DIRECT TAXATION WITHIN THE PROVINCE—IMPOSITION OF TAX ON CONTRACTOR PURCHASING COMPONENT PARTS FOR INCORPORATION INTO HOUSES—EDUCATION AND HOSPITALIZATION TAX ACT (SASK.)

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In the recent case of *Cairns Construction Ltd.* v. *Government of Saskatchwan*[1] the Supreme Court of Canada faced in a new context the familiar problem of deciding whether taxation is direct or indirect, and provincial legislation consequently valid or invalid. *Prefabricated parts,* purchased from Engineering Buildings (Regina) Ltd., were used by the appellant company in the construction of houses for sale to the public. The respondent claimed that a tax was payable by the appellant in respect of these component parts under the provisions of the Education and Hospitalization Tax Act of Saskatchewan, 1953,[2] which, by s. 5 (1), imposes a tax on every consumer or user of any tangible personal property in respect of his purchase at a retail sale in the Province of such property for his consumption or use. "Retail Sale" is defined by s. 3 (5) as "a sale to a consumer or user for purposes of consumption or use, and not for resale as tangible personal property . . ." Engineering Building (Regina) Ltd., as a licensed vendor under the statute, was required to collect the tax. When payment was first demanded of the appellant company it applied for a license under the Act, contending that it was buying the material for resale in the form of houses, and not for purposes of final use or consumption. When the license was refused the appellant paid under protest and later brought action for the return of the monies, alleging that the Act was *ultra vires* or, alternatively, that it did not apply in the circumstances. The Saskatchewan Court of Appeal (Gordon, J.A., dissenting) and the Supreme Court of Canada, Martland, J., delivering the judgment of the Court, found the Act both *intra vires* and applicable to the purchases in question.

The provinces are limited, by s. 92 (2) of the British North America Act, to "Direct Taxation Within the Province". Indirect taxation falls within the broad federal taxing powers given by s. 91 (3). As a test to be applied in characterizing a tax as direct or indirect, the Courts have long accepted the well-known definitions of John Stuart Mill:

> Taxes are either direct or indirect. A direct tax is one which is demanded from the very persons who it is intended or desired should pay it. Indirect taxes are those which are demand from one person in tht expectation that he shall indemnify himself at the expense of another; such are the excise or customs. The producer or importer of a commodity is called upon to pay a tax upon it, not with the intention to levy a particular contribution upon him, but to tax through him he cosumers of the commodity, from whom it is supposed that he will recover the amount by means of an advance in price.[3]

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[1] (1960) 24 D.L.R. (2d) 1. The judgment of the Saskatchewan Court of Appeal is reported in (1959) 27 W.W.R. 297.

[2] R.S.S., 1953, ch. 61.

[3] *In Bank of Toronto* v. *Lambe* (1887) 12 App. Cas. 575 at p. 583, Lord Hobhouse said that he was not taking Mill's test as a binding legal definition but "because it seems to embody with sufficient accuracy for this purpose an understanding of the most obvious indicia of direct and indirect taxation, which is a common understanding, and is likely to have been present to the minds of those who passed the Federation Act." By 1913 their Lordships

In the light of these definitions, *without more,* the result in the *Cairns case* appears difficult to justify. It was clear that Cairns Construction Ltd. purchased the prefabricated building parts merely for the purpose of re-selling them, in assembled form, to buyers of houses. The ultimate burden of any tax in respect of such parts would quite naturally fall upon the latter. A tax on Cairns would appear, on the face of it, to provide a clear illustration of indirect taxation, the levy being imposed upon one person "in the expectation that he shall indemnify himself at the expense of another." Yet is was found to be indirect.

Martland, J., in the Supreme Court of Canada, disposed of the case rather summarily on the basis of *A.-G. B.C.* v. *Kingcome Navigation Co.*[4] and *Atlantic Smoke Shops Ltd.* v. *Conlon*[5] which he found to be indistinguishible in principle from the case before him. In the *Kingcome case* the Fuel Oil Tax Act, 1930, of British Columbia, was in question. A tax was imposed on every consumer of fuel oil according to the quantity which he had consumed. The Judicial Committee held that the tax was direct, nothwithstanding that a taxpayer in the transportation industry, for example, might pass the burden on to his customers. Lord Thankerton emphasized the fact that the tax was in respect of *consumption* and not of any transaction by which the taxpayer acquired title to the oil or any contract under which the oil was used. In the *Conlon case* the Judicial Committee upheld a provincial tax levied on every consumer of tobacco. "Consumer" was defined to mean every person making a retail purchase of tobacco for consumption by himself or others at his expense. In each of these cases the main contention of counsel for the protesting taxpayer was that the tax was levied on a commodity, that it was *capable* of being passed on, and was therefore indirect. It was further contended that such a tax was analagous to a customs or excise duty, according to the general understanding current in 1867, and necessarily indirect as falling within a species of taxation traditionally classified as indirect. These arguments were soundly rejected by the Judicial Committee. Viscount Simon made it clear that a tax is not indirect "merely because it is in some sense associated with the purchase of an article."[6] The significant thing was that the tax in that particular instance was demanded from the very persons who it was intended or desired would pay it. Lord Thankerton, in the *Kingcome case,* had already pointed out that ". . . the customs or excise duties on commodities ordinarily regarded as indirect taxation . . . are duties which are imposed in respect of commercial dealings in commodities, and they would necessarily fall within Mill's definition of indirect taxes."[7]

In relying upon the *Kingcome* and *Colon cases* for the proposition that the tax was not indirect *merely* because it concerned the purchase of commodities,

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appear to have dropped any reservations about accepting Mill's statement as a binding legal definition. Lord Moulton, in *Cotton* v. *Rex* [1914] A.C. 176 at p. 193, after citing the *Lambe* case and other authorities said: "Their Lordships are of opinion that these decisions have established that the meaning to be attributed to the phrast "direct taxation" in s. 92 of the British North America Act, 1867, is substantially the definition quoted above from the treatise of John Stuart Mill, and that the question is no longer open to discussion." See also: *Cairns Construction Co. Ltd.* v. *Govt. of Saskatchewan, supra* at p. 6.

[4][1934] A.C. 45.

[5][1943] A.C. 550.

[6]at p. 565.

[7]at p. 59.

Martland, J., was merely applying settled law. It is respectfully submitted, however, that while the same principles apply, the *Cairns case* is distinguishible on its facts and falls within the class of cases of which Lord Thankerton was speaking in the passage cited above. Cairns Construction Ltd. purchased prefabricated building materials, not for purposes of consumption, but with a view to *commercial dealings* involving these commodities. The claim of the respondent was not that the appellant company was a consumer, as in the *Kingcome* and *Conlon cases,* but that it was a *user* of the goods in question by virtue of its incorporating them into houses. After the trial the section of the statute defining "retail sale" was amended retroactively to include the words "as tangible personal property" as set out above. The fact situation of the *Cairns case* may consequently fall within the terms of the enactment. Even if this is so, however, the validity of the legislation is not thereby established. As Viscount Haldane pointed out in the *Grain Futures case*:

> The question of the nature of the tax is one of substance, and does not turn only on the language used by the local legislature which imposes it, but on the provisions of the Imperial Statute of 1867.[8]

The same point was made by Duff, C.J. in the *Conlon case* in these words:

> It is especially important, I think, in the application of Mill's test, not to be led away by legislative declarations, or collateral legislative provisions, imparting to the legislation a form calculated to give a color of legality to the legislative effort.[9]

If, applying Mill's definitions to the particular case, a provincial taxing statute, in substance, imposes an indirect tax, it is invalid, for "a colourable device will not avail."[10]

The question of colourability was not raised by Martland, J., evidently because of his agreement with the majority in the Appeal Court that the legislation was good in substance, not only in form. He said:

> I would agree that the intention of he Act is to impose the tax upon the final consumer or user of the personal property purchased. It was upon this basis that the Privy Council upheld the New Brunswick legislation under consideration in the *Conlon case*. But it also appears to me that a person who purchases personal property and incorporates it into something else, in the process of which it loses its own identity as personal property, is the final user of the personal property so incorporated.[11]

The fact remains that the tax is passed on. Martland, J. relied, however, on the principle of "general tendency". The Courts, in applying Mill's test, have consistently refused to take into account all the considerations that would concern economists. According to Viscount Cave:

> It is the nature and general tendency of the tax and not its incidence in particular or special cases which must determine its classification and validity.[12]

It is not easy to extract from the cases consistent principles for determining general tendency. It was held in an early case, *A.-G. for Quebec* v. *Reed,*[13] that if the ultimate incidence of the levy were uncertain at the moment of payment it was an indirect tax. The leading case of *Bank of Toronto* v. *Lambe*[14] added the qualification that if the way of recoupment were an obscure or circuitous one, bearing no direct relation to the amount of tax paid, the tax

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[8][1925] A.C. 561 at p. 566.

[9][1914] S.C.R. 670 at p. 682.

[10]Lord Atkin, in *Ladore* v. *Bennett* [1939] A.C. 468 at p. 482: "It is unnecessary to repeat what has been said many times, by the Courts in Canada and by the Board, that the Courts will be careful to detect and invalidate any actual violation of constitutional restrictions under pretense of keeping within the statutory field. A colourable device will not avail."

[11]at p. 10. See also: Culliton, J.A. in the Court of Appeal at p. 493.

[12]*City of Halifax* v. *Fairbanks Estate* [1928] A.C. 117 at p. 126.

[13](1885) 10 App. Cas. 141.

[14]*Supra.*

would not be considered indirect. Rinfret, J., in *City of Charlottetown* v. *Foundation Maritime Co.*, offered this helpful statement:

> It is the normal or general tendency of the tax that will determine, and the expectation or the intention that the person from whom the tax is demanded shall indemnify himself at the expense of another might be inferred from the form in which the tax is imposed or from the results which in the ordinary course of business transactions must be held to have been contemplated.[15]

In the *Cairns case*, Martland, J. found that instances in which the tax would be passed on would be exceptional, *considering the tax as a whole.* Is general tendency to be determined, therefore, with respect to all the commodities to which the tax might conceivably be applied? Surely it is the general tendency of the tax with respect to the *class of commodities* in question and the *ordinary types of transactions* involving those commodities which must be considered. With regard to the assembly of component parts into permanent structures Martland, J. said merely:

> In my view, this attempt to recoup the tax in such cases is no different from the attempt which, in argument in the *Kingcome* case, it was suggested would be made by the manufacturer or the transporter to pass on the fuel oil tax there in question in the price of the article manufactured or transported.[16]

It is submitted that the cases are not analogous. In the context of the entire consumption of fuel oil in a province the passing on of the tax by manufacturers or transporters constituted isolated or exceptional cases. The assembly of component building parts, on the other hand, presents a situation in which the tax on such assembly will almost invariably be passed on in the sale of the finished product. What was an isolated occurrence in the *Kingcome* case becomes the *general tendency* in *Cairns Construction* v. *Government of Saskatchewan*. Furthermore, in the *Kingcome case*, the commodity in respect of which the tax was imposed was never passed on; any recoupment must necessarily have been by circuitous means. The case falls, therefore, within the principle laid down in *Bank of Toronto* v. *Lambe*. In the *Cairns* situation the commodities sought to be taxed are resold, and the tax appears to be indirect "from the results which in the ordinary course of business transactions must be held to have been contemplated."

It is submitted that Gordon, J.A., in the Saskatchewan Court of Appeal, took the more realistic approach to the facts of the *Cairns case* and the principle of general tendency when he said:

> Most definitely the personal property involved in these proceedings was brought for resale in houses. If this was just an isolated transaction in which the law had an indirect application it could still be valid but such is not the case. I can take judicial notice of the fact that companies like the plaintiff are carrying on extensive operations and the tax collected may run into a large sum.[17]

The "extensive operations" mentioned might include not only the assembly of buildings from component parts, but also pipelines, bridges, and other structures into which, for example, structural steel or pre-cast concrete are incorporated. One can scarcely refer to these operations as isolated transactions, especially in view of their increasing importance in the construction business. It is submitted that a practical consideration of the number and value of the transactions involved and the incidence of the tax in the ordinary course of business provides ample reason to suggest that a tax like the one in the *Cairns case* should be held to be indirect and hence *ulta vires.*

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[15] [1932] S.C.R. 589 at pp. 594-595.
[16] at p. 11.
[17] (1959) 27 W.W.R. 297 at p. 323.