Atlantic Smoke Shops Limited *v.* Conlon*, 1943*

There is one element in the division of powers about which the intentions of the framers of the constitution seem reasonably clear: in the allocation of financial powers the main sources of revenue were to be assigned to the federal government. While the B.N.A. Act restricts the provinces to "direct taxation within the province" (section 92[2]), it grants the central government the power to raise funds "by any mode or system of taxation" (section 91 [3]). Section 122 explicitly brings customs and excise duties under the control of the Dominion. Thus, of the three main tax sources which existed in 1867, customs duties, excise duties and property taxes, the B.N.A. Act left only the latter field open to the provinces. However with the expansion of the role of government in general and of provincial responsibilities in particular there was increasing pressure on the provinces to develop new forms of taxation. This search for more revenue led provincial governments not only into such fields of taxation as income taxes and succession duties which were obviously direct but also into other areas of taxation such as corporation and sales taxes which were of more dubious constitutional propriety. These efforts gave rise to a series of challenges to the constitutional validity of provincial taxation measures. In most of these cases the question of whether or not the provincial tax was direct constituted the most serious test of its validity.

In *Bank of Toronto* v. *Lambe*,[1] decided in 1882, the Judicial Committee, in concluding that a Quebec tax on corporations was constitutional, adopted the distinction between direct and indirect taxation which is found in John Stuart Mill's classic work, *Principles of Political Economy.* According to Mill's definition a direct tax is one which is demanded from the very person who it is intended should pay it; whereas an indirect tax is one which is imposed on one person in the expectation that he will reimburse himself at the expense of another. But Lord Hobhouse stressed that the judiciary could not attempt to apply this economist's test of directness as an economist would by carefully tracing the real effects of the tax in order to ascertain its ultimate incidence. Instead, Mill's criterion was to be applied as a verbal formula to the language of taxing statutes. The mere possibility that someone subject to a tax might pass the burden on to someone else would in itself not constitute grounds for calling the tax indirect. A tax could be characterized as an indirect tax only if it had the general tendency of shifting the burden of taxation in an obviously traceable way to someone other than the actual taxpayer.

In succeeding cases Mill's definitions, offered at first with some diffidence as an indication of what the Fathers of Confederation must have had in mind in 1867, hardened into a firm principle of constitutional law. As a test of directness Mill's formula was qualified only by the rule that species of taxation which according to the common understanding in 1867 would obviously have been considered direct or indirect must continue to bear the same legal character. It was on the basis of this principle that a local "business" tax was upheld as a direct tax by the Privy Council in 1928.[2]

As the provinces continued to seek new sources of revenue it became increasingly difficult to apply John Stuart Mill's distinction. For instance, in 1928 the Privy Council found that Alberta's mine owners tax was unconstitutional because it was imposed directly on producers and would most likely be passed on to consumers.[3] But six years later the Privy Council held that British Columbia's tax on consumers of fuel oil was direct and therefore constitutional because it was demanded from the very persons who the legislature intended should pay it.[4] The judges gave no weight to the tendency of consumers engaged in manufacturing, transportation or other service industries to pass the burden of the tax on to their customers.

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[1] 12 App. Cas. 575.

[2] *Halifax* v. *Estate of Fairbanks* [1928] A.C. 117.

[3] The King v. Caledonian Collieries Ltd., [1928] A.C. 358.

[4] *Attorney General of British Columbia* v. *Kingcome Navigation Co. Ltd.* [1934] A.C. 45.

The frequency with which the question of constitutional limitations on provincial taxation powers came up in cases before both the Supreme Court and the Privy Council reflected the continuing uncertainty in Canada over the financial powers of the provinces. In the 1930s the impact of the depression on traditional sources of revenue increased the provinces' interest in imposing retail sales taxes. But there were still grave doubts concerning the provinces' capacity under the B.N.A. Act for effectively entering the retail sales tax field. To remove these doubts the Dominion government, at the unanimous request of the provinces, agreed to seek an amendment to section 92(2) of the B.N.A. Act which would allow the provinces to impose a retail tax in the form of an indirect tax on the vendor. The resolution calling for this amendment was, however, defeated in the Senate. The attack on it was led by Arthur Meighen who argued that the power of imposing a sales tax would enable the provinces to erect what would amount to provincial tariff walls.

The Privy Council's decision in the *Atlantic Smoke Shops* case took a good deal of the steam out of the provinces' drive for a constitutional amendment. The New Brunswick tax challenged in this case was one imposed on anyone who purchased tobacco, by himself or through an agent, for his own consumption. It was also imposed on anyone who imported tobacco into New Brunswick for his own consumption. To obviate the charge that the burden of this tax, which was in effect a retail sales tax, would be shifted by the retailer to the purchaser, it had been so designed that the retailer became the tax-collector, collecting the tax directly from the consumer. A majority of the Supreme Court, while willing to uphold the tax as direct when levied on the actual consumer, ruled that it was indirect when imposed on the consumer's agent. The Privy Council denied the significance of this distinction and upheld the tax as direct and valid in all of its aspects.

Although this case had originated in private litigation between a retail tobacco company which had raised constitutional objections to the tax and the Tax Commissioner responsible for administering the tax, the federal government and most of the provinces intervened and supported their respective sides of the case before the Judicial Committee. The outcome was undoubtedly a victory for the provinces. In effect it reduced the provinces' difficulties in entering the retail sales tax field to one of shrewd draughtsmanship.

The result of this case which confirmed that it was possible to impose a tax on products imported into the province seemed, to some, to make a mockery of section 121 of the B.N.A. Act, which requires that the goods of any province be admitted free into each of the other provinces. But it should be noted that while, as a revenue-raising measure, a tax such as the one upheld in the *Atlantic Smoke Shops* case might perform the function of a customs duty, it could hardly perform the protective function of a tariff. ~

ATLANTIC SMOKE SHOPS LIMITED V. CONLON

In the Privy Council. [1943] A.C. 550; III Olmsted 403.

Judgment: July 30, 1943.

Present: Viscount Simon L.C., Viscount Sankey, Viscount Maugham, Lord Atkin, Lord Russell of Killowen, Lord Wright and Lord Romer

Interveners: The Attorney General of Canada, the Attorney General of Ontario, the Attorney General for Manitoba, the Attorney General of Saskatchewan, the Attorney General of Prince Edward Island, the Attorney General of Quebec, the Attorney General of Nova Scotia.

The judgment of their Lordships was delivered by

VISCOUNT SIMON L.C. This appeal from a judgment of the Supreme Court of Canada raises the important and difficult question whether the Tobacco Act of New Brunswick, 1940 (4 Geo. 6, c. 44), and the regulations made thereunder are within the powers of the provincial legislature as constituting "direct taxation within the province," or whether, on the contrary, all or any part of these provisions must be held to be ultra vires having regard to the distribution of legislative powers effected by the British North America Act, 1867, and to the bearing of ss. 121 and 122 of the Act on provincial taxing powers.

The New Brunswick Tobacco Act is entitled "An Act to provide for imposing a tax on the consumption of tobacco." [His Lordship referred to ss. 2 to 10 of the Act and continued:] There are thus four applications of the tax provided for by ss. 4 and 5: (a) In its main and simplest form the tax is to be paid by anyone who purchases tobacco, as defined, for his own consumption (or for the consumption of other persons at his expense) from a retail vendor in the province. The tax amounts to ten per cent on the retail price charged on the sale. By regulations made under s. 20 of the Act it is to be collected by the retail vendor, who is constituted an agent of the minister for the collection of tax, and has to give a receipt for the tax to the customer and account to the Tobacco Tax Commissioner for the tax thus collected, subject to the allowance of three per cent as remuneration, (b) If the purchase from the retail vendor is made by an agent acting for a principal, who desires to acquire such tobacco for his own consumption (or for the consumption of other persons at his expense), the tax is payable by the agent. It is, however, clear that if the agent has not already been put in funds by his principal, he will be entitled to be indemnified by his principal for the tax, no less than for the purchase price. In both cases ((a) and (b)) the tax is payable at the time of making the purchase, (c) If a person residing or ordinarily resident or carrying on business in New Brunswick brings into the province such tobacco, or receives delivery of it in the province, for his own consumption (or for the consumption of other persons at his expense), he is to report the matter to the minister, with any invoice and other information required, and he becomes liable to pay the same tax as would have been payable if the tobacco had been purchased at a retail sale in the province, (d) Lastly, if such a person as is last described brings the tobacco into the province, or receives delivery there, as agent for a principal who desires to acquire it for his own consumption (or for the consumption of other persons at his expense), the agent is put under a similar obligation to report and to pay an equivalent tax. It may be noted that in this last case the principal is not in express terms limited to a principal within the province. This is perhaps implied, but, in any event, the instance of an agent within the province acting for a principal outside can seldom occur.

A striking difference of opinion has disclosed itself in the Canadian courts as to the validity of this taxing legislation. In the Supreme Court of New Brunswick, Baxter C.J. and his two colleagues, Grimmer and Richards J.J., held that the tax was valid. Applying the definition of a direct tax which was used by Lord Hobhouse in Bank of Toronto v. Lambe (12 App. Cas. 575, 582), and which is derived from John Stuart Mill's "Principles of Political Economy" (bk. V. c. 3) as "one which is demanded from the very persons who it is intended or desired should pay it," they held that the tax in all its forms was a direct tax and within the power of the provincial legislature to impose. On appeal to the Supreme Court of Canada, conflicting views were expressed, and these need to be carefully analysed.

~ His Lordship then stated the conclusions reached by the individual judges. ~

. . . In the result, therefore, the majority of the Supreme Court of Canada decided that the tax in the forms (a) and (c) was valid, but that it was invalid in the forms (b) and (d), since these latter forms involved taxation of an agent, whereas the burden of the taxation would fall on his principal. The arguments addressed to the Board, which included arguments on behalf of the Attorney-General for Canada supporting the appellants, and of other

interveners representing Quebec and five other provinces supporting the respondents, ranged over all aspects of the tax, and their Lordships are requested to reach a conclusion as to the validity or non-validity of the tax in all its forms.

Their Lordships must first consider whether the tax in the form (a) is a valid exercise of provincial legislative powers. It has been long and firmly established that, in interpreting the phrase "direct taxation" in head 2 of s. 92 of the Act of 1867, the guide to be followed is that provided by the distinction between direct and indirect taxes which is to be found in the treatise of John Stuart Mill. The question, of course, as Lord Herchell said in Brewers and Maltsters' Association of Ontario v. Attorney-General for Ontario ([1897] A.C. 231, 236), is not what is the distinction drawn by writers on political economy, but in what sense the words were employed in the British North America Act. Mill's Political Economy was first published in 1848, and appeared in a popular edition in 1865. Its author became a member of parliament in this latter year and commanded much attention in the British House of Commons. Having regard to his eminence as a political economist in the epoch when the Quebec Resolutions were being discussed and the Act of 1867 was being framed, the use of Mill's analysis and classification of taxes for the purpose of construing the expression now under review is fully justified. In addition to the definition from Mill's Political Economy already quoted, citations may be made of two other passages as follows: "Direct taxes are either on income or on expenditure. Most taxes on expenditure are indirect, but some are direct, being imposed not on the producer or seller of an article, but immediately on the consumer" (bk. V. ch. 3). And again, in ch. 6, in discussing the comparative merits of the two types of tax, he takes as the essential feature of direct taxation that "under it everyone knows how much he really pays." Their Lordships, therefore, consider that this tobacco tax in the form they have called (a) would fall within the conception of a ''direct" tax, and ought so to be treated in applying the British North America Act. It is a tax which is to be paid by the last purchaser of the article, and, since there is no question of further re-sale, the tax cannot be passed on to any other person by subsequent dealing. The money for the tax is found by the individual who finally bears the burden of it. It is unnecessary to consider the refinement which might arise if the taxpayer who has purchased the tobacco for his own consumption subsequently changes his mind and in fact re-sells it. If so, he would, for one thing, require a retail vendor's licence. But the instance is exceptional and farfetched, while for the purpose of classifying the tax, it is the general tendency of the impost which has to be considered. So regarded, it completely satisfies Mill's test for direct taxation. Indeed, the present instance is a clearer case of direct taxation than the tax on the consumer of fuel oil in Attorney-General for British Columbia v. Kingcome Navigation Co. ([1934] A.C. 45), for fuel oil may be consumed for the purpose of manufacture and transport, and the tax on the consumption of fuel oil might, as one would suppose, be sometimes passed on in the price of the article manufactured or transported. Yet the Privy Council held that the tax was direct. In the case of tobacco, on the other hand, the consumer produces nothing but smoke. Mr. Pritt argued that the tax is a sales tax, and that a sales tax is indirect because it can be passed on. The ordinary forms of sales taxes are, undoubtedly, of this character, but it would be more accurate to say that a sales tax is indirect when in the normal course it can be passed on. If a tax is so devised that (as Mill expresses it) the taxing authority is not indifferent as to which of the parties to the transaction ultimately bears the burden, but intends it as a "peculiar contribution" on the particular party selected to pay the tax, such a tax is not proved to be indirect by calling it a sales tax. Previous observation by this Board as to the general character of sales taxes, or of taxes on commercial dealings, ought not to be understood as denying the possibility of this exception.

There remains, on this first head, the question whether, notwithstanding that the tax in the form (a) is "direct" within Mill's test, it is none the less beyond the powers of the province to impose as being in the nature of "excise" in the sense that the attempted imposition would be an alteration of the "excise laws" of New Brunswick which the provincial legislature is debarred from affecting under s. 122 of the British North America Act. "Excise" is a word of vague and somewhat ambiguous meaning. Dr. Johnson's famous definition in his dictionary is distinguished by acerbity rather than precision. The word is usually (though by no means always) employed to indicate a duty imposed on home-manufactured articles in the course of manufacture before they reach the consumer. So regarded, an excise duty is plainly indirect. . . . Their Lordships do not find it necessary in the present case to determine whether this tobacco tax in the form (a) is for any purpose analogous to an excise duty, for it is enough to accept and apply the proposition laid down on behalf of this Board by Lord Thankerton in

the Kingcome case, namely, "that if the tax is demanded from the very persons who it is intended or desired should pay it, the taxation is direct, and that it is none the less direct, even if it might be described as an excise tax" ([1934] A.C. 45, 55). . .

Next comes the question whether the tax, though "direct" when the principal deals personally with the retail vendor across the counter, ceases to be "direct" if the purchase is made by an agent acting for his principal. Their Lordships have already pointed out that in this case also the person who bears the tax is really the principal, either because he has already given his agent the money to pay it or because he is bound forthwith to repay his agent for the expense incurred with his authority and on his behalf. This indemnification does not follow because there is any fresh transaction analogous to re-sale after the purchase by the agent has been made. It is part and parcel of a single transaction. The agent pays the tax for and on behalf of his principal. If, indeed, the agent gave the name of his principal to the vendor the contract of sale would be with the principal. If there was anything to complain of in the quality of the article it would be the principal, whether named or not, who might have a remedy against the vendor. It is said that the tax in this second form is not direct because the agent, who is personally liable for the tax and has to pay it when receiving the tobacco, is distinct from the principal who bears the burden of the duty, but, in their Lordships' opinion, this circumstance does not, according to the distinction laid down by Mill, prevent the tax from being a direct tax. . . . Their Lordships find it impossible to suppose that, in applying the economic distinction which is at the bottom of Mill's contrast, it would be correct to call this tax ''direct" if a man bought a packet of cigarettes over the counter by putting his hand in his pocket and paying price and tax himself to the vendor, but "indirect" if he stood outside the shop and gave his wife the necessary amount to get the cigarettes and pay the tax for him. . . . Their Lordships, therefore, take the view that the tax imposed by s. 4 of the Act is valid both in the form (a) and in the form (b).

For the same reasons, and apart from other considerations which apply only to s. 5, their Lordships are of opinion that the tax is valid in the forms (c) and (d), but the tax imposed by s. 5 raises difficulties of a different order. It is manifest that s. 5 is enacted merely as a supplementary provision, to guard against the methods of avoidance of s. 4 which might otherwise remain available. At the same time, the validity of s. 5 must be judged according to its terms, and, if its enactment by the provincial legislature be beyond the powers of that legislature, it cannot be justified on the ground that it is needed to make the whole scheme watertight.

Objection is taken to the validity of s. 5 on the alleged ground that it offends against ss. 121 and 122 of the British North America Act. When the scheme of Canadian federation is considered as a whole, the purpose and effect of these two sections seem plain enough. Previous to the date of federation, each province was a separate unit raising part of its revenue by customs duties on certain commodities imported from outside—it might even be from another province. One essential purpose of federating such units is that they should cease to maintain customs barriers against the produce of one another, and hence s. 121, supplemented by s. 123, established internal free trade from July 1, 1867, which was the date proclaimed for the Union. It was not, however, practicable to abolish provincial customs entirely on that date. Ordinary customs and excise are, as Mill's treatise shows, the classical examples of indirect taxation, and thus fell thenceforward within the exclusive legislative competence of the Dominion parliament. But until the Dominion had imposed and collected sufficient taxes on its own account, it was desirable to continue to gather in the revenue arising from the customs and excise laws of the provinces (with the exception of interprovincial import duties), though it would appear from the s. 102 of the British North America Act that after federation the proceeds passed into the consolidated revenue fund of the Dominion. A Dominion tariff has long since been enacted and the customs and excise laws of the different provinces have been brought to an end by Dominion legislation. The question, therefore, on this part of the case, which has to be determined is whether s. 5 of the New Brunswick Act is invalid as amounting to an attempt by the province to tax in disregard of the restrictions contained in ss. 121 and 122 of the constitution. If s. 5 purports to impose a duty of customs, it is wholly invalid, and, if it denies free admission of tobacco into New Brunswick, it is invalid so far as this refers to tobacco manufactured in another province of Canada. Their Lordships have reached the conclusion that s. 5 does not impose a customs duty, and they adopt the reasoning on this point of Rinfret J. and Crocket J. The argument to the contrary is the argument that failed in the Kingcome case. Lord Thankerton pointed out the distinction in his judgment in that case when he said: "Customs and excise duties are, in their essence, trading taxes, and may be said to be more concerned with the commodity in respect of which the taxation is

imposed than with the particular person from whom the tax is exacted" (Ibid. 59 (A.C.)). Here the tax is not imposed on the commodity as such at all, and is not imposed on anyone as a condition of its lawful receipt. The "particular person" from whom the tax is exacted is the recipient in the province only if he is the prospective smoker, and, as Lord Hobhouse said in Bank of Toronto v. Lambe, "any person found within the province may legally be taxed there if taxed directly." Their Lordships agree with the majority of the Supreme Court that this is not a duty of customs.

Similar considerations dispose of the contention that, as applied to the recipient of tobacco manufactured in another province, the tax offends s. 121. Here again, it is important to remember the special feature of the tax that it is imposed as a direct tax on the consumer. Sect. 121 was the subject of full and careful exposition by the Supreme Court of Canada in Gold Seal Ltd. v. Attorney-General for Alberta ([1921] 62 S.C.R. [Can.] 424, 439), where the question arose whether the parliament of Canada could validly prohibit the importation of intoxicating liquor into those provinces where its sale for beverage purposes was forbidden by provincial law. The meaning of s. 121 cannot vary according as it is applied to dominion or to provincial legislation, and their Lordships agree with the interpretation put on the section in the Gold Seal case. Duff J. held that "the phraseology adopted, when the context is considered in which the section is found, shows, I think, that the real object of the clause is to prohibit the establishment of customs duties affecting interprovincial trade in the products of any province of the union" (Ibid. 456 (A.C.)). . . . These considerations make it clear that if s. 5 of the Tobacco Tax Act is not obnoxious to s. 122 of the British North America Act, it is also free from objection on the score of s. 121. That the tax is taxation within the province is, their Lordships think, clear for the reasons given by Taschereau J.

Their Lordships will humbly advise His Majesty that the appeal fails and that the Tobacco Tax Act, 1940, is in all respects a valid exercise of the powers of the legislature of the province of New Brunswick. The order of the Supreme Court must, therefore, be varied by omitting the words "with the exception of the provisions thereof making the agent liable for the tax."