplied by law.

We explore this proposition with two reference points.

The recent case of *Guindon v R*,² which we examine more closely in Part III(C), below, involves the confrontation of sound tax policy to regulate the marketing of tax shelters with the ultimate behavioural constraint, criminal sanctions. The Canada Revenue Agency (CRA) criticized the diligence with which an advisor had advised on what the tax authorities evidently considered to be a controversial tax plan, and sought to impose very large financial penalties under the authority of a provision in the *Income Tax Act*³ (Act) targeting advisors' complicity in tax shelters according to a "culpable conduct" standard.⁴ In that case, the Tax Court was moved by the law's apparently draconian consequences to hold that an ostensibly civil penalty amounted to a "criminal sanction" imposed by the Act,⁵ which collided with due process rights mandated by the *Canadian Charter of Rights and Freedoms*⁶ (*Charter*).

The court held, essentially, that the tax law imposes bespoke fiscal limits that are consistent with, indeed part of, a more expansive legal order protecting citizens from incursions on their personal and economic liberty by the state, through the expectation of rigorous, principled, and transparent processes.⁷ On appeal, the

2. 2012 TCC 287, 2012 CCI 287 [*Guindon*, TCC].

3. RSC 1985, c 1 (5th Supp) [*ITA*].

4. *Ibid*, s 163.2.

5. *Guindon*, TCC, *supra* note 2 at paras 52-53.

6. Part I of the *Constitution Act, 1982*, being Schedule B to the *Canada Act 1982* (UK), 1982, c 11 [*Charter*].

7. *Guindon*, TCC, *supra* note 2 at paras 58-59, 70.

Federal Court of Appeal held that the penalties did not cross the constitutional line; they were justified by “the proper functioning of the administrative system of self-assessment.”⁸ The issue is a close one, however, and the Supreme Court of Canada recently heard the appeal of the Federal Court’s decision. As we write these comments, it has not yet issued its decision. There is no doubt that the integrity of the tax system requires adherence to overarching legal principles that are applicable to every subset of the legal system, including tax law.

Our second reference point takes us to the opposite end of the rule-of-law constraints, namely, the “international tax” setting, where it has become increasingly common for national tax administrations to collaborate in various ways, even if only to be better informed about a broader range of developments. These developments relate to and influence recurring patterns of taxpayer behaviour that attempt, within the boundaries of opportunities seemingly offered by the law as it is commonly perceived, to plan for how income is earned or expenses are incurred so as to shift income, and with it tax liability, out of high-tax jurisdictions into more sheltered locations. Ongoing, widely known work of the Organisation for Economic Co-operation and Development (OECD), in collaboration with the G-20, is concerned with “base erosion and profit shifting” (“BEPS”). Scoping work in 2012 and early 2013 became the basis for a 2013 *Action Plan* to address BEPS.⁹ The *Action Plan* is the platform for a series of detailed international tax studies essentially concerned with the compatibility of entrenched legal perceptions and situations in which these perceptions, and the circumstances they would seek to organize in the interest of containing, shaping, and funding social priorities, actually seem to collide.¹⁰

Increasingly, with these sorts of considerations as catalysts, tax administrations often agree on guidance of various kinds to achieve relatively uniform approaches to these recurring transnational problems. They form informal associations to share information and experience. Sometimes they adopt internationally consistent related “best practices” through participation in the activities of supranational organizations such as the OECD. These practices and the norms they project often reflect sound tax policy in a global environment—notably when perceived through a social justice filter. But sometimes the good works of tax administration may not have a solid basis in the legal rules of the Canadian tax system and may therefore be vulnerable to taxpayer challenge. This scenario arose

8. 2013 FCA 153 at para 42, 360 DLR (4th) 515 [*Guindon*, FCA].

9. OECD, *Action Plan on Base Erosion and Profit Shifting* (2013), online: <dx.doi.org/10.1787/9789264202719-en> [OECD, *Action Plan*].

10. *Ibid.*

in *Canada v GlaxoSmithKline Inc.*,¹¹ with respect to the OECD *Transfer Pricing Guidelines*¹² (*Guidelines*). We discuss this case in Part IV(B), below.

In the *Guindon* situation, supervening or general law polices perceived excesses of the tax law and its administration in the interest of a just outcome consistent with cognizable and uncontroversial societal standards and objectives that are incorporated into our constitutional law. In the case of international guidance, what is applied as “the law” may not be what it seems. The norms lack the democratic provenance of legislative (or at least authorized regulatory) enactment. The rule of law insists that outcomes outside the scope of the positive law’s reasonable contemplation cannot and should not be given effect simply by administrative practices, even if forcefully expressed and well motivated in a social and economic policy sense.

These are two examples, no doubt among many, that raise questions relevant to our topic, which is essentially a consideration of the rule of law in relation to tax matters. Despite how we may perceive the sound objectives served by the tax law, that law can only exist, let alone function effectively, within the legal system that hosts it.

II. THE TAX LAW: ITS POSSIBILITIES AND LIMITATIONS

A. WHAT LAW? WHAT PURPOSE?

There is no “common law of tax.”¹³ The common law never raised money for public purposes. Indeed, a foundational principle of our constitution is that only Parliament can raise taxes.¹⁴ Tax law can only be statutory, a collective expression by the citizenry through their legislators of the circumstances in which private resources may be appropriated, with legal sanction, to the “public good” or perhaps more precisely the collective needs of society. Indeed, there was no national income tax in this country until 1917, when ‘temporary’ legislation to provide funding for the war effort was enacted.

11. 2012 SCC 52, [2012] 3 SCR 3 [*GlaxoSmithKline*].

12. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010) [OECD, *Transfer Pricing Guidelines*].

13. This statement is generally acknowledged. See *e.g.* Brooks, *supra* note 1 at 94. Of course, judges often have to decide cases with little guidance from the Act, but all tax decisions are ultimately interpretations of the Act.

14. Peter W Hogg, *Constitutional Law of Canada*, 2012 student ed (Toronto: Thomson Carswell, 2012) at 6-1.

Tax law serves, and was introduced to achieve, very utilitarian objectives. It pays for public consumption—goods and services acquired and consumed by all citizens (ideally, by the poor more than the rich, causing some redistribution of unequal wealth) as elements of a decent and civilized society. Tax law also functions as a device to induce or subsidize economic conduct of particular kinds thought to be instrumental to the achievement of social and industrial policy objectives for the common good, such as charitable work, scientific research, and the propagation of small businesses as foundations for more mature and pervasive economic activity and resulting societal benefit.

Since tax law raises revenue for a wide variety of public purposes, it lacks the singular purpose that can be assigned to other branches of the law, such as contract, tort, or criminal law, each of which serves an important function in the regulation of a civilized society. Tax law serves many functions. It is always accessory. But accessory to what? At a technical level, it is accessory to the general law—the private and public law that ascribe meaning and consequences to events, arrangements, and relationships among social and economic actors. In tax and social policy terms, it is accessory to the perceptions of public good and public need that are held by the public and implemented by the public's representatives. Tax creates the pool of collective resources we use to pay for the features of our life that we want as social beings within the particular political and geographical setting, that we take for granted as the platform for all of our private acts and encounters.

B. WHERE TO START

The starting point for a critical evaluation of tax law is in fact several steps back from the tax system, at the point of understanding the elements of social intercourse and related public systems that foster civility. Tax law is not some sort of self-defining, self-perpetuating behemoth. The policy choices that the tax law implements, and that courts try to comprehend and effectuate when interpretive doubt arises, require adherence to the rule of law, that is, standards found both within but also beyond the tax law—notably the constitutional, public, and private law footings of the tax law.

C. TRANSLATING ASPIRATIONS TO OUTCOMES

It is only within the law that the social and political choices the tax law is meant to animate, and their distributional effects,¹⁵ acquire legitimacy. Accordingly, our

15. Brooks, *supra* note 1 at 97-98.

reference to standards found both within and beyond the tax law is important. The challenge is to understand the law in terms of the policy choices it is meant to reflect and serve according to legal principles that speak with authority. Neil's "pragmatic and dynamic approach to statutory interpretation"¹⁶ offers insight into how respect for the law and indeed recognition of the need to operate within it as a concomitant dimension of civility and decency would be balanced by an unwillingness to accept ostensibly "legal" outcomes when the law seems to serve false masters or seems stultified by needless and even foolish constraints relative to the tax policy it evidently should enliven.

According to Neil,

[a] pragmatic and dynamic approach to statutory interpretation has five advantages over the conventional approach that judges apply: it is more consistent with democratic theory, it results in a more sensible specialization of functions between the legislature and the courts, it leads to more objective and determinate decisions, it allows for a system of implementation that accounts for changing circumstances, and it results in a better tax system.¹⁷

To those ends, judges (we use the term expansively to include anyone entrusted with and responsible for interpreting and giving practical effect to tax law, including the "judges" of first instance who are taxpayers and advisers making initial determinations about how the law should be interpreted and applied) should always consider tax principles to reach legitimate and principled conclusions despite the particular state or narrowly perceived limitations of the statutory tax law.

We perceive tax principles, however, to be more than aspirational tax policy apart from the statutory law. These principles are "in" the statutory law and their discovery involves no less legal analysis than other possibly less challenging aspects of applying law.¹⁸ Moreover, those tax principles are principles of law in themselves, and are infused with the influence of private, public, and constitutional law that determine the nature of rights and relationships to which tax principles and tax law are responsive. This perception of tax principles is one with which we think Neil would agree, and, in fact, it has animated much of his scholarship.¹⁹ A just tax outcome, according to this reference point, should be just regardless of whether an interpretation strains "the usage ... [of the same words] ... in any other context," the "words used are ambiguous or are used in a

16. *Ibid* at 101.

17. *Ibid* at 101-102.

18. *Ibid* at 100.

19. *Ibid* at 99-100.

way that is over- or under-inclusive of a sensible interpretation of the section,” or the words used are “specific.”²⁰

How the tax law nevertheless exists as part of a larger legal system, it is important to note, underpins Neil’s observation, expressed as encouragement to tax judges to be active interpreters of law whose organic context requires a dynamic approach to its application. He has said:

Indeed, the only circumstance in which judges should reach a result that they feel is not consistent with the tax policy principles underlying the structure of the legislation is in a case in which it is clear that the statute was designed to resolve the specific case in a way other than the judge thinks sensible in terms of tax policies and principles.²¹

In other words, the point of departure is “the tax policy principles underlying the structure of the legislation.”²² These are generally controlling. Departures are permitted as long as they are required by the law, that is, “it is *clear that the statute was designed* to resolve the specific case,”²³ not as judicial inclinations otherwise might recommend.

Put slightly differently, in terms that help us get on with our thesis, the defining objective of applying the tax law should be to promote detectable tax policies and principles, albeit still as evident law, and to be constrained from giving full pragmatic effect to this approach only where the statute effectively forbids the preferred outcome. Regardless of how the proposition is framed, the law, and the rule of law, as the host of the tax law, matters.²⁴ This objective compels our attention regardless of the intensity or direction of our social and political views.

D. FEDERAL CONSTITUTIONAL CONSTRAINTS

The most obvious way in which tax law is influenced by the larger legal system is the legal requirement to conform to the Constitution of Canada. The power to impose taxes is granted by the *Constitution Act, 1867*²⁵ to both the Parliament of

20. *Ibid* at 100-101.

21. *Ibid* at 100.

22. *Ibid* [emphasis added].

23. *Ibid* [emphasis added].

24. See *ibid*. For a concise allusion to related thinking of some legal theorists, see Ronald Dworkin, *Law’s Empire* (Cambridge, Mass: Harvard University Press, 1986). Regardless of the selected notion of formulation of “law” or approach to its interpretation, the law is the essential framework for the imposition of enforceable limitations on otherwise unrestricted activity.

25. (UK), 30 & 31 Vict, c 3, reprinted in RSC 1985, App II, No 5.

Canada and the legislatures of the provinces. In the case of Parliament, the head of power is “The raising of money by any mode or system of taxation.”²⁶ This power extends to any kind of taxation. In the case of the provincial legislatures, the head of power is “Direct taxation within the province in order to the raising of a revenue for provincial purposes.”²⁷ This power is limited to “direct” taxes, and they must be levied “within the province.” Failure to comply with these and other constitutional restrictions²⁸ leads to the invalidity of the tax. It is outside the scope of this article to discuss these federal restrictions on the power to tax, a field that has been well tilled elsewhere.²⁹

The *Charter*, which was only adopted in 1982, has had a pervasive influence on tax law (as it has on other areas of Canadian law). We set out below some examples of interactions between the *Charter* and the tax system that have brought changes to or otherwise challenged the tax system.

III. THE IMPACT OF THE *CHARTER*

A. TAX POLICY

The adoption of the *Charter* imposed a new set of restrictions on Parliament and the legislatures, which applied to their respective taxation powers no less than to other heads of legislative power. What the *Charter* did was to insist that tax law take account of more fundamental human rights values, even when they conflicted with sound public policy. In *Thibaudeau v Canada*,³⁰ the claimant was a divorced woman who had custody of the children of the marriage and who received child-support payments from her ex-spouse. She objected to the provision of the *Income Tax Act* that required her to pay income tax on the support payments she received. She argued that the Act discriminated against separated custodial parents (who were mostly women) by forcing them to pay tax on their child-support payments, and that this infringed the equality guarantee in section 15 of the *Charter*.

26. *Ibid*, s 91(3).

27. *Ibid*, s 92(2).

28. Section 125 of the *Constitution Act, 1867* provides that “No lands or property belonging to Canada or any province shall be liable to taxation.” See *ibid*.

29. For an account of the law and references to the literature, see generally Peter W Hogg, *Constitutional Law of Canada*, 5th ed (Toronto: Carswell, 2007) ch 31 [Hogg, *Constitutional Law*, 5th ed]. See also Joseph Eliot Magnet, “The Constitution Distribution of Taxation Powers in Canada” (1978) 10:3 *Ottawa L Rev* 473.

30. [1995] 2 SCR 627, 124 DLR (4th) 449 [*Thibaudeau* cited to SCR].

The Supreme Court rejected the argument by a majority. It was true that in an intact family, all the tax would be paid by the spouse who earned the income. But the Court pointed out that the inclusion requirement on the recipient spouse was matched by a deduction for the payor spouse. Since the payor spouse was normally in a higher tax bracket than the recipient spouse, the tax saved by the deduction would normally exceed the tax incurred by the inclusion. This income split would usually result in a reduction of tax for separated couples—a reduction that cost the treasury over \$300 million each year.³¹ That was the cost of a system that was designed to deliver a subsidy for the benefit of separated custodial parents like Ms. Thibaudeau.

While the payor of the support received the benefit of the deduction and the recipient bore the burden of the tax, family law required that the tax consequences be taken into account in fixing the amount of child support: the payor's enhanced ability to pay should be recognized and the amount of child support should be grossed up to fully compensate the recipient for her added tax liability. In *Thibaudeau*, the family court that made the support order had taken her additional tax into account, but had underestimated the liability so that the gross-up for tax was insufficient.³² But the Supreme Court majority held that the solution to that problem was a review of the support order by the family court.³³ Although not all separated custodial parents benefitted from the deduction-inclusion system, as a group they did benefit, and the Act did not discriminate against them.³⁴ Therefore, there was no breach of section 15 of the *Charter*.

Although Ms. Thibaudeau lost the court battle, she won the war against the deduction-inclusion system. Her cause was taken up successfully by women's groups, who were no doubt encouraged by the fact that Justices McLachlin and L'Heureux-Dubé, the two (highly respected) female judges on the Court, both dissented on the basis that the family law system could not be relied upon to pass the tax subsidy forward to the dependent spouse. In 1997, the Act was amended to deny the child support recipient's income tax liability and the payor's corresponding deduction. At the same time, guidelines were adopted for calculating child support and improvements were made in the enforcement of court-ordered support. But the tax changes eliminated the subsidy that had been in place since 1942 when it was introduced with the avowed purpose of helping

31. See *ibid* at para 12.

32. *Ibid* at paras 160-61.

33. *Ibid* at para 151.

34. *Ibid* at paras 149-50.

split families bear the extra costs of maintaining two households. The only clear beneficiary of the tax changes was the treasury!

Does *Thibaudeau* tell us anything useful about the relationship between the *Charter* and the tax system? Although the tax subsidy was upheld by a majority of the Supreme Court, the perception that it offended the *Charter* value of equality was probably decisive in its repeal. Subtle arguments about a tax subsidy created by income splitting could not overcome the undeniable facts that the dependent recipient spouse had to pay tax on her child support payments, while the payor spouse received a deduction for making the payments. It looked unequal.

B. INVESTIGATION OF TAX OFFENCES

The *Income Tax Act* confers on tax officials the power to require a taxpayer to produce books and records and the power to inspect books and records; neither power requires a search warrant or similar process. According to the Act, these powers are available for the “administration or enforcement” of the Act.³⁵ Under section 8 of the *Charter*, which guarantees against “unreasonable search or seizure,” exercise of the power of police or other officials to demand documents and inspect their contents must normally be authorized by a search warrant issued by a judge, who must be persuaded with evidence that there are reasonable grounds to suppose that an offence has been committed and that evidence of the offence is likely to be found in the place stipulated in the warrant.³⁶

35. *ITA*, *supra* note 3, s 231.1(1)(a).

36. The *Income Tax Act* itself contains its own provisions authorizing search and seizure by tax officials in support of the investigation of tax offences. After the adoption of the *Charter* in 1982, these provisions were struck down for multiple constitutional defects. The Act authorized the warrant to be issued by the Minister, not by an independent judge; there was no requirement that the Minister had grounds to believe that evidence would be found in the place to be searched; there was no requirement that the warrant list the documents and things that were to be searched for; and, once the warrant was issued, the warrant-holder was not limited to searching for evidence of the suspected offence stipulated in the warrant, but could search for violations of “any” of the provisions of the Act. For all these reasons, the search and seizure provisions of the Act did not satisfy s 8 of the *Charter* and were struck down. See *MNR v Kruger*, [1984] 2 FC 535, 13 DLR (4th) 706 (CA). See also *Re Print Three* (1985), 51 OR (2d) 321, 20 DLR (4th) 586 (CA). The Act was amended and all of these defects were corrected, but a further constitutional challenge revealed another defect: the amended provisions did not allow for any discretion on the part of the issuing judge. In *Baron*, the Court held that this was also a breach of s 8; the issuing judge could not be an impartial arbiter if he or she were simply “to act as a rubber stamp.” See *Baron v Canada*, [1993] 1 SCR 416 at para 38, 99 DLR (4th) 350 [*Baron*]. Part of the new section was struck down for this reason. The current iteration of the search warrant requirements is s 231.3 of the Act; it now seems to be well and truly *Charter*-proof. See *ITA*, *supra* note 3, s 231.3.

However, the Supreme Court has made an exception for “regulatory inspections,” recognizing that many regulatory regimes use inspectors who visit the locations of the regulated activity to check for compliance with the law. These routine or random inspections are in the nature of spot checks. They are not premised on the suspicion that an offence is being committed, and therefore there would be no point in requiring inspectors to obtain a search warrant for each visit to a building site, restaurant, factory, office, or other regulated site. In effect, there is a diminished expectation of privacy in the sites and records of regulated activity. Therefore, while administrative inspections of sites and records during normal business hours in order to check for compliance with the law must be authorized by the regulatory statute, they do not require the additional authority of a search warrant. They are not unreasonable searches within the meaning of section 8 of the *Charter*.

In *R v McKinlay Transport Ltd.*,³⁷ the Supreme Court held that the *Income Tax Act* was a regulatory statute and that tax officials needed powers of spot-checking to supervise taxpayers’ self-reporting of income. The Court upheld the Act’s grant of power to the Minister to make a warrantless demand for a taxpayer’s private documents and to search those documents for evidence of non-compliance with the Act. By analogy with regulated industries, the Court held that taxpayers have a diminished expectation of privacy with respect to records pertaining to the earning of income or other taxable activities. In *Baron v Canada*,³⁸ however, the regulatory character of the Act did not suffice to authorize a warrantless entry onto private premises to search for evidence of a tax offence. The search in that case was not a routine monitoring of compliance with the Act, but was based on suspicion that an offence had been committed and was intended to yield evidence for the prosecution of the offence. That kind of search required a warrant.

The Supreme Court explained the distinction between *McKinlay* and *Baron* in more detail in *R v Jarvis*.³⁹ The Court said that a distinction must be drawn between the audit function of tax officials and their investigative function.⁴⁰ The audit function is the spot-checking of taxpayers’ records to monitor compliance with the Act. When engaged in that function, tax officials may exercise the statutory powers they were granted to demand the production of documents and to inspect the documents without the need for the authority of a warrant. This is so even if the audit turns up evidence of non-compliance with the Act: such

37. [1990] 1 SCR 627 at 13, 21, 68 DLR (4th) 568 [*McKinlay*].

38. *Baron*, *supra* note 36.

39. 2002 SCC 73, [2002] 3 SCR 757 [*Jarvis*].

40. *Ibid* at para 84.

evidence may be used by tax officials as the basis for the imposition of civil penalties or even prosecution for less serious summary offences. The Act may validly confer regulatory powers to demand records and inspect them provided that the powers are limited to the audit function.

However, section 239 of the Act also contains a set of *mens rea* offences essentially concerned with tax evasion, and for these offences, the Act provides severe penalties, including imprisonment. When tax officials develop a suspicion that a tax-evasion offence has been committed, and the “predominant purpose” of their work becomes an inquiry into whether the suspected offence has been committed, their function changes from audit to investigation.⁴¹ At that point, the regulatory powers of demand and inspection that sustained the audit function cease to apply. Tax officials may not use audit powers to conduct a criminal investigation. Documents already obtained during the audit phase may be retained and used in the investigation phase and may also be used as evidence in any subsequent criminal trial. This follows from the taxpayer’s low expectation of privacy in documents that have already been lawfully obtained by the tax officials. But once the investigation phase starts, section 8 of the *Charter* applies in full force,⁴² and no new material may be obtained from the taxpayer except under the authority of a search warrant.

C. TAX PENALTIES

A traditional enforcement tool of tax officials is the civil penalty. The Act provides for a penalty for a variety of acts and omissions that are contrary to the Act or its regulations, including failure to file a tax return, late filing of a tax return, failure to provide information required by a prescribed form, failure to report an item of income, and false statement or omission in a return.⁴³ These penalties are customarily described as “civil,” no doubt because they are imposed by the Minister on a taxpayer as part of the assessment process without any intervention by a prosecutor or criminal court, but they are penalties nonetheless. Many of the acts and omissions that are the subject of civil penalties are also the subject of criminal penalties under section 239 of the Act. If the CRA and the Department

41. *Ibid* at paras 88-89.

42. *Ibid* at paras 69-98. *Jarvis* also held that if the suspected offence carried the penalty of imprisonment, then s 7 of the *Charter* applied to the investigation as well as section 8 (*ibid* at para 95). Section 7 includes protection against self-incrimination, which reinforces s 8 by also requiring any material sought from the taxpayer in the investigation phase to be obtained under the authority of a search warrant.

43. *ITA*, *supra* note 3, ss 162, 163, 163.2.

of Justice take the view that the civil penalty is an inadequate punishment given the culpability of the taxpayer's conduct, a criminal charge will be laid against the taxpayer and criminal penalties will be sought in addition to the civil penalty (if a civil penalty has been imposed).

A prosecution must comply with section 11 of the *Charter*, which prescribes rules of due process when a person is "charged with an offence." In particular, the defendant benefits from the presumption of innocence (section 11(d)), which requires the prosecution to prove the guilt of the defendant beyond a reasonable doubt,⁴⁴ and which also requires that a determination of guilt be made by "an independent and impartial tribunal."⁴⁵ The latter requirement is satisfied by the judge of the criminal court. These safeguards for the protection of a person charged with an offence are of course absent when the Minister imposes a civil penalty. Are the requirements of section 11 of the *Charter* inapplicable when Parliament creates penalties that can be imposed by the Minister as part of the assessment process?

This question has not been directly answered by the Supreme Court in the context of the Act, but an analogous question has been answered in the context of the *Customs Act*.⁴⁶ The *Customs Act* authorizes the forfeiture of property for breaches of the Act. Where the property in issue cannot be found, it authorizes a demand for a monetary sum equal to the value of the property. In *Martineau v MNR*,⁴⁷ a customs officer made a demand for \$315,458, alleging that this amount was the value of stolen vehicles that a person had attempted to export by making false statements. In proceedings to appeal the demand, the exporter refused to participate in an examination for discovery, claiming that he was entitled not to testify by reason of his section 11(c) *Charter* right to not to be compelled as a witness. This contention raised the question whether section 11 of the *Charter* could apply to civil proceedings for forfeiture.

The Supreme Court had said in an earlier case (a disciplinary proceeding against a police officer) that a civil proceeding would attract the protection of

44. Section 238 of the Act contains offences of strict liability in which *mens rea* need not be established by the prosecution, but the taxpayer has a defence of due diligence. See *e.g. R v Sedhu*, 2013 BCSC 2323, 2013 CarswellBC 3828. In the case of "regulatory offences," this interpretation has been accepted as satisfying s 11(d) of the *Charter*. See *R v Wholesale Travel Group*, [1991] 3 SCR 154, 84 DLR (4th) 161. Section 239 of the Act contains offences for which *mens rea* is an essential element, and proof beyond a reasonable doubt would be required.

45. See generally *Valente v The Queen*, [1985] 2 SCR 673, 24 DLR (4th) 161.

46. RSC 1985, c 1 (2nd Supp).

47. 2004 SCC 81, [2004] 3 SCR 737 [*Martineau*].

section 11 if it “may lead to a true penal consequence”;⁴⁸ and a monetary penalty would be a true penal consequence if “by its magnitude” it “would appear to be imposed for the purpose of redressing the wrong done to society at large.”⁴⁹ In terms of magnitude, the figure of \$315,458 was higher than the maximum fine for an actual offence under the *Customs Act*, but only if the prosecution were summary; the figure was less than the maximum fine if the prosecution were brought by indictment. However, unlike the fines that were imposed for offences under the Act, forfeiture was directed at the thing itself, not the guilt or innocence of the owner (who might not even be the person alleged to have breached the Act). A demand for money in lieu of forfeiture (as in this case) was also not premised on guilt or innocence, in that the sum demanded was arrived at simply by estimating the value of the goods, not by reference to the principles that normally guide sentencing in criminal courts. The Court concluded that the “deemed forfeiture” was not a true penal consequence and that section 11(c) of the *Charter* was not applicable to protect the exporter from being examined for discovery.

It is a safe inference from *Martineau* that a tax penalty that is imposed on a taxpayer by the Minister, and that is calculated by reference to an objective standard that is proportionate to the breach of the Act (for example, a percentage of the tax avoided by virtue of the non-compliance) would not be a true penal consequence and would not be unconstitutional by reason of section 11 of the *Charter*. In other regulatory contexts, courts below the level of the Supreme Court have been surprisingly ready to take a few steps beyond *Martineau* by upholding “administrative monetary penalties” that are imposed at the discretion of an administrative tribunal based on considerations of blameworthiness and deterrence, provided the magnitude of the penalties does not seem disproportionate in that regulatory context.

For example, the Ontario Court of Appeal upheld an administrative monetary penalty of \$520,000 imposed by the Ontario Securities Commission on an individual stockbroker who had committed breaches of securities law.⁵⁰ Justice Sharpe for the court said that the Commission’s penalty “was geared to its regulatory mandate” and did not rise to the level of a true penal consequence.⁵¹ This decision and others like it have encouraged legislative bodies to do an end run around the section 11 safeguards by conferring on tribunals or officials the

48. *R v Wigglesworth* [1987] 2 SCR 541 at 559, 45 DLR (4th) 235 [*Wigglesworth*].

49. *Ibid* at 561.

50. *Rowan v Ontario Securities Commission*, 2012 ONCA 208, 110 OR (3d) 492.

51. *Ibid* at para 54.

power to impose civil penalties that are very similar to the fines that used to be the exclusive domain of the criminal courts.⁵²

Where the *Income Tax Act* may have crossed the line is in the third-party penalties imposed by section 163.2. This section empowers the Minister to impose a penalty on tax advisers (“planners” and “preparers”) who make “false statements” to taxpayers in “circumstances amounting to culpable conduct.” What is unusual about this penalty is that it is imposed, not on the taxpayers who are the primary subjects of the regulatory system, but on third parties. This arguably takes the penalty outside the regulatory system “for the purpose of redressing the wrong done to society at large.”⁵³ In addition, the magnitude of the penalty has the potential to be very large indeed for advisers engaged in marketing tax shelters, because it is essentially calculated as the sum of all the penalties to which the taxpayers receiving the advice would be liable if they had made the false statement in their own tax returns. This brings us to *Guindon*.

In *Guindon*,⁵⁴ the Minister assessed a section 163.2 penalty of \$546,747 against a lawyer who became a participant in a complex scheme, the end result of which was that taxpayers claimed charitable donation credits for donations that were never made. The lawyer had provided a legal opinion on documents that she did not see and that did not in fact exist, and after she became aware of the true situation she had nevertheless signed tax receipts for charitable credits to the 134 people to whom the scheme had been marketed. She appealed the assessment of the penalty and was successful at the Tax Court, which held that section 163.2 was unconstitutional because it purported to impose a “true penal consequence” without the safeguards guaranteed by section 11 of the *Charter*.⁵⁵ In effect, the lawyer was a “person charged with an offence,” and she was entitled to the presumption of innocence, which raised the standard of proof from a balance of probabilities to proof beyond a reasonable doubt.⁵⁶ She was also entitled to be tried by an “independent and impartial tribunal,” which meant that she would have to be prosecuted in provincial court under the criminal procedure provided for in the *Criminal Code*.⁵⁷ The Tax Court accordingly vacated the penalty that had been imposed on the lawyer.⁵⁸

52. For a fuller discussion of administrative monetary penalties, see Hogg, *Constitutional Law*, 5th ed, *supra* note 29 at 51-4.

53. *Wigglesworth*, *supra* note 48 at 561.

54. *Guindon*, FCA, *supra* note 8; *Guindon*, TCC, *supra* note 2.

55. *Ibid* at para 70.

56. *Ibid* at para 31.

57. *Ibid* at para 6.

58. *Ibid* at para 113.

However, on appeal to the Federal Court of Appeal, the penalty was restored. Justice Stratas, who wrote for the court, held that the proceedings were administrative in nature (rather than criminal) and had the object of protecting “the proper functioning of the administrative system of self-assessment and reporting under the Act.”⁵⁹ He emphasized that the penalty (like the others in the Act) is calculated by a “non-discretionary formula,” with the result that the Minister, unlike a criminal court, does not in any way “evaluate the moral blameworthiness or turpitude of the conduct.”⁶⁰ As for the magnitude of the penalty, administrative penalties sometimes have to be large “to deter conduct detrimental to the administrative scheme,” and the adviser penalty “does not demonstrate a purpose extending beyond deterrence to denunciation and punishment of the offender for the ‘wrong done to society.’”⁶¹ The conclusion was that the adviser penalty in the Act did not fall afoul of section 11(d) of the *Charter*.

Guindon was a very close case. There was much to be said on both sides of the constitutional argument, and the definitive word is still to be spoken. The Supreme Court heard the appeal of the Federal Court of Appeal’s decision late in 2014, but has not yet rendered its decision. Although the Court of Appeal upheld the adviser penalty, there must be a point at which a “civil penalty,” by its purpose and magnitude, becomes indistinguishable from the sanction for an “offence.” At that point, the Act’s system of civil penalties would enter the realm of criminal justice: the person subject to the penalty would have to be accorded the same safeguards as other persons in jeopardy of punishment by the state. The efficiency and convenience of allowing the Minister to assess a penalty does at some point have to give way to the normal due process norms that protect those charged with an offence.

Of course, the Act itself has never shied away from these distinctions. As we have noticed, section 239 provides for offences under the Act where tax has been wilfully evaded, and provides for fines and imprisonment as penalties. Offences under section 239 cannot be dealt with simply by ministerial assessment; they are prosecuted in provincial court with all the due process protections of the *Charter* and the *Criminal Code*. In *Guindon*, the judge of the Tax Court commented that

59. *Guindon*, FCA, *supra* note 8 at para 42.

60. *Ibid* at para 44.

61. *Ibid* at paras 46-47. Stratus JA also pointed out that, if a penalty set by formula really were too harsh, the Minister had a discretion to cancel all or part of the penalty (*ibid* at para 56). Stratus JA even raised the possibility of the application of s 12 of the *Charter* to a penalty that was so disproportionate as to amount to “cruel and unusual punishment,” but acknowledged that this was unlikely ever to succeed in view of the proportionality built into the formulae by which tax penalties are calculated (*ibid* at para 60).

the conduct covered by section 239 was “strikingly similar” to the “culpable” conduct covered by section 163.2 and added that “one suspects that section 163.2 of the Act was enacted as an alternative to section 239, which has proven to be cumbersome for the Crown.”⁶² But the prosecution of accused persons is always cumbersome for the Crown because of the due process safeguards that have always been part of the common law’s criminal justice system and are now enshrined in the *Charter*. Although section 163.2 received a reprieve from the Federal Court of Appeal, no regulatory system can escape the fundamental norms of the larger legal system. That includes the tax system.

IV. INTERNATIONAL TAX LAW AND TAX POLICY

The second theme of this article about tax law within the larger legal system has to do with the tax system’s fundamental dependence on notions of property, contract, relationship, activity, and entitlement that must have well-defined and enforceable legal effects as the precursor to affecting and being affected by tax law. We tend to take this for granted, almost as an inevitable inherent feature of the law, when the tax law applies to domestic circumstances—those that are exclusively within Canada’s economic and geographic confines. However, the significance of the larger legal system becomes more acute and much more visible when “our law” encounters, even competes with, the tax and private law of other countries because income earning activities of taxpayers transcend political borders and geography. Those sorts of limitations are indeed increasingly irrelevant economically. Income that has its source in one country often has an owner who resides in another. The complexity is compounded when this two-country axis is further subdivided by the intervention of other participants and third countries in the transmission of income to its owner: there may be a variety of stops along the way, orchestrated by legal instruments drawing authority from different countries’ legal systems.⁶³

62. *Guindon*, TCC, *supra* note 2 at paras 45-46.

63. For an example of the stresses that arise from typical international tax jurisdiction notions and the country-to-country trade-offs and accommodations that are embedded in “international tax policy,” see Charles I Kingson, “The Coherence of International Taxation” (1981) 81:6 Colum L Rev 1151. See also Richard M Bird & Scott Wilkie, “Source- vs. Residence-based Taxation in the European Union: The Wrong Question?” in Sijbren Cnossen, ed, *Taxing Capital Income in the European Union: Issues and Options for Reform* (Oxford: Oxford University Press, 2000) 78.

A. “INTERNATIONAL TAX LAW”

The first “rule” of international tax law is that there is no “international tax law,” nor an international tax code or tax regulator. That said, impelled by globalization’s challenge to many aspects of international business and personal relations, systematic connections among tax authorities and taxpayers’ responses to them give rise to effects in some respects akin to a constructive international tax system. For example, this may be inferred from countries’ adoption of compatible or similarly directed domestic tax responses to common international economic events, which often are captured in a tailored way through bespoke tax treaties with legal force to align the specific intersection of countries’ tax regimes. The modern tendency towards an international convergence of domestic law responses to international economic circumstances originated with formative work by the League of Nations, leading to early tax treaty drafts under its auspices and that of the Organization for European Economic Co-operation (OEEC), the precursor to the OECD. The OECD succeeded to this work and remains one of the main supranational organizations in the world dedicated to resolving international tax policy and administration issues, reflected most recently in its ongoing work inspired by the G-20 to address “base erosion and profit shifting,”⁶⁴ as well as its continuing examination of “intangibles” in the “transfer pricing” context.⁶⁵ Work of the United Nations in the tax area has followed a parallel and increasingly prominent path, with a closer orientation however to the needs and circumstances of less developed countries. The European Commission exerts influence over international tax issues in and in relation to Europe.

The thinking and direction of the OECD in tax matters has a significant influence on Canada’s tax policy and tax administration and on the adjudication

64. See OECD, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013), online: <dx.doi.org/10.1787/9789264192744-en> [OECD, *Addressing Base Erosion*]. See also OECD, *Action Plan*, *supra* note 9. There are also various OECD discussion drafts and deliverables forming part of its BEPS project, including certain final deliverables on some subjects tendered in September 2014 and additional working drafts on subjects announced publicly in mid-December 2014 and slated for final reports in 2015. See e.g. OECD, *BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions*, Public Discussion Draft (16 December 2014); *OECD Convention*, *infra* note 67.

65. See OECD, Centre for Tax Policy and Administration, *Discussion Draft, Revision of the Special Considerations for Intangibles In Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions* (2012) [OECD, *Revision of Chapter VI*]; OECD, *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* (2013). For the OECD’s most recently release in the context of BEPS, see OECD, *BEPS Actions 8, 9 and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)* (2014) [OECD, *Revisions to Chapter I*].

of tax disputes by officials and courts. At a primary level, the output of the OECD in tax matters has legal significance at least as customary international law and also treaty law. Canada has ratified both the OECD Convention⁶⁶ and the Vienna Convention on the Law of Treaties.⁶⁷ The latter is seen generally as an articulation of customary international law; it obliges its adherents to observe their international treaty commitments in good faith and to abjure from domestic law departures from them. Canada is a member of the OECD Council, which adopts international tax standards formulated as guidance by the OECD. Countries that take exception to these standards may and in fact are expected to express formal reservations absent which their agreement, as a standard within which their laws are expected to operate, may be inferred. This expectation does not mean that the OECD standards are automatically imported with legal force into countries' domestic laws, but the intention of the OECD standard is to erect a bar to domestic law that would be inconsistent with those standards.

B. THE INFLUENCE AND EFFECT OF INTERNATIONAL TAX GUIDANCE

Two particularly influential statements of international tax guidance by the OECD are the OECD *Model Tax Convention*⁶⁸ and the OECD *Transfer Pricing Guidelines*.⁶⁹ Both have considerable probative significance in applying the Act and tax treaties.⁷⁰

The OECD *Model Tax Convention* (including its influential Commentary) is the acknowledged starting point—the model in fact—for many countries' tax treaties, including Canada's. Not infrequently, though, features of the United Nations *Model Tax Convention*⁷¹ are adopted in Canada's tax treaties with developing countries and in treaties where Canada may, oddly perhaps, in a

66. *Convention on the Organisation for Economic Co-operation and Development (OECD Convention)*, 14 December 1960, 1973 UNTS 181, UKTS 1962, No 21 (entered into force 30 September 1961).

67. May 23 1969, 1155 UNTS 332, UKTS 1987, No 11 (entered into force 27 January 1980).

68. OECD, *Model Tax Convention on Income and on Capital* (2014).

69. OECD, *Transfer Pricing Guidelines*, *supra* note 12. But see the ongoing examination of important transfer pricing subjects in OECD, *Revision of Chapter VI*, *supra* note 65.

70. *Crown Forest Industries Ltd v Canada*, [1995] 2 SCR 802, 125 DLR (4th) 485. See also *Prévost Car Inc v Canada*, 2009 FCA 57, [2010] 2 FCR 65.

71. United Nations, *United Nations Model Double Taxation Convention between Developed and Developing Countries* (New York: United Nations, 2011).

particular economic setting be thought to suffer vulnerability akin to that of a developing country.⁷²

The OECD *Transfer Pricing Guidelines* have long been referred to by the CRA as the foundation for Canada's rules in the Act associated with transfer pricing, formerly subsections 69(2) and 69(3) and now section 247. The CRA's relevant administrative practice, Information Circular IC 87-2R,⁷³ as recently supplemented by Transfer Pricing Memorandum TPM-14,⁷⁴ virtually adopts by reference the OECD *Transfer Pricing Guidelines*, although it is to be noted, and was noted by the Supreme Court in the recent *GlaxoSmithKline* case,⁷⁵ that none of the particularity in the *Transfer Pricing Guidelines* nor, indeed, the *Guidelines* themselves, are actually in the Act or have otherwise been given the force of statutory law.

GlaxoSmithKline presented the Supreme Court with one of its first opportunities to adjudicate transfer pricing. Broadly, transfer pricing tests the compatibility of the reported income of a member of a commonly controlled multinational group of corporations arising from transactions between its legally separate group members, against the income that would have been reported by an independent party transacting in equivalent (or in transfer pricing terminology,

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72. In light of the OECD's observations on when the provision of services by a corporation in a country of which it is not a resident might be treated as giving rise in itself to a "permanent establishment," art V(9) of the Canada - United States Income Tax Convention added by the Fifth Protocol (2007) to that Convention is interesting. See US, Department of the Treasury, *Technical Exploration of the Protocol Done at Chelsea on September 21, 2007 Amending the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital* (Chelsea: September 2007) at 10. See also OECD, *Model Tax Convention on Income and on Capital*, Commentary to Article 5 (2012) at paras 42.11-42.48. There is ongoing work by tax experts on the United Nations Tax Committee considering whether the United Nations Model Tax Convention should adopt a protocol for establishing the delivery of services as a "permanent establishment." See *e.g.* Committee of Experts on International Cooperation in Tax Matters, Report on the Sixth Session, ESC, 6th Sess, Supp No 25, UN Doc E/2010/45 (2010). The 2012 Boston General Congress of the International Fiscal Association has discussed this formative work as well.
73. Canada Revenue Agency, Information Circular IC 87-2R, "International Transfer Pricing" (27 September 1999).
74. Canada Revenue Agency, Transfer Pricing Memorandum TPM-14, "2010 Update of the OECD Transfer Pricing Guidelines" (31 October 2012).
75. *GlaxoSmithKline*, *supra* note 11. See also *Commissioner of Taxation v SNF Australia Pty Ltd*, [2011] FCAFC 74, 2011 ATC 20-265 at para 118 (affirming, in line with *GlaxoSmithKline*, that the OECD *Guidelines* "are not a legitimate aid to the construction of the double taxation treaties and neither are they permissible materials for interpreting the double tax treaties Australia has entered into").

“comparable”) circumstances, according to an “arm’s length standard.”⁷⁶ The issue in *GlaxoSmithKline* concerned whether the price paid by the Canadian *GlaxoSmithKline* subsidiary to one group member for the active ingredient in a branded gastrointestinal remedy was overstated compared to the price of generic (but, according to the Crown, pharmaceutically similar version of the ingredient), in circumstances where the Canadian subsidiary paid another group member royalties for the use of certain intellectual property including rights that pertained to this remedy. If so, the Crown argued, other things considered, the Canadian subsidiary’s income would be understated.

This case highlighted the significance of the OECD *Transfer Pricing Guidelines*, which are generally at the heart of tax authority practices addressed to transfer pricing. The Federal Court of Appeal took the view that all relevant business circumstances should be considered, including not just the active ingredient transfer transaction but also circumstances relating to the Canadian taxpayer’s access to group intellectual property. It reversed the Tax Court’s decision that the pricing of the active ingredient transaction, which was in the Tax Court’s view the only relevant transfer in the case, was incompatible with the expectations of the arm’s length standard. The Supreme Court upheld the Federal Court of Appeal’s decision.⁷⁷ The Supreme Court made a number of observations about the significance of the *Transfer Pricing Guidelines* and, more generally, how a transfer pricing analysis framed by the objectives of the arm’s length standard should be conducted to take into account not only relevant circumstances extending beyond the active ingredient transfer per se but also the frailties of a transfer pricing “comparables” analysis as typically understood.

Justice Rothstein observed for the Court that, even though the *Transfer Pricing Guidelines* may offer analytical guidance, they are not and do not have the effect of statutory law.⁷⁸ They are not to be read and applied as if the Act and the Income Tax Regulations had adopted them, or as if they had the kind of

76. This standard has been adopted by the OECD as the “Accepted OECD Approach,” or “AOA,” to attribute business income to a “permanent establishment.” See OECD, Centre for Tax Policy and Administration, *2010 Report on the Attribution of Profits to Permanent Establishments* (2010); OECD, Centre for Tax Policy and Administration, *Revised Commentary on Article 7 of the OECD Model Tax Convention* (2007). Canada and the United States have specifically imported this standard into the application of art VII of the Canada–United States Income Tax Convention, via para 9 of Annex B to the Fifth Protocol (2007), amending that Convention and a related 19 July 2012 agreement between Canada and the United States.

77. *GlaxoSmithKline*, *supra* note 11.

78. *Ibid* at paras 20-21.

sympathetic quasi-legal significance as many who apply them would seem to have thought, including the CRA. In light of the absence, as such, in the Act of any direct or specific manifestation of the transfer pricing methodologies and related practices in the OECD *Transfer Pricing Guidelines*, the *Guidelines*' mandatory and exclusive force is at least debatable, as might also be administrative interpretations and extensions of those Guidelines by tax authorities including the CRA in the absence of statutory law adopting and incorporating them. In the result, the application of the transfer pricing law as legislated is not to be rigidly or narrowly constrained by the *Transfer Pricing Guidelines*. Based on how the Supreme Court saw it, the law may have a much higher tolerance than prevailing administrative practices of tax authorities for the application of various analytical approaches to test the adequacy of a taxpayer's income with reference to transfer prices. This is the overarching objective of transfer pricing. It is served, applying transfer pricing law and guidance, by detecting and neutralizing non-commercial, seemingly tax-driven distortions of a taxpayer's reporting income attributable, essentially, to the opportunity afforded to a commonly controlled corporate group to engage in transactions on terms that would not be possible if only commercial factors and influences were taken into account.

The Supreme Court's critical evaluation of supranational transfer pricing guidance offers a vantage from which to reflect on tax law's legal imperatives and the importance of the larger legal system.⁷⁹ Pointedly, the transfer pricing guidance has long been accepted as informing the scope and application of the arm's length principle in Canadian transfer pricing.⁸⁰ It has been seen and in fact relied upon by all affected to give life to a critical expectation of business income taxation in an international setting. It articulates objectives and outcomes commonly treated as embedded in contemporary transfer pricing, no doubt affecting how well tax law's overarching public objectives are achieved or indeed achievable. But is the law, apart from commonly held expectations about it, the reliable host we expect? Put another way, are our expectations about the force of the guidance qualified to the extent we cannot find the tenets of that guidance in our statutory tax law? And is this a consequence only of how well developed is the tax law, or are there private law considerations also at play?

79. *Ibid.*

80. OECD, *Transfer Pricing Guidelines*, *supra* note 12 at 31.

C. “INTANGIBLES” AND “BASE EROSION”—WHOSE INCOME AND WHERE IS IT?

The possible inadequacy of Canada’s tax law (not unlike that of other countries) to give effect to its international tax policy commitments that are not tax law is highlighted by two recent OECD developments.

In the transfer pricing area, the OECD has undertaken a study of “intangibles.” Broadly, these are conceived as manifestations of knowledge, experience, know-how, goodwill, and other encapsulations of commercial value, including but not confined to legally protectable intellectual property. There is a concern, as recent considered discussion as well as popular journalism reflect, and which is recognized by the OECD, that these intangibles—drivers of value and profitability—may be easily configured and directed using contracts and other legal conventions essentially to economically disassemble corporate groups and business transfers within them, which formerly would have been accepted to be unitary. As a result, countries’ corporate tax bases may be much more infirm and the reach of their tax laws much shorter than thinking “inside the tax policy box” would have indicated. The effect, it is debated, is a separation of profits from the activities that generate them. In short, profits may be directed (and some would say misdirected), according to well-established legal conventions—respect for the corporate fiction and for contracts among them—that underlie most countries’ tax systems, possibly coming to temporary or permanent rest in places where neither the income formally arises nor its formal owner resides. In June 2012, the OECD took the unprecedented step of releasing for comment a non-consensus discussion draft of current thinking by OECD delegates on how to address this increasingly permanent feature of international business, which cuts to the core of the arm’s length principle that transfer pricing embodies.⁸¹ That OECD report envisages, essentially, an approach to analyzing and applying tax law to transmissions of value accountable to the development and use of intangibles within corporate families which is unconstrained by legal notions of property and ownership or by accounting conventions for defining and measuring contributors to profits. The essential direction of the report is preserved and refined in the OECD’s “Revised Discussion Draft on Transfer Aspects of Intangibles” published at the end of July

81. See OECD, *Revision of Chapter VI*, *supra* note 65; OECD, *Revisions to Chapter I*, *supra* note 65. See also S Wilkie, “Reflecting on the ‘Arm’s Length Principle’: What is the ‘Principle’? Where Next?” in Wolfgang Schön & Kai A Konrad, eds, *Fundamentals of International Transfer Pricing in Law and Economics* (Berlin: Springer, 2012) 137 [Wilkie, “Reflecting”]; Scott Wilkie, “The Definition and Ownership of Intangibles: Inside the Box? Outside the Box? What is the Box?” (2012) 4:3 WTJ 222 [Wilkie, “Definition”].

2013, still subject to ongoing work at the OECD and international consultation solicited by the OECD.⁸²

It is fair to ask how analytical tendencies of this nature become effective in Canada's or any other country's tax system. Tax law, the framework for imposing tax and achieving the objectives served by a tax system, generally requires a tax subject (the taxpayer), a tax object (an item of property, a service, or some other manifestation of value) that the tax law defines or that is defined by the underlying private law to which the tax law is accessory, and a tax "realization event" (commonly associated with a "disposition" or some other reckoning event by which the tax system brings to account the value of a tax object in relation to a tax subject).⁸³ What happens if the law is a poor host for the tax policy and economic guidance proposed by supra-national organizations of which Canada is a member? As Justice Rothstein observed in *GlaxoSmithKline*,⁸⁴ saying it is so—saying it is or is like law—does not make it so.

What are we to make of this? Let us assume for the moment that we would all agree on the importance and right-mindedness at least directionally of the OECD's work in this area, or indeed any other area in which the OECD offers guidance. Let us further assume that in the absence of being able to act on this guidance, the integrity of our tax system—its responsiveness to changing global business and economic events and its capacity to function well as an instrument of social justice—would be imperilled. Is it a good thing, a "right" thing, nevertheless, to sanction our citizens—even our business citizens and visitors — as if the law captured this guidance, to ensure that as a country we are able to fund our social priorities and encourage economic activity favoured by the tax system?

On 12 February 2013, the OECD published a G-20-inspired formative study entitled *Addressing Base Erosion and Profit Shifting*⁸⁵ (February Report). This exploratory document was the first substantive response to the perceived

82. See OECD, *Addressing Base Erosion*, *supra* note 64; OECD, *Action Plan*, *supra* note 9.

83. See Wilkie, "Reflecting," *supra* note 81; Wilkie, "Definition," *supra* note 81. See also RM Bird & Scott Wilkie, "Tax Policy Objectives" in H Kerr, K McKenzie & J Mint, eds, *Tax Policy in Canada* (Toronto: Canadian Tax Foundation, 2012) 2.

84. *GlaxoSmithKline*, *supra* note 11 at para 50.

85. See OECD, *Addressing Base Erosion*, *supra* note 64. See also OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (2012), online: <www.oecd.org/tax/exchange-of-tax-information/HYBRIDS_ENG_Final_October2012.pdf>; OECD, *Aggressive Tax Planning based on After-Tax Hedging* (2013), online: <www.oecd.org/ctp/aggressive/after_tax_hedging_report.pdf>. For ongoing BEPS work that tackles the same or similar subjects, see OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements*, OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD, 2014), online: <dx.doi.org/10.1787/9789264218819-en>.

inadequacy of longstanding international tax jurisdiction conventions, rules, and customary practices underlying many countries' "international tax law" to ascertain where business income is earned in a taxable way. The ongoing work of the OECD and the G-20 advanced by the February Report has quickly evolved to be formulated in the OECD's *Action Plan on Base Erosion (Action Plan)* published in mid-July 2013.⁸⁶ The G-20 countries had an opportunity to consider the *Action Plan* at their September meeting in St. Petersburg, where they endorsed it and affirmed the fiscal urgency underlying it. The February Report and the *Action Plan* are closely identified with populist criticism of some major global corporations that have organized themselves, within the limits of prevailing law as the OECD February Report and *Action Plan* seem to concede, so as to pay very little corporate income tax anywhere.

The global corporations would say, as the OECD (which, we are mindful, is the collection of its member countries' tax and finance authorities) would seemingly acknowledge, that they are "playing by the rules"—operating within the law—the private law as well as accessory tax law. They would deny responsibility for the fact that relevant countries' laws imperfectly mesh in the absence of systematically harmonious private and public law. They would also assert, with some justification, that there is no normative expectation that countries' laws should coincide or intersect in any particular way. Seeing the law, including the tax law, as the exponent of underlying social and economic policy choices, it is almost trite to observe that countries will have different priorities, and in that connection can be expected to mobilize their legal systems to support these priorities in ways that are not in principle constrained by other countries' choices. As well, countries may not readily accept responsibility for perceived inadequacies of prevailing "international tax law" (or their own domestic law in this connection), the foundations and antecedents of which are increasingly exposed by contemporary business practices, the infinite flexibility of legal fictions, and the tectonic interactions of countries' tax and private laws.⁸⁷

D. POSSIBLE RESPONSES

The starting point for civilized society is respect for the law. This proposition presumes the existence of law as the manifestation of social and economic policy imperatives we are meant to observe and choices we have collectively made. It presumes respect for order offered by the law rather than looser standards, as the

86. See OECD, *Action Plan*, *supra* note 9.

87. For additional supporting commentary on related inadequacies in international tax law, see *ibid.*

Guindon case well frames, that could entail serious extra-legal consequences. We are right to be concerned about whether our tax system can withstand international incursions on its tax base. But we must think carefully about whether administrative action fostered by international collaborations among tax administrations—even if acknowledged to be salutary for the tax system, high minded in the most positive sense, just in social and economic policy terms, and proposed in good faith in relation to what is sometimes referred to as “soft law”⁸⁸—is acceptable or sustainable without suitable legal validation.

Should our response be to sharpen our law by political and legislative consensus to align it more closely with just democratic principles that Neil consistently and forcefully argues should be empowered by the tax system? We might ask whether our response should be simply to enact the OECD *Transfer Pricing Guidelines*, as have some other countries, notably the United Kingdom and Australia. Even then there are perils with such an approach, possibly, in so far as tax law is much more than the visible statutory fiscal tip of a much larger private and public law iceberg; possibly simply giving supranational guidance a statutory home would still not be immune from criticism as incomplete law, because it would fail to capture the important private law relationships that enliven the tax law.⁸⁹

What would Neil argue for? Enacting the OECD *Guidelines* into domestic tax law clearly is not impossible; other countries have taken such a path. But as noted earlier and again here, the law is more than the “tax law.” A socially just formulation of tax policy and its articulation in tax law seemingly depends, usually without much fanfare, on understanding and responding to all the various manifestations of private law (including property law, contract law, and legal procedure) as well as public, international, and constitutional law. We anticipate that Neil might take such an outlook—indeed, we think that he has taken such

88. Soft law is a term used casually to refer to the adoption by way of administrative guidance of legal constructs associated with property law, contract law, and other law, to describe and suggest consequences akin to legal consequences for economic events and manifestations of value and “transfers” of that value even though the adopted legal constructions or, indeed, specific statutory provisions strictly may not apply with the suggested effects. It is common, for example, to refer to “intangibles” to subsume economic interests of various kinds that are not intellectual or any other kind of property in a legal sense. See, for example, ongoing examinations by the OECD referred to in notes 66, 67, and 85. For a discussion of issues in this regard, see also Allison Christians, “Hard Law, Soft Law, and International Taxation” (2007) 25:2 *Wis Int'l LJ* 325.

89. By way of explanation, see *e.g.* Wilkie, “Definition,” *supra* note 81 at 240-47. See also J Scott Wilkie, “Intangibles and Location Benefits (Customer Base)” (2014) 68:6&7 *Bull Int'l Tax'n* 352 at 359-60.

an outlook in examining tax law critically throughout his career. The OECD's present study of "intangibles" and inquiry into "base erosion" remind us that the tax system, operating within or at least with reference to the larger legal system, is neither self-defining nor an island.

In the same context, administrative developments are taking place that command similar retrospection. It is increasingly common for tax administrations, including the CRA, to collaborate systematically in the exchange of information, ostensibly under the authority of tax treaties and information exchange agreements, and otherwise to share tax administration experience.⁹⁰ A recent innovative expression of this collaborative tendency is the OECD's proposal Tax Inspectors Without Borders, seemingly directed to making the experience of established tax authorities broadly available to authorities of developing tax systems.⁹¹ Related to the OECD's and the G-20 countries' commitments to address base erosion and transfer pricing, guidance and proposed practices are evolving for sharing taxpayer information (including through automatic exchanges) and for transfer pricing documentation. These sorts of collaborations among tax authorities including advances in the compilation of taxpayer information and its general availability on a common platform no doubt are seen to serve the interests of their members' tax systems: to understand global circumstances affecting their taxpayers as well as the taxpayers themselves do and to have early, informed warning about circumstances bearing on the integrity of those tax systems, which they may wish to consider closely under their respective tax laws according to developing international best practices. They may also serve a greater good that many of us would readily associate with international social justice as Neil would espouse it.

All of that said, though, do these arrangements present legal process concerns, less obvious perhaps than those presented by *Guindon*, but no less important to evaluate in legal terms? Everyone concerned with the effective application of evolving international tax standards should be interested in this question. No matter how well-directed these standards may be, and even allowing for a sympathetic reaction to their evolution, the standards and related guidance could

90. One important example is Canada's participation in the Joint International Tax Shelter Information Centre, or JITSIC. Other well-known associations or gatherings of this nature in addition to Global Forums under the auspices of the OECD have included the Pacific Association of Tax Administrators and the Leeds Castle Group. For general commentary on related subjects, see Allison Christians, "Networks, Norms, and National Tax Policy" (2010) 9:1 Wash U Global Stud L Rev 1; Allison Christians, "Sovereignty, Taxation, and Social Contract" (2009) 18:1 Minn J Int'l L 99.

91. OECD, *Tax Inspectors Without Borders* (2014).

be destined to be and remain only aspirational unless legal systems are hospitable hosts. For example, what is the legal authority for the existence and influence of these administrative groups and for their activities (and for that matter the guidance that they formulate as tax principles in particular areas on which their collaborations are grounded), taking account of their possible effects on how a country's tax law is applied to its taxpayers? Do those taxpayers effectively meet a composite tax authority in the guise of their own, whose outlook is formed by the approaches and institutional attitudes of other tax authorities to which the taxpayer does not have direct access through legal process and, indeed, of which the taxpayer may not even be aware?

In so far as information exchanges are concerned, presumably this authority is thought to be grounded in the various bilateral tax treaties between countries comprising these groups. Is it necessarily the case, though, that all of these tax treaties have the same or substantially similar terms, that those terms even if expressed in seemingly equivalent language have the same implications or meaning, or that they manifest the same limits on information exchange? Are these groups and their activities—the influence that they conceivably have on shaping the application of member countries' tax law—readily observable? Is there a forum in which, or are there principles according to which, taxpayers may know about and test these influences as they try to understand and address how the tax law to which they know they are subject is being administered? Do these groups operate with sufficient resources to fully and rigorously consider the often very difficult comparative law analysis of tax systems necessary before any informed inferences can be drawn about the significance of one country's law for the application of another's, with due sensitivity to the implications of often very different underlying private law that inevitably affects the meaning of deceptively similar looking tax law? Additionally, it is not to be assumed that the tax and social policy choices underlying countries' tax regimes are the same or even, necessarily, similar.

These considerations, as we noted at the outset, cut to the heart of what we mean by tax law. Tax law is more than "best practices" concerning its administration, even though they may be important as equally may be approaches in the international area that are at least sensitive to how other countries administer their laws. Nevertheless, we are ultimately concerned with law. We enact and enforce tax law on the platform of private and public law, to achieve certain

objectives associated with our collective national priorities and interests.⁹² We must be careful about absorbing the reactions of others about their, and our, tax systems to infuse our law and administrative practices and legal procedures that give the law “life” without understanding what underlying priorities animate each tax and legal system. This is not a situation in which behavioural notions—“best practices”—simply can be legislated as a substitute for thoughtful law thoughtfully expressed, even though those practices are essential to maintain, and sometimes restore, the dynamism of the law as it confronts situations—to note two, difficult facts and conflicting legal characterizations and the influence of other countries’ laws, as frequently it does in the international area—that may well not have been foreseen or foreseeable concerning our law.

We do not make any judgments about administrative arrangements except to note their importance to orderly legal systems and the good faith with which tax authorities contending with the same difficult questions as others affected by the law struggle to give effect to the law and taxpayers’ rights according to it. In fact, we understand their need and respect the interests of tax authorities to be able to administer the law with the same facility that taxpayers apply it. But in this article, we ask fundamental questions about the place of tax law within a legal system. We, and we presume everyone else, would agree on the need for adherence to a legal system as the starting point for having and giving effect to tax law.

V. BACK TO OUR THESIS

It may be that we would adopt the pragmatic approach to understanding and applying the tax law that grounds Neil’s merger of tax law and social justice. But the starting point is still the law. Sometimes, the law as legislated, even if interpreted with reasonable elasticity and attention to social context, may fall short of our objectives and aspirations for our tax system. Particularly, in the “compressed”⁹³ world in which we live, where distance and time are no longer reliable qualitative, quantitative, or even temporal markers of economic activity,

92. For example, Canada’s tax treaties typically contain “non-discrimination” articles, but, in fact, these articles systematically preserve Canada’s entitlement effectively to discriminate in the use of its tax system to provide economic benefits through the tax system to residents of Canada which non-residents of Canada are not meant to enjoy. See Richard Lewin & J Scott Wilkie, “Non-discrimination Rules in International Taxation” (1993) 78:b C de D Fisc Int’l 357.

93. See Wilkie, “Reflecting,” *supra* note 81 at 148; David Harvey, *The Enigma of Capital and the Crises of Capitalism* (New York: Oxford University Press, 2010) at 158.

we confront regularly the shortcomings, vulnerability, and frailty of our tax and legal systems as they are matched against and must confront those of other countries and the ingenuity of taxpayers. As *Guindon* reminds us, tax law is still law, and the sanctions of the law must be clearly visible and the processes to give them effect transparent and fair.

We need to care for the tax system, recognizing that it is part of a legal system. We should cultivate the tax law to make it compatible with Canada's domestic norms encapsulated by the rule of law. And when the quest for justice in the tax law, to which Neil Brooks has directed his career, points us in the direction of international norms, we should make sure that those norms are properly translated into domestic law according to the precepts and expectations of Canada's legal system. Only in that way will taxpayers, tax officials, and Canadian courts all be safely reading from the same Canadian page.