Although it is debatable whether the concept of property is an established principle of law, it is undeniable that it has strong roots in the common law, and any changes to its ordinary and accepted meaning should be clear and unambiguous.

CONCLUSION

"Property" is a central concept in the Act, whether we refer to income from property, capital gains realized on the disposition of property, or capital cost allowance claimable on depreciable property. The characterization of something as property or not can have drastic consequences. In the *Manrell* case, the characterization of Mr. Manrell's right to compete as not being property resulted in the proceeds he received for entering into the non-competition agreement being non-taxable to him.

Madam Justice Sharlow recognized that her interpretation of the Act in this case led to consequences that may not reflect the legislator's intention. She wrote:

> This case presents a strong temptation to legislate in the guise of statutory interpretation. No doubt many will consider the result of this case to be unsatisfactory in terms of fiscal policy. I am sympathetic to the view that it seems unfair that the shareholder of a corporation who bargains for a non-competition payment in the context of a sale of the shares is not taxed on the payment, even though in economic terms it may represent the realization of a substantial part of the commercial value of the business of the corporation.[20]

It remains to be seen how the Department of Finance will resolve this "unfairness" and how it will characterize proceeds from non-competition agreements.

Hong Ky Luu

THE "POWERFUL" PERILS OF SECTION 173 OF THE INCOME TAX ACT

The Queen v. Nova Scotia Power Inc.
2003 DTC 5090

KEYWORDS: DEPRECIATION ALLOWANCES ■ PRIVATIZATION ■ PUBLIC UTILITIES ■ AGENCY ■ CROWN CORPORATIONS ■ INTEREST

As the costs of litigation continue to rise, taxpayers have begun to explore alternative means of resolving tax disputes with the minister of national revenue. The enactment of section 173 of the Act was ostensibly aimed at introducing a simplified means of posing questions of law or fact to the Tax Court of Canada. In *Nova Scotia Power Inc. v. The Queen*,[21] the Tax Court was asked to respond to two questions relating to

20 Supra note 3, at paragraph 60.

21 2002 DTC 1432; [2002] 2 CTC 2276 (TCC).

the appropriate characterization of the activities of the Nova Scotia Power Corporation ("the corporation") during the period in which it was publicly owned. The decision of Judge Bowman was appealed by the minister to the Federal Court of Appeal. The resulting ruling of the Court of Appeal is significant because it may influence the way in which public entities are privatized and may actively dissuade parties from making use of section 173 of the Act in the future.

The facts in *Nova Scotia Power* were largely undisputed. In the late 1960s, the production and delivery of electricity in Nova Scotia was consolidated in the hands of the Nova Scotia Power Commission ("the commission"). In 1973, the statute under which the commission operated was amended and renamed the Power Corporation Act,[22] and the commission was continued as the corporation.

The corporation enjoyed a number of rights typically possessed only by privately operated entities, including the authority to acquire assets, borrow funds on its own undertaking, and utilize its profits as it deemed appropriate. The corporation also had a number of attributes generally associated with public bodies, such as the power to expropriate property and the right to claim certain protections against civil litigation. Of particular note, pursuant to section 4(1) of the Power Act, the commission was continued "as a body corporate and as *agent* of Her Majesty in right of the Province [emphasis added]."

Between 1973 and the date on which the corporation was privatized, the corporation borrowed significant sums of money. A portion of the borrowed money was used to acquire depreciable property.

The corporation never paid income tax under the Income Tax Act and never filed an income tax return. Accordingly, it never claimed any capital cost allowance or interest deductions for tax purposes.

In 1992, amid pressure to privatize public enterprises, the provincial government enacted the Nova Scotia Privatization Act, pursuant to which a new corporation, Nova Scotia Power Incorporated ("the appellant"), purchased the assets previously used by the corporation to produce and distribute electricity. By virtue of subsection 85(5.1) of the Income Tax Act, the capital cost of the depreciable property acquired by the appellant was equal to the capital cost of the property to the corporation.

In the appellant's income tax returns for the 1994 through 1996 taxation years, the appellant claimed capital cost allowance on the basis that a portion of the interest paid on borrowed funds used by the corporation to acquire depreciable property was included in the capital cost of the relevant property. The corporation later filed income tax returns for the 1979 through 1992 taxation years, in which it elected, pursuant to subsections 21(1) and (3) of the Act, to add accumulated interest on amounts borrowed to purchase depreciable assets to the capital cost of such property. Virtually simultaneously, the appellant filed revised capital cost allowance schedules for its 1994 through 1996 taxation years, claiming additional capital cost

22 SNS 1973, c. 47 (now RSNS 1989, c. 351, as amended) (herein referred to as "the Power Act").

allowance on the interest amounts capitalized by virtue of the corporation's elections for the 1979 to 1992 taxation years.

The minister reassessed the appellant, asserting that interest on borrowed money used by the corporation to acquire depreciable property should not be included in the undepreciated capital cost of the property. The minister's reassessment was predicated on the contention that, throughout the period in which the corporation had elected to apply subsections 21(1) and (3), the corporation was "an agent of Her Majesty the Queen in right of Nova Scotia" and, in accordance with section 17 of the Interpretation Act,[23] the Income Tax Act did not apply to the corporation.

In bringing their disagreement before the Tax Court, the appellant and the minister chose to proceed in a unique fashion. Section 173 of the Income Tax Act permits a taxpayer and the minister to submit a question of law, fact, or mixed law and fact in respect of an assessment, proposed assessment, determination, or proposed determination to the Tax Court for resolution.[24] Rather than simply wait for the appellant to appeal the reassessment issued by the minister, the parties jointly elected to submit the following two questions ("the questions") to the Tax Court pursuant to section 173:

1. Did the corporation conduct its principal income-earning activities as an agent of Her Majesty the Queen such that section 2 of the Act (including ancillary provisions such as section 21 of the Act) did not apply to it?
2. If the answer to question 1 is no, was the corporation an agent of Her Majesty the Queen with respect to the ownership of assets used in its business such that section 21 of the Act did not apply to depreciable assets acquired by it?

DECISION OF THE TAX COURT

Judge Bowman, speaking for the Tax Court, was extremely critical of the manner in which the parties had framed the questions. Judge Bowman determined that he was not in a position to rule upon the latter half of either of the questions because he was not provided with sufficient factual background; accordingly, he restricted his analysis to whether the corporation conducted its principal income-earning activities or owned the assets used in its business as an agent of the Crown.

Although section 4(1) of the Power Act explicitly established the corporation as a Crown agent, Judge Bowman paid little heed to that provision and instead attempted to discern whether the Power Act, read as a whole, served to constitute the corporation as an agent of the Crown. In substance, Judge Bowman's analysis appeared to be coloured by the realization that the primary issue in dispute was whether the corporation was acting as an agent of the Crown in holding its assets

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23 RSC 1985, c. I-21, as amended. Section 17 of the Interpretation Act states that "[n]o enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except as mentioned or referred to in the enactment."

24 Although the expedience and relative lack of expense that mark such proceedings appear to be obvious, before *Nova Scotia Power*, section 173 had been used on only three occasions.

for use in its business. Yet, given the puzzling wording of the questions, it was necessary for Judge Bowman first to find that the corporation did not "conduct its principal income-earning activities as an agent of Her Majesty the Queen" before being able to consider what was arguably the parties' real concern.

While one could certainly take issue with Judge Bowman's disposition of the questions, it is possible that his strained reasoning at least partially reflects a desire to consider the fundamentals of the dispute in a more purposive fashion. In essence, he may have inadvertently worked backward: having first decided that the Power Act, read as a whole, did not envision that the corporation would hold its assets as a mere alter ego of the Crown, he endeavoured to construe the questions in a manner that would yield a judgment that was consistent with what he perceived to be the intentions of the legislature.

Decision of the Federal Court of Appeal

Not surprisingly, the Crown took issue with Judge Bowman's approach to the questions. In allowing the Crown's appeal, Mr. Justice Pelletier, speaking for the court, adopted a strict analytical approach. Although this approach may be justifiable, it may have ultimately led to the unjust tax treatment of the appellant.

In contrast to Judge Bowman's free-flowing and purposive analysis, Mr. Justice Pelletier focused on whether the corporation had been designated as an "agent" of the Crown. He rightly pointed out that the Power Act stipulated that the corporation was an agent of the Crown and that, unless the legislature was to be taken to have misspoken, the corporation must have been acting in that capacity. While questions regarding the scope of the agency may remain, Mr. Justice Pelletier concluded that the corporation's status as a Crown agent was beyond dispute.

Mr. Justice Pelletier then posited that, so long as the corporation was, at all material times, acting "within the scope of the public purposes it [was] statutorily empowered to pursue,"[25] it must have conducted its principal income-earning activities as an agent of the Crown. In assessing the corporation's authorized purposes, Mr. Justice Pelletier undertook a thorough examination of the Power Act and the activities of the corporation and found that "in operating its electrical system, and in borrowing money for the purposes of developing and maintaining that system, [the Corporation] was acting within its authorized purposes so as to [constitute an agent of the Crown]."[26] Accordingly, he concluded that the answer to the first question was "yes" and that, given the wording of the second question (that is, that it need be answered only if the answer to the first question was no), he was not required to address the latter query.[27]

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25 *The Queen v. Nova Scotia Power Inc.*, 2003 DTC 5090, at paragraph 23 (FCA), quoting *R v. Eldorado Nuclear Limited*, [1983] 2 SCR 551, at 565-66.

26 *Nova Scotia Power*, supra note 25, at paragraph 38.

27 As a technical side note, the last paragraph of Mr. Justice Pelletier's judgment suggests that both of the questions should be answered in the affirmative. However, his ruling unfolded on the

In rendering its judgment, the Court of Appeal seems to have knowingly cast a blind eye on the primary concern of the parties. As Judge Bowman implicitly recognized, the parties may have failed to properly restrict the scope of the questions to the issue of whether the corporation was acting as an agent of the Crown with respect to the ownership of its assets. Although it may be beyond dispute that the corporation was acting within its statutorily authorized objectives, there is arguably a fundamental distinction between acting as the agent of another and owning assets used in discharging one's obligations as an agent.

For instance, were the Crown to secure the services of a real estate agent, there is little doubt that, in conducting its solicitation and sales activities, the real estate agent would be acting as an "agent" of the Crown. Yet, it would not necessarily follow that the real estate agent's automobile and other business equipment would automatically be deemed to be held on behalf of the Crown.

The jurisprudence canvassed by Mr. Justice Pelletier related almost exclusively to the determination of whether the *activities* of a particular body were performed as an agent of the Crown. Little, if any, jurisprudence appears to have been cited in support of the proposition that an agent of the Crown also holds its assets as a Crown agent. While the determination of whether the corporation was, in fact, holding its assets as an agent of the Crown is inherently complex, it remains an open question that was not adequately addressed by either the Tax Court or the Court of Appeal.

In fairness to Mr. Justice Pelletier, he did recognize that other considerations may be of principal importance in determining the appropriate tax treatment of the appellant. He observed at the end of his judgment:

> Immunity from taxation is not the same as immunity from prosecution under a statute. The immunity from taxation of the land and property of the federal and provincial governments is enshrined in section 125 of the *Constitution Act 1867*. . . .
>
> It would be a curious result if the taxation of a provincial crown corporation fell to be decided on the basis of the application of the *Interpretation Act* when the fundamental principle is a constitutional one. It may be that the real issue is whether [the corporation] can be said to be property of the Province of Nova Scotia. . . . *As a result, these reasons should not be taken as approving the parties' premise that issues of Crown immunity from taxation fall to be decided on the same basis as issues of immunity from prosecution. Like the trial judge, we are limited by the questions stated by the parties* [emphasis added].[28]

In essence, Mr. Justice Pelletier appeared to acknowledge that his judgment might result in the unjust taxation of the appellant and that he had been constrained by the unfortunate manner in which the questions had been framed.

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basis that the first question was answered in the affirmative and, therefore, he was not required to consider the second question. In all probability, the strange wording of the last paragraph was simply an oversight and was not meant to serve as a firm response to the second question.

28 *Nova Scotia Power*, supra note 25, at paragraphs 39 to 40.

Finally, in addition to the technical flaws in the wording of the questions, neither the minister nor the appellant appears to have addressed whether the use of the term "binding" in section 17 of the Interpretation Act may have been significant in the context of the unique facts of the case. Both parties appear to have accepted the proposition that the term "binding" is synonymous with the term "applies," despite the distinct meanings of these terms in traditional parlance. Is it not possible that the use of the term "binding" in section 17 of the Interpretation Act may dictate that, although the Crown and its agents are not obligated to abide by a particular statute, they may voluntarily defer to its application? It seems peculiar that the appellant chose not to address this question in its arguments.

While the result in this case may have been dictated by the unfortunate wording of the questions, the technically restrictive manner in which the Court of Appeal interpreted the questions may serve to further relegate section 173 of the Income Tax Act to the fringes of conventional tax litigation. A simplified means of posing questions to the Tax Court undoubtedly serves a useful purpose. However, the risk that an appellant's tax liabilities may be decided on the basis of semantic carelessness, rather than the fundamentals of the law, will surely make even the most cost-conscious taxpayer think twice before attempting to employ section 173.

Michael F. Friedman

THE TAX COURT OF CANADA

GAAR UPDATE

Loyens et al. v. The Queen
2003 DTC 355

KEYWORDS: GAAR ■ COMMERCIAL PURPOSE ■ MISUSE AND ABUSE

A steady flow of assessments based on the general anti-avoidance rule (GAAR) is now reaching the courts. The decisions in these cases are gradually adding flesh to the bare bones of the legislation, and not without some surprises.

A successful GAAR assessment must clear three hurdles. There must be a demonstrated tax benefit; the primary purpose of the transaction (or series of transactions) must be to obtain the tax benefit; and the tax benefit must result in a misuse of a provision of the Act or an abuse of the Act read as a whole.[29]

The *Loyens* case is one of several recent GAAR decisions and is fairly representative of the emerging jurisprudence. While there were a number of evidentiary issues in the case, the facts as ultimately found are quite simple. The two taxpayers each owned an interest in a parcel of real estate inventory. They negotiated a sale of their interests to one of the other co-owners. A direct sale would have resulted

29 Subsections 245(3) and (4) of the Act.