

THE CONSTITUTION AND NATURAL RESOURCE REVENUES

by

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CONTENTS

ACKNOWLEDGEMENTS	i
PREFACE	iii
1 INTRODUCTION	1
2 TAXATION	3
3 OWNERSHIP	15
4 STATE FIRMS	21
GENERAL	21
THE SECTION 125 PROBLEM	23
What is Taxation?	25
What is Included Within the Idea of "Province"?	28
What is "Property" Within Section 125?	35
5 CONCLUSION	39
NOTES	41

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PREFACE

The last decade has witnessed dramatic political battles over the division of the vast revenues to be derived from Canada's rich natural resources. In this paper, John Whyte analyzes the central constitutional ambiguities which have underlain these struggles and which still remain unresolved. He examines the constitutional status of three key instruments by which governments extract resource revenues: taxation, ownership, and state entrepreneurial activity. In doing so, he focuses on a host of critical issues, including the uncertainties created by the CIGOL decision, the implications of the new constitutional provision on provincial resource powers, and the complexities inherent in the "Section 125" controversy over whether provincial crown corporations are subject to federal revenue taxes.

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Keith G. Banting
Associate Director
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1 INTRODUCTION

Even the most casual observer of Canadian political life has been able to discern that over the last half decade political cleavages within Canada have not only been deep but until recently were effective in frustrating the development of needed national policies. Although it is not unique for a country to experience conflict over competing and irreconcilable views about its policies for the future, what made the heart beat faster, at least for constitutional lawyers, was that the Canadian conflict was rooted in different conceptions of the basic constitutional order.

On both major political fronts, constitutional reform and resource revenue sharing, truces or partial truces have been reached. The area of conflict with which this paper is concerned – the problem of dividing the revenues from non-renewable resources – is one in which none of the constitutional issues have been finally resolved. The Canada-Alberta Energy Agreement,¹ signed on September 1st, 1981, and the subsequent British Columbia and Saskatchewan agreements² will quiet some aspects of the debate for some years, but the basic question of the constitutional limits of provincial resource revenue taking remains.

There are three methods by which governments may obtain direct fiscal benefit from resource extraction. First, they may tax the benefits derived from mining the resources. Second, to the extent they own the resources, they may exact a rent from enterprises to which they give the right to extract the resource. Third, they may assume an entrepreneurial role and engage in the production and marketing of resources for their own account.

There are, of course, other indirect benefits which governments may seek to gain from resource extraction within the boundaries of the province, state or country. Attempts to acquire these benefits (or reduce the economic and social costs which accompany this "blessing") are also subject to constitutional constraints. In fact, the single biggest blow to provincial constitutional economic regulatory powers in recent years came in a 1978 Supreme Court of Canada decision³ in which a provincial attempt to compensate for overproduction in the potash industry through a prorationing and price stabilization scheme was struck down as being a law interfering with the federal trade and commerce power. The constitutional dispute over the limitation on provinces to regulate the structure of an industry, its rate of growth and ancillary features (such as the composition of the work force), the commodity of which moves largely in extra-provincial trade, is a problem of major proportions in the years ahead.⁴ Nevertheless, in this paper I shall not undertake a review of this area but shall restrict my analysis to constitutional problems relating to taxation, ownership and state entrepreneurial activity.

2 TAXATION

The provincial and federal powers to tax are included in the two lists by which legislative powers are assigned to the two levels of government in the British North America Act, 1867, Canada's major constitutional document. Under the BNA Act, provinces are limited in section 92(2) to the power to levy "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes." Canada's taxation power under section 91(3) is plenary: "The raising of Money by any Mode or System of Taxation." Constitutional interpretation most frequently entails assigning mutually compatible meanings to classes of activity which have been so described to produce a vast area of overlap between competing heads of power. Only to a limited extent has this been the process of giving meaning to the provincial power. In general, the competing federal head has not been the taxation power found in section 92(3) but rather the federal Parliament's power under section 91(2) to regulate trade and commerce, which is a classification less formal and more functional than the federal taxation head. The scant history of attempts to reconcile the two taxation powers in the courts⁵ bears out Lederman's observation: "There is no constitutional prohibition against killing geese that lay golden eggs. Federal and provincial governments can be severally or collectively foolish about this."⁶ (As we shall see, this view may not go unchallenged much longer but the claim against rapaciousness will not be based on the view that one taxation power carries an implicit limitation

of the other, but rather that excessive taxation is colourably regulatory.)

The general pattern of constitutional interpretation is further deviated from in the sense that the provincial taxation power contains clear but indefinite textual limitations requiring exegesis. The most obvious limitation is the exclusion of indirect taxes. This exception is not as considerable as one used to economic taxonomy would expect. In the leading case in the area, *Bank of Toronto v. Lambe*,⁷ the Judicial Committee of the Privy Council, adopting the views of John Stuart Mill, defined "direct" and "indirect" in this way:

A direct tax is one which is demanded from the very person who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another; such are the excise or customs.⁸

This completely unstartling starting point has been rendered more startling (and more reasonably generous to provinces) in operation. The only passing on of tax costs, inherent in the tax, which creates indirection, for the purposes of section 92(2) is that which is recovered in precisely recognizable form. In other words, if the recoupment is circuitous the tax will nevertheless be counted as direct. For example, Mr. Justice Rand in *C.P.R. v. Attorney General of Saskatchewan*⁹ offered this test for indirect taxes:

If the tax is related or relatable, directly, or indirectly to a unit of the commodity or its price, imposed when the commodity is in course of being manufactured or marketed, then the tax tends to cling as a burden to the unit or the transaction presented to the market.

Furthermore, the courts have recognized that there is a received wisdom about the character of certain taxes; despite their economic incidence some taxes will be accepted as falling historically within, or without, the category of direct tax. Net income and profit taxes and real property

taxes are historical categories of direct tax, while import and export taxes, taxes on gross income or on production and commodity taxes are recognized categories of indirect tax. If a tax fits a recognized category, it is classified as direct or indirect accordingly. If it does not fit, the court will resort to the general test.

The other textual limitations of provincial taxation are that the taxation must be within the province and must be for "the raising of a revenue." Both these limitations have been hypothetically put forward to strike down resource taxes.¹⁰ But in respect of both phrases, when the argument, which would be advanced by a taxpayer challenger, is considered it is seen to be less based on the words of section 92(2) and more on the claim that the tax trenches on the federal power to regulate trade and commerce. The lesson to be learned, therefore, is that exercises of the provincial power to tax revenues from resources, unless constructed mindlessly, should not overrun the basic grant of provincial taxing power. On the other hand, the effect produced by such taxes can produce a different constitutional result; if taxes substantially interfere with interprovincial and international trade they may be struck down as invading the federal power. It will quickly be appreciated that taxes directed specifically at oil and gas revenues will inevitably be under a constitutional cloud since the three Canadian producing provinces produce overwhelmingly for out-of-province markets. This problem is highlighted by the November, 1977 decision of the Supreme Court of Canada in the CIGOL case.¹¹

Following the jump in oil prices in the autumn of 1973, the Government of Saskatchewan moved quickly to capture what were perceived to be the windfall profits of oil producers.¹² By a complex set of legislation and regulations, Saskatchewan moved on three fronts. First, revenues from oil produced from lands held in freehold were subjected to a "mineral income tax." The tax was one hundred percent of the difference between the price received at the well-head (normally the new, rising, world price) and the statutorily defined "basic well-head price" which was established at

approximately the same level as the price per barrel received by producers prior to the oil embargo and price escalation. The tax scheme allowed some deductions, under approval of the Minister of Mineral Resources, for increases in production costs and extraordinary transportation costs. As a device to counter tax avoidance the Minister was given power to determine the well-head value of the oil when he was of the opinion that oil had been disposed of at less than its fair value.

Second, freehold rights in about one half of the forty per cent of the producing tracts in the province not held by the province as Crown lands were expropriated. Third, a royalty surcharge was imposed upon oil whether it came from existing Crown lands or whether it came from newly expropriated lands. The royalty surcharge was generally calculated on the same basis as the mineral income tax.

The Saskatchewan Court of Queen's Bench and the Saskatchewan Court of Appeal both upheld this scheme as a valid taxation measure.¹³ The law did not, however, survive review by the Supreme Court of Canada which, in a seven to two decision, found the tax to be invalid both because it was considered to be a form of indirect taxation and because it was thought to interfere with international and interprovincial trade to such a degree that it constituted an invalid encroachment on a federal head of power.

The Court did not declare the expropriation of freehold interests to be unconstitutional. Beyond that, however, the provincial scheme was found to be unsupportable. The Court considered the royalty scheme not to be an exercise of the province's proprietary rights but rather in substance, if not in form, taxation. Neither conclusion need concern us except to say that it does not seem unwarranted for the Court to conclude that the statutory imposition of contractual terms requiring payment, during the life of a contract is indistinguishable from taxation (unless, of course, the capacity to inflict statutory changes has been agreed upon as a term of the contract).

The majority decision was written by Mr. Justice Martland. He found the tax to be ultra vires the province since its effect was to regulate the

export price of oil. Two critical comments may be made. First, it is not true that the effect of this taxation measure was to set the export price. In fact the scheme had, in most cases, no impact on price. Second, although the scheme touched on goods moving in international trade, Canadian jurisprudence is clear in sustaining the proposition that provincial schemes which affect price, supply or quality of goods moving largely in extra-provincial trade are not for that reason invalid. Invalidity results when it is imperative to see the design of the legislation as being in relation to the regulation of the terms of such trade. When the design is credible to achieve a valid provincial purpose, and that purpose does not directly produce such an alteration in the terms of trade so that that effect becomes a putative legislative aim, then the provincial legislation is allowed to stand.¹⁴ Interestingly, Mr. Justice Martland did not directly disagree with this test for provincial validity. Rather he concluded that the taxation so closely controlled the price of goods in the export market that there was no doubt about the character of the law.

Mr. Justice Martland's views of the operational effect of the tax is found in these passages:

In considering this issue the important fact is, of course, that practically all of the oil to which the mineral income tax or the royalty surcharge becomes applicable is destined for interprovincial or international trade ... The producer must, if he is to avoid pecuniary loss, sell at the well-head value established. The company which has its own oil production transported from the Province must, if it is to avoid pecuniary loss, ultimately dispose of the refined product at a price which will recoup the amount of the levy. Thus, the effect of the legislation is to set a floor price for Saskatchewan oil purchased for export by the appropriation of its potential incremental value in interprovincial and international markets, or to ensure that the incremental value is not appropriated by persons outside the province.¹⁵

[The] Minister is empowered to determine the well-head value of the oil which is produced which will govern the price at which

the producer is compelled to sell the oil which he produces. In an effort to obtain for the provincial treasury the increases in the value of oil exported from Saskatchewan which began in 1973, in the form of a tax upon the production of oil in Saskatchewan, the legislation gave power to the Minister to fix the price receivable by Saskatchewan oil producers on their export sales of a commodity that has almost no local market in Saskatchewan. Provincial legislative authority does not extend to fixing the price to be charged or received in respect of the sale of goods in the export market. It involves the regulation of interprovincial trade and trenches upon ss. 91(2) of the British North America Act, 1867.¹⁶

The crux of Mr. Justice Martland's error, therefore, lies in his view of the function of the commonplace anti-avoidance provisions. At one point of the decision, he gives these provisions an uninflated significance ("... it enabled the Minister to prevent a reduction of the tax payable by reason of a sale at less than what he considered to be fair value of the oil"¹⁷) but when he comes finally to attributing the leading constitutional aspect to the taxation scheme the Minister's power is seen as compulsion to sell the product "at a price equivalent to what the Minister considers to be its fair value."¹⁸ Professor Paus-Jenssen has observed that "the Minister of Mineral Resources of Saskatchewan must indeed have been very surprised to discover the immense power to set prices in export markets which was attributed to him by the Supreme Court of Canada, power which in fact he does not possess and never did possess."¹⁹ In passing it should be observed that this attribution to the Minister of price control powers was also the basis of the majority's finding that the tax was indirect and, accordingly, on that basis alone, invalid.

It was pointed out by Mr. Justice Dickson, writing in dissent for himself and one other justice, that the price of Saskatchewan oil was not affected in any way by the provincial tax; it simply could not be claimed that the price was altered in order to allow the producers to recoup the tax cost.²⁰ Mr. Justice Martland's response to this incontrovertible observation was this:

It is contended that the imposition of these taxes will not result in an increase in the price paid by oil purchasers, who would have been required to pay the same market price even if the taxes had not been imposed, and so there could be no passing on ... This, however, overlooks the all important fact that the scheme of the legislation under consideration involves the fixing of the maximum return of the Saskatchewan producers at the basic well-head price per barrel, while at the same time compelling him to sell at a higher price. There are two components in the sale price, first the basic well-head price and second the tax imposed. Both are intended by the legislation to be incorporated into the price payable by the purchaser. The purchaser pays the amount of the tax as a part of the purchase price.²¹

Thus Mr. Justice Martland has confused the fact of economic recoupment with the test of whether the taxpayer has, through pricing, passed on the tax burden to a third party.

In dealing with the question of the character of the tax Mr. Justice Martland also employed the "categories test." He labelled the tax as export tax²² which, by definition, is not only indirect, but is not "for Provincial Purposes" as required by section 92(2). This was a highly suspect line of reasoning since the tax applied to all production whether the oil left Saskatchewan or not. The only basis upon which the Court would have been warranted in ignoring this fundamental aspect of the tax is if it had been willing to impute subterfugeous intent to the Saskatchewan legislature. Clearly it could not do so since the universality of the tax accorded with the reasonable or constitutional aim of the tax, the raising of revenue. In other words, extending the application of the tax to oil destined for out-of-province markets is consistent with the "tax" motives of the law.

The result of the CIGOL case has been to cast a cloud over provincial taxes directed at oil and gas revenues. The mere fact that the tax affects the value of a produced commodity moving largely in interprovincial and international trade is sufficient to raise the spectre of a "Trade and Commerce" classification.

Saskatchewan, daunted but not resigned after this decision, enacted The Oil Well Income Tax Act²³ (commonly called Bill 47) with retroactive provisions which allowed the retention of the \$500 million collected under the invalid law. However, the legislative history of Bill 47 and the fact of the CIGOL decision present substantial concerns about whether any tax on provincial resources might be challenged at some time. For one thing, it would appear, perhaps illogically, that provincial legislation designed to remedy the constitutional defects of earlier legislation is especially vulnerable.

Part of the aftermath of CIGOL has been provincial determination to remove this constitutional cloud through constitutional amendment. It is clear that CIGOL's impact on resource taxes is so uncertain that that decision alone would not have provided the impetus for constitutional change. There are other causes for Canada's engagement, since the fall of 1978, in broadly based constitutional reform. The chief motives have been the need to patriate the constitution and develop a procedure under which the Constitution of Canada may be amended by a procedure which is wholly domestic rather than one requiring resort to the Westminster Parliament for implementation, and secondly the wide-spread desire to respond to the threat posed by the election of the Parti Quebecois in Quebec in November, 1976. However, western provinces, notably Saskatchewan and Alberta, have pushed for changes which respond directly to the west's constitutional needs. As a result, during the negotiating processes in 1978-79 and the summer of 1980 resources and taxation of resources were "on the table."

When eleven-sided negotiations broke down at the First Ministers' Conference of September, 1980, the federal government chose to proceed with unilateral constitutional amendment. As a condition of support for the constitutional package and the unilateral process, the federal New Democratic Party took up the western interest in constitutional reform of the resources and taxation area. Although the draft text agreed to by the federal NDP seemed to reveal that Party's unfamiliarity with the

constitutional needs of provinces with significant energy resources, it did contain a provision for provincial taxation powers in respect of non-renewable natural resources which was hoped would solve, in part, the so-called CIGOL problem. Subsequently, the federal government's plans for unilateral constitutional reform were challenged in the courts by some provinces. On September 28, 1981, the Supreme Court of Canada handed down its decision holding, in part, that a federal request to the United Kingdom Parliament for amendment to the British North America Act, over the opposition of most of the provinces, was contrary to constitutional convention in respect of amendment.²⁴ Following that decision the Prime Minister and provincial premiers met in November, 1981, to see if a general agreement on constitutional change between most, or all, governments could not be reached. The meetings were successful to the extent that the federal government and the governments of nine of the ten provinces (Quebec being the dissenting province) agreed on the terms of a Resolution to be sent to the United Kingdom. The accord reached in November radically altered some of the elements of the constitutional text but left intact the provisions relating to jurisdiction over non-renewable natural resources. Consequently new provincial taxation powers over natural resources will soon be included in the Constitution.

The new powers will be contained in section 92A of the British North America Act²⁵ which includes amongst other things, this power:

(4) In each province, the legislature may make laws in relation to the raising of money by any mode or system of taxation in respect of

- (a) non-renewable natural resources and forestry resources in the province and the primary production therefrom, and
- (b) sites and facilities in the province for the generation of electrical energy and the production therefrom,

whether or not such production is exported in whole or in part from the province, but such laws may not authorize or provide for taxation that differentiates between production exported to

another part of Canada and production not exported from the province.

In other clauses of the new section 92A provinces are granted exclusive legislative authority over development, conservation and management of natural resources.²⁶ These provisions may not be so much a novel grant of powers as an amplification of powers already enjoyed by provinces under existing provisions of the British North America Act.²⁷ In any event, this constitutional grant, or recognition, could conceivably have the effect of immunizing resource specific taxes from the attack based on the overwhelmingly extra-provincial trade in the subject matter of the tax. This argument, however, would be only makeweight in light of the specific taxation provisions in the Constitution. Furthermore, the recognition of non-renewable resources jurisdiction logically does nothing to diminish the scope of the federal "Trade and Commerce" power which can be advanced as a limitation on provincial powers, no matter what terms those power are cast in. Likewise, this may be the chink in the CIGOL "solution;" the provincial taxation measures or its anti-avoidance provisions can at some point be classified as an extra-provincial trade regulatory mechanism and not as a tax or a measure necessary to enforce the tax. This would clearly occur when the taxation measure is colourable in that it is unambiguously directed at regulating that trade without significant revenue-raising objects. This result would not be unreasonable; constitutional powers are meant to be exercised in good faith and when they are not, constitutional integrity requires a finding of invalidity. However, in light of CIGOL, it remains a possibility that when the tax, regardless of legislative motive, affects the costs of goods moving largely extra-provincially, the courts will simply label the leading aspect of the legislation to be "Trade and Commerce." This possible outcome causes concern about the real benefit of section 92A(4). The legacy of CIGOL seems to be that when the process of characterizing challenged laws does not treat competing heads as equally important, there may be no means, through altering the constitutional text, to get around the characterization problem.

Earlier I advanced the view that the provincial taxing power created no implicit limitation on the federal power to tax but stated that, nevertheless, the apparently unlimited federal power might be subject to a restriction. This possibility is raised in the Statement of Claim²⁸ of the City of Medicine Hat in its application for a Declaration against the Attorney General of Canada and the Minister of National Revenue that the two taxes announced in the federal government's National Energy Program are unconstitutional as applied to that city. Medicine Hat is making the predictable claim that it, as an instrumentality of the provincial government, is entitled to the constitutional immunization from taxes on Crown property. However, Medicine Hat's claim is also that the rate of tax on natural gas is, compared to its pre-tax cost, so high, and the effect on the cost of gas for consumers is so drastic, that the city's constitutionally recognized local government function has been impaired. In other words, Medicine Hat is advancing a version of the "colourability" argument. The federal Energy Program taxes, although possessing the form of taxes, impact so heavily on a provincial head of power ("Municipal Institutions in the Province") that the proper characterization of the tax, at least as applied to Medicine Hat, is that it is a law in relation to a provincial head.

3 OWNERSHIP²⁹

The majority of lands in the western provinces from which oil and gas is currently being produced is "public land," that is land which is owned by the Crown in the right of the province. The implications of provincial Crown ownership of resource producing tracts is that the provinces are able to extract a royalty payment in respect of each unit of production. The obligation of producers to pay the royalty arises out of a contract between the producer and the province as owner of the producing tract. In exercising the rights of an owner, as opposed to legislative powers constitutionally granted, there are no constitutional limits on the contractual terms that can be entered into. This is not to say that a province exercising its ownership powers need fear no overriding constraints, since it is always possible for valid federal law to be passed which would limit the province in the terms which it imposed in its leases. Such overriding federal legislation would not, of course, be common or easily found to be constitutional since, *ex hypothesi*, such legislation would be interfering with constitutionally recognized ownership rights of the province. However, it is possible to conceive of circumstances in which valid federal overriding legislation could be enacted. Federal jurisdiction over the regulation of Trade and Commerce (section 91(2) of the British North America Act) could support legislation respecting international or interprovincial trade in resources which limited, in some way, the scope of contractual freedom for the

province, so long as this limitation was purely incidental, or ancillary, to a legitimate trade regulatory scheme. Likewise the power of the federal government to make laws for "the Peace, Order and Good Government of Canada," a power found in the opening words of section 91 of the BNA Act, has been held to support legislation enacted to meet emergency situations. It is not at all inconceivable that Canada could experience an energy supply emergency which would justify a comprehensive federal policy in relation to resource extraction, distribution and revenue sharing which overrode the royalty pattern put in place by a provincial government.³⁰

In addition, it should be noted that section 121 of the British North America Act may place a limitation on the rights of the province in the exercise of its proprietary powers.³¹ That section states:

All Articles of the Growth, Produce, or Manufacture of any one of the Provinces shall, from and after the Union, be admitted free into each of the other Provinces.

The effect of this proscription might be to foreclose a royalty rate structure which contained differentials based on whether the production was destined for intra-provincial use or extra-provincial use. This distinction would result if a province were to use the royalty structure to provide cheap energy to its residents or, alternatively, if the province were to encourage, through the reduction of royalties, a domestic secondary energy industry.³²

It should be noted that section 121 could well be construed not to have any such effect. The words of the section state that goods shall "be admitted free into each of the other Provinces." The proscription, therefore, may simply be against levies on imports and not address the question of export levies. The federal government's belief that the Canadian Economic Union does not enjoy sufficient constitutional buttressing³³ is an indication that the wider reading of the section might not be sustained in the courts. On the other hand, there is the suggestion in the opinion of Mr. Justice Rand in *Murphy v. C.P.R.* and *Attorney*

General of Canada³⁴ that section 121's purpose is to create a general prohibition on restraints on the movement of products.³⁵ And elsewhere in the same opinion he implicitly identifies section 121 as being concerned with "interference with the free current of trade across provincial lines."³⁶ Under this view of the section there is a potential limitation on the provinces' contracting powers.

The power to make laws in relation to Crown minerals is conferred upon provinces by section 92(5) of the British North America Act which gives provinces exclusive jurisdiction over "the Management and Sale of the Public Lands belonging to the Province and of the Timber and Wood thereon." The primary nature of this jurisdiction over Crown lands is not limited by the reference to timber rights.

Provincial ownership of public lands is conferred under section 109 of the BNA Act which states:

All Lands, Mines, Minerals, and Royalties belonging to the several Provinces of Canada, Nova Scotia, and New Brunswick at the Union, and all Sums then due or payable for such Lands, Mines, Minerals, or Royalties, shall belong to the several Provinces of Ontario, Quebec, Nova Scotia, and New Brunswick in which the same are situate or arise, subject to any Trusts existing in respect thereof, and to any Interest other than that of the Province in the same.

This section refers only to the original provinces but with the exception of Alberta, Saskatchewan and Manitoba parallel sections were enacted at the time new provinces joined Confederation. When the three prairie provinces were created, Manitoba in 1870 and Alberta and Saskatchewan in 1905, the lands, mines, minerals and royalties incident thereto were retained by the Dominion. This situation, which was a constant irritant to those provinces, persisted until 1930 when Canada entered into an agreement with Manitoba, Saskatchewan and Alberta under which they were placed on an equal footing with the other provinces; provincial rights under section 109 of the BNA Act were extended to those provinces. The opening section in each of the agreements states "In order

that the Province may be in the same position as the original Provinces of Confederation are in by virtue of section one hundred and nine of the British North America Act, 1867, the interest of the Crown in all Crown lands and all sums due or payable for such lands, mines, minerals or royalties ... belong to the Province³⁷

There is a degree of uncertainty about the extent to which public land ownership confers on the provinces the right to regulate the exploitation of resources on those lands. It is altogether likely that the province enjoys broader powers in respect of regulating exploitation of these lands than they have by virtue of the legislative powers under section 92. For instance, in the early case of *Smylie v. The Queen*,³⁸ the Ontario Court of Appeal held that Ontario could validly require, as a condition of granting a licence to cut timber from Crown lands, that all cut timber must be processed within Canada. Likewise, in *Brooks-Bidlake and Whittall Limited v. Attorney General of B.C.*,³⁹ the Judicial Committee of the Privy Council allowed a provincial prohibition against employing Chinese or Japanese labour to be inserted as a condition of a Crown timber licence. The results prevailed notwithstanding federal jurisdiction over trade and commerce and over aliens. As indicated above, had there been valid federal law with which these conditions conflicted, the results would likely have been different. In any event, this form of exercise of proprietary powers does not relate directly to resource revenues; ambiguity about either the propriety or current significance of these decisions need not cast doubt on the central point that true royalty provisions are clearly valid.

A final point about this power is that provinces may not only contract for whatever royalty rate they are able to obtain but they are also able to contract for the inclusion of a provision under which lessees agree to comply with all relevant provincial legislation in force from time to time. In this way, ownership is used to bring about a prospective adoption by reference of provincial laws, as a term of the lease, with attendant contractual remedies for their breach. In other words, provincial control

over resource revenues includes the ability to change the terms of the contract whenever the province chooses. Under Alberta law, all Crown leases are subject to two significant features: the first is that the lessee agrees to deliver his oil to the Alberta Petroleum Marketing Commission which acts as his exclusive agent for marketing the oil,⁴⁰ and the second is that there is a prospective adoption of all royalty rates which may be set from time to time by regulation.⁴¹

4 STATE FIRMS

GENERAL

To the extent that a province wishes to become an entrepreneur in the oil and gas industry it is able to exert a considerable influence over the province's share of resource revenues. This is true whether the provincial enterprises derive revenue from Crown lands, freehold lands acquired since Confederation (or in the case of the Prairie provinces, since 1930) or from lands worked under mineral leases. There seems to be no constitutional limitation on a province's capacity to create Crown corporations through which provincial monies are dedicated to the acquisition or creation of commercial enterprises. It is true that the provincial taxation power is limited to "raising of a Revenue for Provincial Purposes" and the provincial incorporating power is limited to "the Incorporation of Companies with Provincial Objects" but neither of these provisions has been read to impose a constraint on the provincial policy objectives which are achievable through the creation of Crown corporations. It would appear that what a provincial legislature determines is of benefit to the province, either by way of spending or by way of incorporation, will satisfy the tests of "Provincial Purposes" and "Provincial Objects."

A related issue is the extent to which the province is constitutionally permitted to expropriate existing energy enterprises as a means of

becoming involved in the industry. This is an issue of purely academic relevance at the present time since there seems to be an adequate capacity for provinces to become engaged in the field through contractually based activity. In fact, the only circumstance under which expropriation would be a necessity is if a province were to set, as its policy, state ownership of the entire industry within the province. Twice in the last two decades British Columbia has passed legislation designed to "nationalize" an industry (that is, establish a state monopoly for either the whole province or a part of the province). The courts disallowed the first attempt, the B.C. Power Corporation case,⁴² and permitted the second, the Insurance case.⁴³ The attempt which failed, however, failed because the expropriation was of a single company which was the sole asset of its federally incorporated parent. It was held that British Columbia's compulsory purchase of the company impaired the federal incorporating power as exercised in the incorporation of the purchased company's parent. In the second case, where nationalization entailed the creation of a state monopoly in automobile insurance to the detriment of a large number of companies conducting business in an area subject to provincial legislation, the state monopoly was permissible.

The reasoning in the B.C. Power Corporation case would not apply to a strategy of expropriating all of the companies in the energy resources area. On the other hand, the Insurance case could also not be relied on. In the first place, it did not deal with expropriation. In the second place, it is not clear that provincial legislation allowing expropriation of oil and gas businesses, because of their extra provincial character, could be said to be passed in relation to a provincial head of power, namely, Property and Civil Rights, as opposed to a federal head, namely, the Regulation of Trade and Commerce. The recent Quebec Court of Appeal decision in the Asbestos Corporation⁴⁴ case which upheld the right of the Province of Quebec to expropriate the assets of Asbestos Corporation lends support to the view that the nationalization of an industrial sector is a

permissible provincial policy notwithstanding the largely inter-provincial and international trading of the products of that sector.

THE SECTION 125 PROBLEM

The major constitutional issue bearing on the operation of state firms is the extent to which the revenues or income of those firms are subject to federal revenue taxes or federal corporate income taxes. At first blush it appears that the British North America Act provides an easy answer to this question. Section 125 states simply "No Lands or Property belonging to Canada or any Province shall be liable to Taxation."

Case law on this section has not been plentiful and, indeed, it is only in recent years that the "125 problem" has gained widespread attention. The significance of section 125 to sharing resource revenues arose on the introduction of the National Energy Program at the end of October, 1980. That Program introduced two new taxes, the first was an excise tax of 30 cents per Mcf (the Natural Gas and Gas Liquids Tax) (NGGLT) and the second, an 8% Petroleum and Gas Revenue Tax (PGRT). The legislation in respect to both taxes makes explicit that the taxes are to be leviable against the Crown in the right of the Province.⁴⁵ The three major producing provinces of Canada (British Columbia, Alberta and Saskatchewan) all responded by challenging the validity of imposing the new energy taxes on the provincial Crown. Alberta directed questions to the Alberta Court of Appeal in order to obtain a judicial ruling on the constitutional validity of applying the NGGLT to gas produced by the Province of Alberta and sold by the province to purchasers in the United States. The Alberta Court of Appeal handed down its decision in the spring of 1981⁴⁶ holding that the application of that tax to export transactions by the province of its own gas is unconstitutional. The Government of Canada appealed that decision to the Supreme Court of Canada and argument of the case was heard in late June, 1981. Both British Columbia and Saskatchewan which, unlike Alberta, have Crown corporations operating in

the oil and gas production and distribution business and therefore attract these taxes, refused to make payment of them to the Government of Canada. The Government of Saskatchewan passed an Order in Council referring questions as to the validity of the application of these taxes to two of its Crown corporations, Saskatchewan Power Corporation and Saskatchewan Oil and Gas Corporation, to the Saskatchewan Court of Appeal.⁴⁷

However, before the matter was set down for hearing, discussions were held between the governments of Canada and Saskatchewan and an agreement over oil and gas prices and taxation of revenues was reached.⁴⁸ The parties to these negotiations had come to realize that the issue of the liability of the provincial Crown for federal taxes was one which had to be resolved in the context of pricing and taxation agreement. Since the purpose of the agreement is to allocate projected oil and gas revenues between the industry, the provincial government and the federal government, it was imperative that the two governments know whether or not the federal share included tax revenues in respect of resource either produced by or, in the case of some taxes, marketed by provincial Crown corporations. In other words, if agreement were reached on the assumption that section 125 immunized the production of the Saskatchewan Oil and Gas Corporation from federal taxes and if the courts later concluded that this production should bear federal tax the revenue "splits" between federal and provincial governments, worked out in the agreement would be disrupted. Consequently, the pricing and taxation agreement contains clauses under which the monies which would be payable under the various federal taxes by the provincial Crown are paid in the form of grants and the Government of Canada agrees not to collect the taxes. The agreement is stated to be without prejudice to the positions of each government.⁴⁹ A similar arrangement was reached in the British Columbia-Canada Agreement.⁵⁰

Although these agreements, together with the situation that Alberta has little, if any, Crown production, mean that Canadian courts will not be

as burdened with questions concerning the meaning and scope of the section 125 tax immunity as they might have been, the recent confrontation has underscored the growing importance of this issue. Federal ambitions to subject all non-renewable resource revenues to a uniform federal tax regime will not have evaporated with the signing of the energy pricing agreements. The question has only been postponed and only in respect of oil and gas. There are other major resources, exploited under Crown ownership, producing revenues in respect of which the federal government is not a beneficiary.

There are three interpretative questions posed by section 125. The first is to determine whether the new energy taxes are "Taxation" within the meaning of the section. The second is to determine whether imposing tax liability on Crown corporations performing an entrepreneurial role in the oil and gas industry is tantamount to making "the Province" liable to taxation. The third is to define exactly what tax bases count as imposing liability on the "Property" of the province.

What is Taxation?

An examination of the legislative history behind section 125 of the British North America Act suggests that the motive for its inclusion was to constitutionalize the Crown prerogative immunity from taxation.⁵¹ This suggests that the language of section 125, particularly "taxation," should not be construed particularly narrowly. On the other hand it should not be construed to immunize the provincial Crown against regulatory burdens not primarily concerned with the raising of money which are placed on provincial property through valid federal legislation. In fact, the case law dealing with the reach of federal regulation vis a vis provincial governmental agencies suggests that the tax immunity in section 125 has not been thought of as a source of broad immunity from regulatory levies.

The major analytical issue in applying the tax immunity has been the extent to which federal imposts could avoid the constitutional immunity for provinces on the basis that the impost, although in the form of a tax

or duty, was in fact an instrument of federal legislation allowable under a head of section 91 other than section 91(3) - the taxation power.

In *Attorney General of British Columbia v. Attorney General of Canada* (the Johnny Walker case)⁵² the Judicial Committee of the Privy Council held that section 125 did not apply to exempt the Province of British Columbia from liability to pay federal customs duty on the importation by the province of a case of Scotch Whiskey intended for sale in the province's Crown owned liquor stores. The best reading of the Privy Council decision seems to be that the law imposing the customs duty was primarily a law in relation to trade and commerce under section 91(2) and not a law primarily in relation to taxation. Lord Buckmaster in a somewhat obscure judgment states:

The imposition of customs duties upon goods imported into any country may have many objects; it may be designed to raise revenue or to regulate trade and commerce by protecting native industries, or it may have the two-fold purpose of attempting to secure both ends; in either case it is a power reserved to the Dominion [S. 125] is to be found in a series of sections which, beginning with s. 102, distribute as between the Dominion and the Province certain distinct classes of property, and confer control upon the Province with regard to the part allocated to them. But this does not exclude the operation of Dominion laws made in exercise of the authority conferred by s. 91. The Dominion have the power to regulate trade and commerce throughout the Dominion, and, to the extent to which this power applies, there is no partiality in its operation. Sect. 125 must, therefore, be so considered as to prevent⁵³ the paramount purpose thus declared from being defeated.

This passage seems to indicate a finding that the customs duty being imposed in this case had as its paramount purpose the regulation of international trade and, therefore, the ratio of the case would seem to be that when a taxing statute is enacted in relation to trade and commerce and not in relation to taxation, it will not be subject to the limitation found in section 125. The Supreme Court of Canada decision⁵⁴ from which British Columbia appealed, does not give forth any clear principle but it too seems to proceed on the assumption that section 125 was drafted to

protect government property only from "taxation" and not from regulation even though regulation can in some instances amount to a deprivation of property as in the Johnny Walker case itself, or as in expropriation cases.

Although the point was not made in either the Supreme Court of Canada judgment or the Privy Council judgment, it is worth noting that the act which was imposed in the Johnny Walker case contains in it, in section 1, the following clause: "... provided, however, that nothing herein contained is intended to impose or to declare the imposition of any tax upon, or to make or to declare liable to taxation, any property belonging to His Majesty either in the right of Canada or of a province."⁵⁵ This indicates that the federal government, in that case, clearly viewed its customs duty as a device not to raise revenue but to control importation. This goal may be distinguished from the explicitly stated purposes of the National Energy Program taxes. In the document announcing that program it is stated: "Another source of revenue is needed. The Government of Canada will, therefore, impose a new natural gas and gas liquids tax."⁵⁶

Although in the Alberta case the federal government attempted to apply the Johnny Walker decision to the National Energy Program taxes, it is likely that this attempt will fail, on the facts of the Alberta Reference, in the Supreme Court of Canada. The federal government stated that the tax being challenged was a tax on exports (this is semantically true), that a tax on exports is an export tax, that an export tax is equivalent to an import duty, that an import duty is designed to regulate international trade and, therefore, the tax on exports did not fall under section 125. There are clear logical fallacies in this line of reasoning but, apart from these, the argument in any event is not available in a general challenge to the application of these taxes to provincial government operations since in such a case all aspects of the National Energy Program taxes would be subject to consideration and not merely the export aspect. An attempt by the federal government to support the energy taxes under the trade and commerce power using arguments similar to those

used in the Johnny Walker case, would not likely succeed. Although these taxes are levied on commodities that enter the flow of international and interprovincial trade and commerce and, therefore, incidentally affect trade and commerce, it can hardly be said that the purpose of the taxes is to regulate trade and commerce. As has been noted, the federal government, both in the National Energy Program and in the budget papers, labelled the taxes as taxation and identified their purpose as raising sufficient revenues to support the Canadianization program outlined in those papers. It is clearly valid for the federal government to pursue the Canadianization purpose but it does not follow that the raising of monies to promote that valid objective transforms taxation into regulation. The test can only be the purpose of the levy itself and not the purpose to which the funds raised by it are put. If the latter were the test then all federal taxes could be imposed on provinces so long as the funds produced were dedicated to federal purposes.

In addition, since neither the taxes nor the other legislative goals which are pursued treat differently the oil and gas kept within the producing province from the oil and gas taken out of the province, the scheme arguably does not meet the test for valid federal trade and commerce regulations. In other words, the National Energy Program is probably best sustained under Parliament's taxation and spending powers and it is self-defeating for the federal government to deny its reliance on the former head. In any event, the federal government already has in existence ample legislative and regulatory controls over the production, distribution, pricing and sale of gas and oil. To superimpose a tax on this regulatory framework with the excuse that the tax is an integral part of the regulatory scheme appears to be specious.

What is Included Within the Idea "Province"?

The main issue under this aspect of section 125 seems to be whether provincial Crown corporations can be considered to be an integral part of

the government of a province. There seems to be little doubt about the answer; it is clear that a Crown corporation which is controlled by the Crown is entitled to enjoy the same rights and privileges as the Crown itself whether those rights and privileges derive from common law, from statute, or from the constitution. Furthermore, there are a number of cases which have confirmed this principle in relation to the application of section 125.⁵⁷ Property belonging to the following Crown corporations has been held to belong to the Crown for the purposes of section 125: Canada Mortgage and Housing Corporation,⁵⁸ British Columbia Power Commission,⁵⁹ the Canadian Broadcasting Corporation,⁶⁰ and the Halifax Harbour Commissioners.⁶¹

The two Saskatchewan Crown corporations which under the terms of the National Energy Program would have been liable for taxes have been legislatively identified as agents of the Crown. For example, The Saskatchewan Oil and Gas Corporation Act provides that:

2(4) The corporation is for all purposes an agent of Her Majesty in right of Saskatchewan, and its powers under this Act may be exercised only as an agent of Her Majesty.

(5) The corporation may, on behalf of Her Majesty, contract in its corporate name without specific reference to the Crown or Her Majesty.

(6) All property whether real or personal, and all money acquired, administered, possessed or received by the corporation is the property of Her Majesty in right of Saskatchewan and shall for all purposes be deemed to be the property of Her Majesty.⁶²

The matter becomes more complicated in relation to the question of the tax liability of subsidiaries of Crown corporations. It is possible that a court would find that the subsidiaries are not Crown agents and not entitled to the protection of section 125. The subsidiaries, for example, of both the Saskatchewan Crown corporations to which the energy taxes purportedly apply are neither creations of the provincial Crown nor are their assets the property of the provincial Crown. Even if the degree of

control actually exercised by the provincial government over the subsidiaries were as great as that exercised over the parent corporations the courts would likely fasten upon the separate legal existence of the subsidiaries as distinct corporations. Likewise, the statutory designation of these subsidiaries as agents of the Crown may not be effective in immunizing them from federal taxes. The subsidiaries would remain as privately incorporated companies, and in most cases, created under the laws of other jurisdictions and not operating within the province. It would be hard to maintain that extra-provincial subsidiaries are agents of a Crown the constitutional jurisdiction of which is limited to governmental activity "within the province."

A more difficult aspect of the question of the scope of protection of section 125 is whether that section protects provincial property acquired through commercial activity as opposed to forming part of the province's conventional governmental operation. For some years the federal government has maintained that section 125 ought not to be considered to be available to shield provincial Crown corporations engaged competitively in commercial activities. The most recent manifestation of federal anxiety on this score is found in the report of the parliamentary task force on federal-provincial fiscal arrangements, entitled *Fiscal Federalism in Canada*, issued on August 31, 1981:

[S. 125] means that provincial hydro electric utilities and firms such as the Potash Corporation of Saskatchewan pay no income taxes. Combined with the complicit backing of the provincial governments, the advantageous tax treatment available to some provincial Crown corporations could make them formidable competitors. In addition, tax exemption for Crown corporations provides an incentive to convert profitable private industry firms to this status.

The real issue is the extent to which a large portion of what is now private property may become immune from federal taxation.

It has been suggested that if the provinces' position vis a vis section 125 is fully supported by the courts (including the

Supreme Court of Canada), the producing provinces could turn major portions of their oil and gas industries into Crown corporations. This would enable these provinces to shelter a large part of their oil and gas revenues from federal taxation. Since all property of provinces is immune from federal taxation, it may be worthwhile for the provinces generally to "nationalize" other industries so as to pre-empt the federal government from deriving revenues it believes it is justified in collecting.⁶³

There may be a certain appeal to the proposition that when a province embarks on a commercial enterprise it should be treated as having accepted the same tax regime as would be imposed on a privately owned enterprise. And, as is pointed out in the above extract, if tax exemptions are extended to all activities carried out by provinces the expansion of "state capitalism" would be encouraged and this could erode seriously the federal tax base.

On the other hand there is no satisfactory principle, either as a matter of constitutional law or as a matter of economic discernment, to be used in characterizing an activity of a Crown corporation as "commercial." It might be said that once a government decides to embark upon an enterprise this indicates that a governmental interest has been identified. Which undertakings would a court feel comfortable in labelling as being without legitimate government purpose, or as being the result of pure commercial motives? Professor W.H. McConnell in his *Commentary on the British North America Act* states:

Rarely does a government launch a commercial undertaking or Crown corporation purely in an effort to compete for private profit.⁶⁴

No doubt there are public policy (i.e. governmental) considerations which have drawn Saskatchewan so deeply into the oil and gas industry.

Furthermore, section 125 itself gives no textual support for such a distinction. It might be argued that had the distinction been appropriate for applying section 125 it would have been picked up in the *Johnny Walker*

case since in that case the province's liquor retailing activity was motivated, at least in part, by a desire to capture the profits of that business. Furthermore, it cannot be argued that the distinction was not thought of in that case since Mr. Justice Idington, in the Supreme Court of Canada, in his decision, noted that the province's activity could not have been within the contemplation of the framers of the BNA Act.⁶⁵ No other Justice in that Court or in the Privy Council adopted this point of analysis.

The distinction is, however, not unknown in United States constitutional jurisprudence. The limitation on state tax immunity based on the commercial activity of the state was first articulated in *South Carolina v. United States*⁶⁶ in which it was held that a state was liable to pay a federal tax, in the form of a licence fee, on the sale of liquor in state liquor stores. The court said that the exemption of the state was limited to functions "of a strictly governmental character" and did not extend to "the carrying on of an ordinary business." In *New York v. United States*, (the Mineral Water case)⁶⁷ in which a federal tax on the sale of mineral waters was held to be applicable to the sale by New York State of mineral

waters taken from state owned springs at Saratoga, it appears that the "governmental/commercial" distinction is in operation. Although all judges rejected the distinction as untenable, the majority then held that the tax was allowable since it did not "curtail the business of the state government more than it does the like business of the citizen,"⁶⁸ thereby implicitly perpetuating the distinction. However, it should be noted that there is no provision of the American constitution explicitly creating intergovernmental tax immunity and that difference between the American and Canadian constitutional texts makes the American jurisprudence of only marginal interest.

We are, nevertheless, left with the problem of defining a limit on the operation of section 125 that would forestall massive disruption of federal taxation policies through high levels of provincial

"nationalization." Perhaps the answer might be found in the suggestion from the Mineral Water case that when the activities of the State are paralleled by "the like business of the citizen" (or in other words, when the Crown corporation acts in competition with the private sector in a particular market) intergovernmental tax immunization ought not to be available. This would not be because of the unfair advantage given to Crown corporations since it is difficult to discern competitive fairness as a constitutionalized value. Rather it would be because the governmental decision not to create a state monopoly is an indication that the economic and social function is being performed adequately under the normal competitive model. In other words, in these situations it is not possible to discover governmental objectives that override the social welfare produced by normal market activity; there are no special policies that the government has in relation to the delivery of those goods and services that are not capable of being met through the operation of the market. This is not to say that there are no governmental objectives behind the creation of the state firm, such as obtaining access to an industry or capturing a share of a lucrative market for the public benefit, but that those objectives do not meet the threshold test of governmental interest.

The major difficulty with such a test is that it would provide a powerful inducement to provinces when initiating governmental participation in a particular sector of economic activity to enter it through the removal of all private activity. Of course, the creation of a government monopoly in this way is often precisely what the government wants. For instance, provincial automobile insurance schemes designed to implement efficient indemnification schemes logically require a government insurance monopoly, at least to the minimum level of protection established as government policy. On the other hand there are times when governmental economic goals are satisfied through merely being a participant. The effect of the proposed test might be to induce provinces to exclude all private actors, merely as a tax avoidance measure, each time the province became involved for whatever reason. If this happened

the purpose of the test or distinction (i.e., to prevent broad erosion of the federal tax base) would be defeated. In turn the result of this could well be that courts would begin to determine which provincial monopolies were "valid" and which were "invalid." Courts would undertake assessments of the legitimacy of creating provincial Crown monopolies. This is not a function which is appropriate for a court since "nationalization" policies are totally political - are a product of distinct ideological views concerning the role of the state.

A further test by which Crown market activity could be judged as being governmental or not is whether the activity is conducted through the instrumentality of a government department or a Crown corporation. This test which appears to be overly formal, can be justified as responsive to a rational "governmental/commercial" distinction on the basis that if the activity is able to be carried out in a department, governmental objectives would seem to be satisfied by less free-wheeling and entrepreneurial activity. If it must be carried out through a corporation, that is, under an organization acting under less severe jurisdictional and "rule of Law" constraints it would appear that the governmental objectives are more purely competitive or entrepreneurial. However, this test like the former one might lead to the use of inefficient structures (and even false and arbitrary structures) in order to obtain the benefit of the tax immunity.

On balance both attempts to give content to the "governmental/commercial" distinction lead to tests which, while containing some rational elements, would likely produce inefficient tax avoidance behaviour. Once that happened courts would have to undertake a "second generation" enquiry of whether the apparent satisfaction of the test for immunity ought not to be recognized because the governmental structure and behaviour is the product of no rational motive other than tax avoidance. The potential for intrusive economic judgment by the judiciary under the "second generation" enquiry is high and unfortunate.

What is "Property" Within Section 125?

There are two aspects to this question. The first aspect is to discover the nature of the property which is mentioned in the section and the second is to determine whether some tax bases may be considered not to amount to a tax on property.

With respect to the first of these questions, it has been argued that since section 125 appears in Part VIII of the British North America Act entitled "Revenues; Debts; Assets; Taxation" the immunity created by that section is limited to taxation on property which is otherwise identified in that part of the Act. In particular, it is suggested that the tax immunity refers only to what is known as section 109 property. But there is nothing within the text of section 125 to suggest this limitation apart from its location within the same part of the British North America Act. Furthermore, it is not altogether clear that Part VIII is not a pot pourri of provisions, the sections of which do not necessarily interrelate. The title of the Part does not suggest any interconnection between the various sections. Although there is clearly a fiscal tone to the Part, the fact of a common theme does not make it evident that the section dealing with tax immunity should be bound by the section dealing with land ownership. Indeed, the rather unusual punctuation in the title suggests that the Part is not all "of a piece."

If section 125 were seen to be limited to section 109 property, the result would be that only Crown property or the revenues produced by the use of Crown property would be exempt from taxation. Crown property in this context means simply that property which the province owns by virtue of either section 109 or, in the case of prairie provinces, the Natural Resources Transfer Agreement; that is, property which was Crown property at the time a province entered Confederation or at the time of the public property transfer. Section 109 refers only to property held by the Crown at the time of Confederation or the transfer from one Crown to another,

since that section simply states that lands belonging to the pre-Confederation provinces shall belong to the post-Confederation provinces. In this way, the section identifies specific lands and constitutionalizes ownership of them. Its basic function is not to delineate the concept of ownership, but to confer a specific ownership. The result is that if the property referred to in section 125 is restricted to section 109 property, section 125's immunity relates only to those specific lands.

There is a further potential test for classifying property under section 125. It could be that property held by the province whether it is section 109 property or not so long as the property is held as a provincial asset, but if the property is held by the province merely in trade, it would not be protected by section 125. Applying this point to the National Energy Program taxes, the NGGLT would be payable by the Saskatchewan Power corporation in respect of natural gas which it purchased for distribution to consumers. There is no textual support for this distinction. Furthermore, no previous case on section 125 has made a distinction between various pedigrees of property whether pre-Confederation, post-Confederation or inventory property. Nor is there a great deal of textual support for the distinction between "conduit" or "inventory" property on the one hand and "provincial assets" on the other. Nevertheless, such a distinction does allow for a break point so that there would be protection for the tax base if a province were to create a Crown corporation which performs a conduit role in respect of virtually all commodities. On the other hand the ability of the federal government to recover commodity taxes through a retail sales tax or consumption tax under which the province would not be the taxpayer is such that there is no real need for this sort of break point.

The last issue in connection with the concept of property is whether federal taxes are payable by provincial Crown corporations if the taxes are on persons, or on transactions, or on income, so long as they are not on commodities (or property). Although there is support for classifying taxes as not imposing a liability on property, in the recent Federal Court

decision of *Snow v. The Queen*,⁶⁹ it would seem that the possibility of providing a rational test whereby the tax could be seen as not burdening property but only burdening, say, a transaction, is not high. In the *Alberta Reference*,⁷⁰ the Alberta Court of Appeal rejected the attempt to classify taxes in this way:

Section 125 refers only to lands or property. It does not expressly relate to taxes on persons, or on transactions, or on the exercise of property rights such as use or movement of the property. But the practical effect of a tax on the transaction by which a government disposes of its property, or a tax on the person of the proprietor of that property, differs little from a tax on the property itself. We do not agree that the plain purpose of section 125 can be avoided by so simple a device. The immunity extends not only to the property of a Province but to a Province with respect to its property.

The true flaw in the attempt to distinguish taxes on property from taxes on persons or transactions is that if it were to succeed it would render section 125 meaningless. Small drafting changes could easily change the classification of any federal tax. The tax on property could be transferred easily into a tax on a person or transaction, with the property being used to measure the amount of the tax. Also changes in the basic tax scheme could effect a different constitutional result. A tax on net income could be changed to a tax on production at a lower rate. It is not likely that the Supreme Court of Canada would accept a distinction which enables section 125 to be so easily evaded.

5 CONCLUSION

It will be seen that in respect of interjurisdictional tax immunity the problems of interpretation and delineation have barely begun to be addressed by the courts. Governmental activity and economic conditions which have permitted these issues to go unresolved for so long are quickly changing; section 125 jurisprudence can be expected to be an important factor in the sharing of resource revenues by governments.

The other forms of governmental capture of revenues pose less diverse juridical speculation. But even here the imminent introduction of section 92A and especially section 92A(4), the new provincial taxing power, will produce a slightly new configuration of competing powers. Judicial interpretation of the powers to tax and to regulate through the exercise of Crown ownership rights is not complete; the tensions in these areas are not purely historic.

At a very general level provincial powers in this area – the wide power to tax, the control of resource development and revenue that flows from ownership of crown land, and the immunity of uncertain scope of the provincial Crown from federal taxes – are considerable. In a federal state the central government can always, if it chooses to make inroads on provincial activity, generate a centripetal force.⁷¹ There is evidence that central economic regulation has been alluring to the federal government over the past decade. This is not surprising; activist

governments, such as Canada has had, normally proceed through equal part of self-confidence and ambition. The question that remains open is whether the considerable provincial resource powers will serve to keep the tension alive, to hold up the present balance between the centre and the regions. If so, resources may be serving a double duty in Canadian development: enhancing its economic growth and, through federal-provincial conflict over resources, producing long term political stability.

NOTES

- 1 Memorandum of Agreement between the Government of Canada and the Government of Alberta relating to Energy Pricing and Taxation, September 1, 1981. Paragraph 14 of the Agreement states:

"The Government of Canada and the Government of Alberta do not intend to introduce any tax, royalty or levy specific to the oil and gas producing industry, other than those set out in this Agreement."

Similar undertakings are given severally by the parties in paragraphs 9 and 10.

- 2 The British Columbia Agreement took the form of a letter from the Hon. Marc Lalonde, federal Minister of Energy, Mines and Resources to the Hon. Robert H. McClelland, British Columbia's Minister of Energy, Mines and Petroleum Resources, dated September 24, 1981.

The terms of the Saskatchewan agreement are contained in a letter of Understanding and Appendix between the Government of Canada and the Government of Saskatchewan relating to Energy Pricing and Taxation, dated October 26, 1981.

- 3 *Central Canada Potash v. Government of Saskatchewan*, (1978), 88 D.L.R. (3d) 609 (S.C.C.).

- 4 A new factor in this dispute will be the newly expressed grant of power to the provinces under s. 92A of the British North America Act (Section 92A is contained in s. 50 of the Constitution Act, presently in the form of a Resolution adopted by the Parliament of Canada, December, 1981). This section states, in part:

92A. (1) In each province, the legislature may exclusively make laws in relation to
(a) exploration for non-renewable natural resources in the province;

- (b) development, conservation and management of non-renewable natural resources and forestry resources in the province, including laws in relation to the rate of primary production therefrom; and
- (c) development, conservation and management of sites and facilities in the province for the generation and production of electrical energy.

This new section may not significantly improve the constitutional position of provinces since provincial laws respecting "development, conservation and management" may so markedly affect international trade that courts will ascribe a federal character to them rather than a s. 92A character.

- 5 In *Caron v. R.*, [1924] A.C. 999 (J.C.P.C.) Lord Phillimore stated that Parliament could not levy direct taxation to raise revenue for provincial purposes. This is an instance of reading and placing limits on the federal power in light of the provincial power. See, G. LaForest, *The Allocation of Taxing Power Under the Canadian Constitution* (2d ed.) (Toronto: Canadian Tax Foundation, 1981) 51-53 for a discussion of the relation of federal to provincial taxing power.
- 6 Lederman, "The Constitution: A Basis for Bargaining," in A. Scott *Natural Resources Revenues: A Test of Federalism* (Vancouver: University of British Columbia Press, 1976) 57.
- 7 (1887), 12 App. Cas. 575 (J.C.P.C.).
- 8 *Id.* at 582.
- 9 [1952], 2 S.C.R. 231 at 252. This test has been expressly adopted and applied in the recent Supreme Court of Canada judgment in *Minister of Finance v. Simpsons Sears* (decision of January 26, 1982). In this case Chief Justice Laskin, speaking for the Court, said: "The fact that the company may, competitive and other factors permitting, recoup the tax in its overall pricing structure, is not ground for classifying it as an indirect tax." (at 18).
- 10 These limitations are discussed in Moull, "Natural Resources: The Other Crisis in Canadian Federalism" (1980), 18 *Osgoode Hall L.J.* 1 at 6.
- 11 *Canadian Industrial Gas & Oil Ltd. v. Government of Saskatchewan* (1977), 80 D.L.R. (3d) 449 (S.C.C.).
- 12 For descriptions of the problems created in Canada by the cartelization of Middle Eastern oil in 1973-74 see Breton, "The

Federal-Provincial Dimensions of the 1973-74 Energy Crisis in Canada' in W. Oates, *The Political Economy of Fiscal Federalism* (Lexington: Lexington Books, 1977) 105-113; Moull, *supra* note 10, at 11-12; Smiley, 'The Political Context of Resource Development in Canada' in A. Scott, *Natural Resources Revenues: A Test of Federalism* (Vancouver: University of British Columbia Press, 1976) 61-73.

- 13 Queen's Bench decision: [1975] 2 W.W.R. 481; Court of Appeal decision: (1975), 65 D.L.R. (3d) 79, [1976] 2 W.W.R. 356.
- 14 Extra-provincial effect was rejected as a controlling criterion in *Carnation Co. v. Quebec Agricultural Marketing Board*, [1968] S.C.R. 238.
- 15 *Supra*, note 11, at 463.
- 16 *Id.* at 464.
- 17 *Id.* at 461.
- 18 *Id.* at 462.
- 19 Paus-Jensen, 'Resource Taxation and the Supreme Court of Canada: The CIGOL Case' (1979), 5 *Can. Public Policy* 45 at 53; also quoted in Moull *supra*, note 10, at 24-25.
- 20 *Supra*, note 11, at 481.
- 21 *Id.* at 463.
- 22 *Id.* at 461. Mr. Justice Martland, J. stated: "The tax under consideration is essentially an export tax imposed upon oil production. In the past a tax of this nature has been considered to be an indirect tax."
- 23 Enacted as S.S. 1977-78, c. 26; now cited as R.S.S. 1978, c. 0-3.1.
- 24 Reference re Amendment of the Constitution of Canada (1981), 125 D.L.R. (3d) 1 (S.C.C.).
- 25 Contained in s. 50 Constitution Act, 1981, presently in the form of a Resolution of Parliament adopted December, 1981.
- 26 See note 4, *supra*.
- 27 Provincial powers over resource management, apart from s. 92A, flow from heads 5, 13, 16 of s. 92 of the British North America Act, 1867. These state: "In each Province the Legislature may exclusively make

laws in relation to matters coming within the classes of subjects next hereinafter enumerated; that is to say ...

- 5. The Management and Sale of the Public Lands belonging to the Province and of the Timber and Wood thereon.
- 13. Property and Civil Rights within the Province.
- 16. Generally all matters of a merely local or private nature in the Province.

In addition head 10 giving provinces exclusive jurisdiction over "Local Works and Undertakings" supports provincial regulation of resource management.

- 28 *City of Medicine Hat v. Attorney General of Canada*, Statement of Claim, filed in Court of Queen's Bench of Alberta, Judicial District of Calgary, August 25, 1981.
- 29 See Moull, *supra*, note 10, at 6-8 for a discussion of provincial ownership rights. More detailed discussions of constitutional ownership and its effect on provincial resource regulatory power are found in Crommelin, "Jurisdiction over Onshore Oil and Gas in Canada" (1975-76), 10 U.B.C. Law Rev. 86 at 88-115 and Milen and Savino, "Nationalization or Regulation? Constitutional Aspects of the Control of the Saskatchewan Oil Industry" (1974-75), 39 Sask. Law Rev. 23 at 38-47.
- 30 In fact the federal Parliament has already enacted such legislation. It first enacted the Energy Supplies Emergency Act, S.C. 1973-74, c. 52. The substantive portions of this Act expired June 30, 1976. Second, Parliament enacted the Energy Supplies Emergency Act, 1979, S.C. 1978-79, c. 17. This latter Act contains provisions relating to the mandatory allocation of supplies and the rationing of controlled products.
- 31 This line of argument is suggested, without elaboration in Moull, *supra*, note 10, at 8.
- 32 The new provincial tax power under s. 92A(4) contains an express prohibition of this sort of discrimination (see text accompanying n. 25, *supra*). However, this limitation on legislative power would not apply to provincial royalty schemes unless, of course, the royalty schemes were legislatively altered without a prior contractual term contemplating such changes. In this situation new royalty rates would be viewed, for constitutional purposes, as a tax.
- 33 See Hon. J. Chretien, *Securing the Canadian Economic Union in the Constitution* (Ottawa: Supply and Services Canada, 1980) 19-20.

- 34 [1958] S.C.R. 626.
- 35 *Id.*, at 637-643. For example, at 642 he states:
- "I take s. 121 ... to be aimed against trade regulation which is designed to place fetters upon or raise impediments to or otherwise restrict or limit the free flow of commerce across the Dominion as if provincial boundaries did not exist."
- 36 *Id.*, at 638.
- 37 E.g., see s. 1 Memorandum of [Natural Resources Transfer] Agreement between the Government of Canada and the Government of Saskatchewan, dated March 20th, 1930. This agreement and the agreements with Manitoba and Alberta (and British Columbia in which a transfer of the Railway Belt and Peace River Block, held back in 1871, was made) were constitutionalized by the British North America Act, 1930, 21 Geo. V, c. 26 (Imp.). For a discussion of this history see G. LaForest, *Natural Resources and Public Property Under the Canadian Constitution*, (Toronto: University of Toronto Press, 1969) 27-47.
- 38 (1900), 27 O.A.R. 172. (Ont. C.A.).
- 39 [1923] A.C. 450 (J.C.P.C.).
- 40 The Mines and Minerals Act, R.S.A. 1970, c. 238, as amended by The Mines and Minerals Amendment Act, 1973, S.A. 1973, C. 94, s. 5, which enacted s. 170.1 of the main Act.
- 41 *Id.* s. 4. which enacted s. 142.1 of the main Act. This section voids any royalty form which sets a maximum rate.
- 42 *British Columbia Power Corporation v. Attorney General of British Columbia* (1963), 47 D.L.R. (2d) 633 (B.C. Sup. Ct.).
- 43 *Canadian Indemnity Co. v. Attorney General of British Columbia* (1976), 63 D.L.R. (3d) 468 (S.C.C.).
- 44 *Societe Asbestos Ltee. v. La Societe Nationale de L'Amiante and le Procureur General de Quebec* (decision of Quebec Court of Appeal, March 4, 1981).
- 45 See, Excise Tax, Excise and Petroleum and Gas Revenue Tax, S.C. 1980-81, c. 68, s. 25.12 which states:

This Part [Natural Gas and Gas Liquids Tax] binds Her Majesty in right of Canada or a province and every person

acting for or on behalf of Her Majesty in right of Canada or a province.

See, also, in the same statute, s. 80 which states: This Part [Petroleum and Gas Revenue Tax Act] is binding on Her Majesty in right of Canada and in right of any province.

- 46 Reference re Proposed Federal Tax on Exported Natural Gas (1981), 122 D.L.R. (3d) 48 (Alberta Court of Appeal).
- 47 Saskatchewan Order in Council 809/81, referring certain questions to the Saskatchewan Court of Appeal, passed under authority of The Constitutional Questions Act, R.S.S. 1978, c. C-29.
- 48 *Supra*, n.2.
- 49 This arrangement is expressed in the Canada-Saskatchewan Energy Pricing and Taxation Agreement in the following paragraphs:

7. Payment of Natural Gas and Gas Liquids Tax (NGGLT) and of the Canadian Ownership Special Charge (COSC)

The Government of Saskatchewan takes the position that the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan, are not liable to pay taxes under the NGGLT and COSC and the Government of Canada takes the position that it has the right to levy such taxes on the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan. The Government of Canada and the Government of Saskatchewan have agreed, however, to set aside those differences of position without prejudice to them in order to achieve the general purposes of this letter of understanding. Therefore:

The Government of Canada agrees to remit for the term of this agreement, effective November 1, 1980, the NGGLT and the COSC insofar as they apply or purport to apply to the Crown in the right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan. The Government of Saskatchewan agrees to cause to be paid to the Government of Canada grants in lieu of the NGGLT and COSC in the amounts and at the times that are equivalent to those that would

have been obtained under the NGGLT and COSC in respect of the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan. The grants shall include a payment forthwith to the Government of Canada of a grant in lieu equivalent to all amounts (including interest thereon as calculated by Revenue Canada) that would have been payable to date from November 1, 1980 under the provisions of the NGGLT and COSC by the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan.

The Government of Saskatchewan agrees to provide to the Government of Canada all the information and other material that would have been required under the provisions of the NGGLT and COSC.

8. Payment of the Petroleum and Gas Revenue Tax (PGRT) and the Incremental Oil Revenue Tax (IORT)

The Government of Saskatchewan takes the position that the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan are not liable to pay taxes under the PGRT and IORT and the Government of Canada takes the position that it has the right to levy such taxes on the Crown in right of Saskatchewan, its agents and every person acting for or on behalf of the Crown in right of Saskatchewan. The Government of Canada and the government of Saskatchewan have agreed to set aside those differences of position without prejudice to them in order to achieve the general purposes of this letter of understanding. Therefore:

The Government of Canada agrees to remit for the term of this letter of understanding, effective January 1, 1981, the taxes under the PGRT and IORT insofar as they apply or purport to apply to the Crown in right of Saskatchewan, its agents and every person acting for or on behalf of the Crown in right of Saskatchewan.

The Government of Saskatchewan agrees to cause to be paid to the Government of Canada grants

in lieu of the PGRT and IORT in the amounts and at the times that are equivalent to those that would have been obtained under the PGRT and IORT in respect of the Crown in right of Saskatchewan, its agents, and every person acting for or on behalf of the Crown in right of Saskatchewan. The grants shall include a payment forthwith to the Government of Canada of a grant in lieu equivalent to all amounts (including interest thereon as calculated by Revenue Canada) that would have been payable to date from January 1, 1981 by the Crown in right of Saskatchewan, its agents and every person acting for or on behalf of the Crown in right of Saskatchewan.

The Government of Saskatchewan agrees to provide to the Government of Canada all the information and other material that would have been required under the provisions of the PGRT and IORT.

- 50 The British Columbia-Canada arrangement is expressed in paragraph 1 of the letter of September 24, 1981, *supra* n. 2.

1. I understand that the Government of British Columbia has agreed to cause its emanations to remit immediately to the Government of Canada all amounts owing (including interest owing thereon as determined by Revenue Canada) with respect to the Natural Gas and Gas Liquids Tax (NGGLT) and the Canadian Ownership Special Charge (COSC). Further, it is my understanding that the Government of British Columbia agrees to cause its emanations to pay those taxes for the period up to December 31, 1986 or in the event that the Government of British Columbia or its emanations are determined not to be liable for these taxes, the Government of British Columbia or its emanations will cause to be paid to the Government of Canada an amount equivalent to these taxes and interest owing for the period November 1, 1980 to December 31, 1986.

It is interesting that this paragraph does not make any mention of the two federal energy taxes (the Petroleum and Gas Revenue Tax and the Incremental Oil Revenue Tax). It is assumed that the agreement in respect of the paying of these taxes by the provincial Crown is contained in a further letter which has not been made public. It is also interesting to note that British Columbia agreed to remit the taxes for the duration of this agreement. It is unclear whether the

frank concession by British Columbia to pay federal taxes will weaken any argument based on s. 125 which it may wish to make at the expiration of the agreement or in respect of some other sectors of provincial governmental activity.

- 51 Section 125 was given no recorded attention at the Constitutional debates in Charlottetown (1864) and little attention in Quebec (1864). It also received little attention in the Parliament of the Province of Canada (1865) or in London (1866-67). The only plausible reason for this is the idea it embraced was ordinary and self-evident: the Crown enjoys a general prerogative immunity from taxation. That principle was simply that before tax can be levied on the Crown it must be clear that the Crown has consented to be taxed. The fact that the leading English cases on the scope of Crown immunity *Mersey Docks v. Jones* and *Mersey Docks v. Cameron* (1865), 11 H.L.C. 443 were under appeal to the House of Lords from Court of Exchequer Chamber at the time of the Quebec Conference may be the reason why the principle was expressly included in the British North America Act. Alternatively, it may have been recognized that with the "division" of the Crown brought about by the creation of a federal state the general rule needed to be expressed in adapted form.
- 52 [1924] A.C. 222 (J.C.P.C.).
- 53 *Id.* at 225.
- 54 (1922), 64 S.C.R. 377.
- 55 An Act to amend the Customs Act, S.C. 1917, c. 15, s. 1.
- 56 Government of Canada, *The National Energy Program, 1980* (Ottawa: Supply and Services Canada, 1980) 35.
- 57 For a discussion of the scope of "belonging to Canada or any Province" found in s. 125 see G. LaForest, *supra*, note 5, at 186-7.
- 58 *Societe Centrale d'Hypotheques v. Cite de Quebec*, [1961] Que. K.B. 661.
- 59 *British Columbia Power Commission v. Victoria*, [1951] 2 D.L.R. 480.
- 60 *Re Canadian Broadcasting Corp. Assessment*, [1938] 4 D.L.R. 591; *Recorder's Court v. Canadian Broadcasting Corp.* [1941] 2 D.L.R. 551.
- 61 *City of Halifax v. Halifax Harbour Commissioners*, [1935] S.C.R. 215.
- 62 *The Saskatchewan Oil and Gas Corporation Act*, R.S.S. 1978, c. S-32.

- 63 Report of the Parliamentary Task Force on Federal-Provincial Fiscal Arrangements, *Fiscal Federalism in Canada*, (Ottawa: Department of Supply and Services, 1981) 191.
- 64 W. McConnell, *Commentary on the British North America Act* (Toronto: MacMillan of Canada, 1977) 369.
- 65 *Supra*, note 54, at 380. Brodeur, J. in the same case, however, did refer to Idington, J.'s distinction between governmental and commercial functions. He did not reject the distinction but said that the direct sale of liquor was the final step in the evolution of a public policy relating to liquor consumption (at 391).
- 66 199 U.S. 261 (1905).
- 67 326 U.S. 572 (1946).
- 68 *Id.*, at 588-589.
- 69 (1979), 102 D.L.R. (3d) 191 (Federal Court of Appeal), affirming (1979), 92 D.L.R. (3d) 71 (Federal Court Trial Division).
- 70 *Supra*, note 46, at 16.
- 71 See J. Corry, *My Life and Work: A Happy Partnership* (Kingston: Queen's University, 1981) 226-236, for an exposition on the inevitability of centralizing drifts in democratic states.

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