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J.L. Ilsley and the Transition to the Post-War Tax System: 1943-1946

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PRÉCIS

Déjà en 1943, le gouvernement canadien avait déplacé son attention du financement de l'effort de guerre vers la planification et le financement de la reconstruction d'après-guerre, y compris l'adoption possible de plusieurs programmes importants d'aide sociale. Cela signifiait qu'il continuerait de dépendre, comme en temps de guerre, d'une base de fiscalité élargie touchant les particuliers et les sociétés et qu'il devrait prendre de nouveaux arrangements avec les provinces pour la poursuite ou la modification des accords de location fiscale conclus en 1941. À titre de ministre des Finances, J.L. Ilsley avait la responsabilité première de cette initiative. Bien que les propositions du gouvernement n'aient pas fait l'unanimité à la Conférence fédérale-provinciale prolongée de 1945-1946, la transformation du régime fiscal canadien effectué en 1943 est demeurée essentiellement intacte.

ABSTRACT

By 1943, the Canadian government had turned its attention from financing the war effort to planning and financing post-war reconstruction, including the possible adoption of several major social welfare programs. This involved continuation of the wartime reliance on the expanded personal and corporation income taxes and making new arrangements with the provinces for the continuance or modification of the tax rental agreements reached in 1941. As minister of finance, J.L. Ilsley had primary responsibility for and led this effort. While the government's proposals met only partial acceptance at the extended 1945-46 Dominion-Provincial Conference, the transformation of the Canadian tax system effected by 1943 remained substantially intact.

KEYWORDS: HISTORY ■ FEDERAL-PROVINCIAL ■ TAX SYSTEMS ■ TAX POLICY ■ ECONOMIC POLICY ■ SOCIAL POLICY

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CONTENTS

INTRODUCTION

The delivery of the March 2, 1943 federal budget marked the end of a major transformation of the Canadian tax system, presided over by J.L. (James Lorimer) Ilsley, minister of finance from July 1940. As I have described elsewhere,[1] the demands of financing Canada's war effort had brought about the greatest changes in the Canadian tax system since Confederation. By 1943, personal and corporation income taxes had become the single largest source of federal government tax revenue, tax rates had been raised to levels previously unthought of, and the personal income tax had been extended to most working Canadians, collected by source deductions from wages and salaries. Through the tax rental agreements of 1941-42, the provinces (and, in some provinces, municipalities) had vacated the corporation tax and personal income tax fields for the duration of the war in return for fixed tax-rental payments from Ottawa.

By the spring of 1943, eventual victory for the Allied forces in the war was more or less certain, and the revolution in Canadian public finance brought about by Canada's involvement in the conflict had reached a temporary equilibrium. Total federal government expenditures reached a high point of $5.322 billion in 1943-44 (compared to about $500 million in 1938-39), about 90 percent of which was accounted for by war spending.[2] Tax revenues were equal to slightly more than half of expenditures; the balance was financed by borrowing, largely from the public through successive Victory Loan campaigns. With the end of the war in sight, the attention

1 See Colin Campbell, "J.L. Ilsley and the Transformation of the Canadian Tax System: 1939-1943" (2013) 61:3 *Canadian Tax Journal* 633-70.

2 For a summary of revenue and expenditure data for 1939-40 through 1947-48, see the table in the appendix to this article.

of both the public and the government turned to planning for post-war social and economic policy.

In the United Kingdom, Sir William Beveridge had issued a report in November 1942 proposing the introduction of a comprehensive social security system. The report received wide publicity on both sides of the Atlantic, and in early December 1942 Canada's prime minister, William Lyon Mackenzie King, discussed it at some length with US President Franklin Delano Roosevelt.[3] In January 1943, King read a speech by Beveridge suggesting that Winston Churchill could cap his political career by putting the Beveridge proposals into effect.[4] King was inspired to do likewise, believing that the social security scheme described in the Beveridge report reflected his own views:

> That programme I made very much my own from the days I was Deputy Minister of Labour. It is all set out in my *Industry and Humanity*. I should be happy indeed if I could round out my career with legislation in the nature of social security.[5]

On January 12, King proposed to the Cabinet that the Throne Speech for the pending session of Parliament should include an announcement of the government's intention to introduce legislation for a national social security program.[6] In the event, the promise in the Throne Speech did not lead to legislation in 1943 (although, as discussed below, planning for post-war and related social security issues moved much closer to the centre of attention in the policy-making machinery of the civil service), but it did set out the direction that the King government proposed to take. King's position was driven by both principled conviction and electoral considerations. King was ideologically committed to the modern welfare state and had committed the Liberal Party to its achievement, in principle, in 1919;[7] but despite holding power for 14 of the next 21 years, he had done relatively little to attain that goal. In part, this was because King placed a high value on preserving social harmony and avoiding societal division. As a result, he was reluctant to take action without the support of a perceived national consensus.[8] The combined effect of the Depression of the 1930s and the early years of the Second World War hastened the emergence of such a consensus.

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3 See *The Diaries of William Lyon Mackenzie King*, December 5, 1942 (www.collectionscanada.gc.ca/king/index-e.html) (herein referred to as "Mackenzie King diaries").

4 Ibid., January 10, 1943.

5 Ibid. (citing William Lyon Mackenzie King, *Industry and Humanity: A Study in the Principles Underlying Industrial Reconstruction* (Toronto: University of Toronto Press, 1973)).

6 Mackenzie King diaries, supra note 3, January 12, 1943.

7 See William Christian and Colin Campbell, *Political Parties and Ideologies in Canada*, 3d ed. (Toronto: McGraw-Hill Ryerson, 1990), at 59-61.

8 See the discussion of this point in David J. Bercuson, "Introduction," in King, *Industry and Humanity*, supra note 5, at xx-xxv.

Political developments in late 1942 and 1943 indicated a rising demand from the electorate for policies designed to banish the privation and uncertainty of the 1930s—to translate victory against fascism on the battlefield into a reformed (or at least improved) social order. By 1943, the Commonwealth Co-operative Federation Party (CCF) had identified itself as the main proponent of social reform, and its rising fortunes worried King. When public opinion polling began in Canada in 1941, the CCF had the support of about 10 percent of the electorate.[9] In August 1943, the Ontario CCF narrowly missed winning the provincial election (in which the Liberals were defeated and a minority Conservative government was returned to power); and in the same month, the King government lost four Liberal seats in federal by-elections—one each in Saskatchewan and Manitoba to the CCF, one in Quebec to a Labour-Progressive (Communist) candidate, and another in Quebec to the Bloc Populaire. A September 1943 national Gallup poll showed that the CCF had a narrow lead over both Liberals and Conservatives. Polling also indicated that Canadians were more interested than either Britons or Americans in “reform” in general. The federal Conservative Party, for its part, had embraced in principle a broad program of social security at the Port Hope Conference in September 1942,[10] and in November 1942 had replaced Arthur Meighen as leader by the former Progressive premier of Manitoba, John Bracken.[11]

These developments suggested both that a national consensus on social security reform was emerging and that King and the Liberal Party might pay a price for ignoring it. In the fall of 1943, King took further action. The national advisory council of the Liberal Party was convened to discuss post-war policy, passing resolutions endorsing a post-war full employment policy and social welfare measures that included enhanced old age pensions and family allowances. At a Cabinet meeting in November 1943, King asked ministers to write to him with “their ideas as to government reconstruction policy,” which might be included in the Throne Speech setting out the government’s policies for 1944.[12]

The result of this process was a set of federal policy proposals that included family allowances, a contributory pension scheme (and augmented non-contributory old age pensions), a national health insurance program and a coordinated federal-provincial “shelf” of public (largely infrastructure) investments. The proposals were designed to improve the welfare of individual Canadians and to ensure a high level of post-war economic activity and employment. They engaged the tax system in two

9 See the discussion of these political developments in Robert Bothwell, Ian Drummond, and John English, *Canada, 1900-1945* (Toronto: University of Toronto Press, 1987), at 322-27.

10 See J.L. Granatstein, *The Politics of Survival: The Conservative Party of Canada, 1939-1945* (Toronto: University of Toronto Press, 1967), at 130-35.

11 Bracken insisted on adding “Progressive” to the name of the federal Conservative Party.

12 Letter from A.D.P. Heeney, Cabinet secretary, to J.L. Ilsley, November 29, 1943, Library and Archives Canada (herein referred to as “LAC”), Department of Finance records (RG 19), vol. 326.

ways: first, they involved federal expenditures several times higher than pre-war levels; and second, the authors of the proposals believed that their objectives could be achieved only by continuing the centralization of the tax system effected by the 1941 tax rental agreements. The policy in its final form was set out in the federal government's proposals presented at the 1945-46 Dominion-Provincial Conference, discussed below.

For Ilsley and the Department of Finance, the issue was the direction of post-war tax and expenditure policy. Post-war reduction of military expenditures would eliminate the need for massive borrowing; and post-war tax revenue needs would depend on expenditure policy. Once that policy was determined, decisions were required about the necessary mixture and level of taxes. In addition, the expiry of the tax rental agreements after the end of the war[13] had to be addressed. The challenge for Ilsley was how to finance the government's plans—just as it was when he was faced with financing Canada's commitment to the war effort. As finance minister, Ilsley was of course concerned about the cost of new programs. In 1941, he had resisted plans for health insurance on the basis of cost.[14] In January 1943, after King had decided that references to social welfare legislation would be included in the Throne Speech, "Ilsley at once objected to what it would involve in the way of expenditures."[15] Unlike Ilsley, however, King was not responsible for financing the expenditures.

As discussed in more detail below, Ilsley played a central role in the federal attempt to continue the wartime tax arrangements into the post-war period, principally at the Dominion-Provincial Conference of 1945-46. The attempt was only partially successful, and the toll on Ilsley's health effectively ended his tenure at Finance. Failure to reach agreement with the provinces on tax issues caused the federal government to abandon or postpone major parts of its post-war agenda. Failure was due to a number of factors: King's unwillingness to support a direct confrontation with the provinces; Ilsley's consistently (and perhaps rigidly) principled approach, which did not lend itself to compromise; and, most importantly, the constitutional and political reality that has made Canada one of the most decentralized federations in the world.

The result was by no means a total failure. The changes made to the tax system between 1939 and 1943—in particular, the reliance on progressive and near-universal income taxation—became permanent, and in due course became the norm for the

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13 The agreements were to expire at the end of the first full fiscal year (of the particular province) following the date fixed for the cessation of hostilities. That date turned out to be September 5, 1945; thus, for most provinces, the agreements would expire on March 31, 1947. For New Brunswick, Nova Scotia, and Prince Edward Island, the expiry dates would be, respectively, October 31, November 30, and December 31, 1946.

14 See Doug Owram, *The Government Generation: Canadian Intellectuals and the State, 1900-1945* (Toronto: University of Toronto Press, 1986), at 282-83.

15 Mackenzie King diaries, supra note 3, January 12, 1943.

provinces. The tax rental agreements were continued in seven provinces, largely ensuring that the "tax jungle" of the 1930s did not return. In this way, the federal government was able to finance higher post-war spending, and the anticipated post-war recession failed to materialize.

POST-WAR RECONSTRUCTION POLICY

By 1943, a considerable amount of thought had been given to post-war policy—what was generally referred to as "reconstruction"—within the federal civil service. As a result, an array of possible policy alternatives was available, flowing in part from initiatives taken by the minister of pensions and national health, Ian Mackenzie. Mackenzie, the mercurial representative of British Columbia in the Cabinet and a veteran of the First World War, had been the minister of national defence immediately prior to the war. Demoted in favour of Norman Rogers in September 1939,[16] Mackenzie then took on the task of reconstruction planning. In December 1939, he was appointed chair of the Cabinet Committee on Demobilization and Rehabilitation,[17] whose mandate was to consider issues related to veterans. An advisory committee of civil servants was constituted, which produced recommendations for a wide variety of veterans' benefits, including war service gratuities, trade or professional training, loans to establish businesses or farms, special facilities for the disabled, and equality for female veterans.[18] These recommendations were adopted by order in council[19] and subsequently included in the Veteran's Rehabilitation Act[20] and related legislation. In February 1941, Mackenzie persuaded the Cabinet, first, to expand the mandate of the committee to encompass general post-war reconstruction issues[21] and then, in March 1941, to reconstitute the advisory committee under the leadership of Cyril James, the principal of McGill University.[22]

The most notable product of the reconstituted committee (generally referred to as the Committee on Reconstruction) was the Marsh report. In December 1942, Leonard Marsh prepared a summary of the Beveridge report for the committee for consideration at its meeting on January 8, 1943.[23] The committee then commissioned Marsh to produce a Canadian version of the Beveridge report, which was

16 As described in my earlier article, Rogers's unexpected death in June 1940 resulted in a Cabinet shuffle and Ilsley's appointment as finance minister the following month: see Campbell, supra note 1, at 642.

17 Established by PC 4068½, December 8, 1939.

18 For a detailed description of the veteran-related measures, see Walter S. Woods, *Rehabilitation* (Ottawa: Queen's Printer, 1953).

19 Principally PC 7633, October 1, 1941 (replaced by PC 5210, June 30, 1944).

20 SC 1945, c. 35.

21 PC 1218, February 17, 1941.

22 Formalized by PC 6874, September 9, 1941.

23 See LAC, RG 19, vol. 3583. Marsh was the director of social research at McGill University and the committee's research director.

submitted to the House of Commons Committee on Reconstruction and Rehabilitation in March 1943.[24] The Marsh report's proposals included economic policies to produce full employment, comprehensive pension and employment insurance plans, health insurance, and family allowances. The Committee on Reconstruction also produced a number of plans for a comprehensive health insurance scheme, which Mackenzie promoted, unsuccessfully, both in Cabinet and in House of Commons committees.

The shift in focus of the King government from the initial war emergency to post-war reconstruction had been anticipated by the most powerful group of federal civil servants, the Economic Advisory Committee (EAC). Formed in 1939 to coordinate the activities of the nation's key financial and economic players—the Bank of Canada and the departments of Finance, Munitions and Supply, and External Affairs (with the participation of the Cabinet secretary)—the EAC decided in late 1942 that it should take control of reconstruction planning and so recommended to Cabinet.[25] On December 23, 1942, the War Committee of the Cabinet approved the expansion of the role of the EAC to include responsibility for coordinating reconstruction planning.[26]

By mid-1943, the EAC and the Department of Finance were considering family allowances as a major component of reconstruction policy,[27] and by late 1943, family allowances were clearly the major social welfare policy under consideration (and the largest expenditure item under review by Ilsley).[28] Family allowances satisfied

24 Leonard Marsh, *Report on Social Security for Canada* (Toronto: University of Toronto Press, 1943). See generally Dennis Guest, *The Emergence of Social Security in Canada*, 3d ed. (Vancouver: UBC Press, 1997), at 108-14.

25 See Report on the Reconstruction Committee's Recommendations Regarding Ministerial Responsibility for Reconstruction Planning, November 28, 1942, LAC, RG 19, vol. 4660.

26 Letter from A.D.P. Heeney, Cabinet secretary, to Clifford Clark, December 26, 1942, LAC, RG 19, vol. 4660. The EAC's functions were expanded to include reconstruction planning pursuant to PC 608, January 23, 1943. The Committee on Reconstruction was gradually wound down and formally dissolved on January 1, 1944. See PC 9946, December 31, 1943 and PC 169/93, January 7, 1944. The reassertion of control of reconstruction planning by the central economic organs—principally the Department of Finance and the Bank of Canada—is described in detail in Robert A. Wardhaugh, *Behind the Scenes: The Life and Work of William Clifford Clark* (Toronto: University of Toronto Press, 2010), at 231-34, and Owram, supra note 14, at 279-91.

27 Unsigned memorandum to W.A. Mackintosh, June 21, 1943, LAC, RG 19, vol. 304. The emergence of family allowances has been the subject of a number of detailed (and sometimes conflicting) studies. That issue is beyond the scope of this article, but interested readers should consult Guest, supra note 24; Raymond B. Blake, *From Rights to Needs: A History of Family Allowances in Canada, 1929-1992* (Vancouver: UBC Press, 2009), at chapters 2 and 3; and Alvin Finkel, *Social Policy and Practice in Canada: A History* (Waterloo, ON: Wilfrid Laurier University Press, 2006).

28 See the discussion below of Ilsley's letter of January 4, 1944 to King (in the text at note 52 and following) and an unsigned memorandum to Clifford Clark dated January 7, 1944, enclosing various cost estimates for the program; LAC, RG 19, vol. 304.

both the social welfare goal of alleviating poverty and the economic goal of supporting the system of wage and price controls. In August 1943, a report by the chair of the National War Labour Board, C.P. McTague, had recommended either abandoning wage controls for lower-paid workers (which Ilsley and other key advisers—the group known as "the brain trust"—believed would destroy the whole system of wage and price controls) or instituting family allowances.[29] For Ilsley, who had consistently (and sometimes single-handedly) defended the wage and price control regime imposed in October 1941, family allowances were obviously an attractive option. A memorandum produced by the Department of Finance also pointed out that family allowances would serve the political goal of "bringing the Dominion government closer to the people of Canada" as a "benevolent and useful agency" rather than a "harsh collector and stern controller."[30]

As Robert Wardhaugh points out, Clifford Clark, the deputy minister of finance, also saw family allowances as a means of providing post-war fiscal stimulus and, by increasing the incomes of poorer families, reducing the need for federal government expenditure on low-income housing.[31] Ilsley was clearly familiar with the issues involved. In a note to Ilsley dated June 13, 1943, the governor of the Bank of Canada, Graham Towers, referred to a conversation with him on wage stabilization policy and enclosed his (Irwin's) letter and memorandum to Clark advocating family allowances as a means of increasing the income of poor families without a general increase in wages, which would have imperilled the wage control program.[32] In October 1943, Clark forwarded to Ilsley that month's edition of *Labor News*, which was devoted entirely to the family allowance issue, and later noted that Ilsley had read it.[33]

While concerned about the cost involved, Ilsley loyally supported both the broader commitment of the King government to social security and the family allowance proposal. In a speech to the annual convention of the Trades and Labour

29 For a discussion of the repercussions of the McTague report, see Wardhaugh, supra note 26, at 254-55.

30 Unsigned and undated memorandum, "Children's Allowances," attached to unsigned memorandum to W.A. Mackintosh, January 7, 1944, LAC, RG 19, vol. 304. A revised version was provided to Ilsley on January 12, 1944.

31 Wardhaugh, supra note 26, at 262-65.

32 Letter from G.F. Towers to Ilsley, June 13, 1943, LAC, RG 19, vol. 304. The connection between the family allowance proposal and developing pressures in the wartime system of wage and price controls is clearly very strong, and the proposal served both economic and more purely social objectives. When the decision was made in mid-1944 to delay implementation of family allowances until July 1945 (by which time the war was expected to be over), the welfare objective became dominant, and defence of the proposal was couched entirely in terms of the social benefits of the program. None of this, of course, had any effect on the financing issues that Ilsley had to deal with.

33 Note from W.C. Clark to Ilsley, LAC, RG 19, vol. 304.

Congress in Quebec City in September 1943, Ilsley referred to a speech that King had delivered at a meeting of the American Federation of Labor in 1942, and stated:

> The third objective he [King] specified was "social insurance against privation resulting from unemployment, from accident, from the death of the breadwinner, from ill health and from old age." With this, I think, we are all in agreement now, and it is a matter of pressing ahead with preparations as rapidly as possible. I would hope myself that we can see created at the end of the war a comprehensive, unified scheme of social insurance. We must conceive and carry out social insurance with the same boldness and thoroughness with which we have raised the income tax for war purposes.[34]

As discussed below, Ilsley also included family allowances as the principal item in the list of legislative proposals he submitted to King in early January 1944. At that point, the proposal had been discussed extensively for at least a year in the Department of Finance and at the Bank of Canada. Since Ilsley's practice was to engage in detailed discussions with the brain trust about proposed policy measures,[35] there can be little doubt that he had considered the family allowance proposal at length and that he fully understood it.

On at least two occasions, King suggested that Ilsley was opposed to family allowances, and some commentators have repeated that view.[36] Ilsley missed most of the Cabinet meeting on January 13, 1944 at which family allowances were approved, because of a speaking engagement in Toronto, and Clifford Clark made the case for the proposal from the perspective of the Department of Finance. Before Ilsley left the meeting, King asked him if he supported the measure and later noted that Ilsley had hesitated and said, "I suppose I should; indeed I do—or words to that effect."[37] When the legislation was under final Cabinet review in June 1944, King again confided to his diary that Ilsley (along with T.A. Crerar, the minister of mines

34 J.L. Ilsley, *Sharing the Cost of War: An Address Before the Trades and Labour Congress of Canada at Quebec City, September 1, 1943* (Ottawa: National Liberal Federation, n.d.), at 15-16. See LAC, RG 19, vol. 313.

35 Robert Bryce later recalled that "the department's inner circle . . . met at Ilsley's request on many evenings to debate at length difficult decisions which were going to confront him in cabinet." Robert B. Bryce, *Canada and the Cost of World War II: The International Operations of Canada's Department of Finance 1939-1947* (Montreal and Kingston, ON: McGill-Queen's University Press, 2005), at 6. Bryce served as deputy minister in the Department of Finance between 1939 and 1947.

36 For example, Blake, supra note 27, at 84-85 and 90.

37 Mackenzie King diaries, supra note 3, January 13, 1944. At the January 24 Cabinet meeting that approved the Speech from the Throne, Ilsley remarked that it was "very leftist" and should have something added to reassure the country that the government was not seeking "to outdo the C.C.F." However, he did not oppose the reference to family allowances, and he was prepared to allow Mackenzie's health insurance proposals to go ahead if they were supported by the provinces. Ibid., January 24, 1944.

and resources, and Angus L. Macdonald, the minister of defence for naval services) continued to oppose family allowances. The relevant Cabinet minutes (for June 14 and 15, 1944) are silent on this point.[38] Both the minutes and King's diary refer to the discussion of the quite secondary issue of whether a parent in receipt of a military dependant's allowance could also receive the family allowance, and it is unclear whether the disagreement primarily centred on that issue and whether all three ministers took the same position.

Mitchell Sharp's view was that Ilsley did not have "advanced ideas about social programs" and that Clark had sold King on the merits of family allowances. Sharp's conclusion is probably the most accurate assessment of Ilsley's position: "I don't know if he [Clark] ever sold Ilsley but at any rate Ilsley accepted it."[39]

FINANCING RECONSTRUCTION

As reconstruction moved into the centre of the government's focus, the magnitude and method of financing reconstruction became a major concern. For Ilsley, this issue would largely displace that of financing the war. The content of the government's reconstruction policy, like its decision to enter the war, was not of Ilsley's making (though as a senior minister he had an important voice in setting that policy); he was, however, responsible for financing the policy choices and framing the required taxation policies. While he may have had misgivings about specific items of reconstruction policy, once they had been approved by Cabinet, he turned his attention to the appropriate financing measures.

When the EAC effectively took control of reconstruction planning, Ian Mackenzie's planning for social welfare measures was viewed in the broader context of the government's overall fiscal and economic policy. That policy was directed primarily to the management of the economy in the transition to peacetime and necessarily involved the tax system. In April 1943, the EAC considered a memorandum prepared by Alex Skelton[40] discussing constitutional problems relating to post-war policy.[41] The memorandum contemplated significant fiscal stimulus from the federal government, including a substantial public works program, direct assistance to the unemployed and lower-income individuals, and the eventual implementation of a

38 See Cabinet Conclusions, June 14-15, 1944. The Cabinet Conclusions (minutes of Cabinet meetings) for 1944-1946 are found in LAC, RG 2, vols. 2636-2639, and a digital version can be accessed online at LAC (www.bac-lac.gc.ca/eng/discover/politics-government/cabinet-conclusions/Pages/cabinet-conclusions.aspx).

39 Mitchell W. Sharp, interview of May 25, 1989 for the Institute for Research on Public Policy oral history project, "Ottawa Decides, 1945-1971," LAC, ISN 135194, accession no. 1989-0331, at 12 and 36.

40 The head of the Research Department of the Bank of Canada and former secretary of the Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois commission).

41 Minutes of meeting of the EAC, April 22, 1943, LAC, RG 19, vol. 4660; memorandum attached to the minutes. An earlier version of this memorandum dated April 3, 1943 is found in LAC, RG 19, vol. 3446.

comprehensive social security system (including old age pensions and health insurance) on a contributory basis by the federal government. The memorandum pointed out that the implementation of such a plan would have "important financial implications," resulting in federal spending three to four times higher than that before the war; therefore, "[t]he Dominion must be assured the financial means to carry these burdens and to distribute them fairly."[42] Skelton argued that this required implementation of the Rowell-Sirois recommendations for the allocation of taxing power and the continuation of the tax rental agreements:[43]

> [T]he people, who must ultimately carry the burden of these Dominion financial responsibilities, must be protected against the inequities and inefficiencies that arise and develop when similar taxes are imposed by several taxing authorities. Consequently, it is of vital importance that the Dominion continue after the war to have the exclusive use of income and corporation taxes which has been secured for the duration of the war, and also that it obtain exclusive jurisdiction to impose succession duties.[44]

The memorandum concluded that such readjustment should be effected by constitutional amendment ("the temptation to break a simple agreement . . . would in some instances be irresistible") and that the provinces could be compensated by cash payments consisting of a "fixed minimum and a sliding scale of accretions."[45]

While the federal government's position was to evolve over the next two years (particularly in abandoning any hope of formal constitutional amendment), its approach to fiscal and taxation policy did not change: federal financial requirements and management of the economy required exclusive federal occupancy of the progressive tax fields[46] on the basis of efficiency and equity, with compensation to the provinces in the form of cash payments similar to those under the tax rental agreements. The further unstated assumption was that reliance on income taxation as the single principal source of federal revenue was to continue and that there would be no return to the pre-war tax structure. The Skelton memorandum did not consider possible provincial resistance to this policy but merely contemplated discussions with the provinces regarding the financial and constitutional arrangements necessary to effect post-war policy.[47]

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42 Ibid., at 8.

43 See Canada, *Report of the Royal Commission on Dominion-Provincial Relations* (Ottawa: King's Printer, 1940), book II, chapter III.

44 Memorandum attached to minutes, supra note 41, at 8.

45 Ibid.

46 That is, personal and corporation income taxes and succession duties. While the 1941 tax rental agreements prevented the provinces from imposing other corporate taxes such as capital or place-of-business taxes, there was no intention that the federal government would impose such taxes—they were proscribed in order to protect the corporation income tax base.

47 Memorandum attached to minutes, supra note 41, at 10.

The EAC, in its final report to Cabinet on the subject in November 1943, concluded:

> The Report [the final version of the Skelton memorandum] points out that as between the Dominion and the provinces responsibilities are disproportionate to financial capacities. The provinces are constitutionally competent but financially unable to carry out comprehensive schemes of social security and reconstruction. Even if they were able, there would be a lack of coordination or uniformity in places when these are necessary. The Dominion lacks constitutional power to undertake such plans and reversion to the pre-war division of taxing power would leave it without the necessary financial capacity.[48]

Grant Dexter, the Ottawa correspondent for the *Winnipeg Free Press*, interviewed Clifford Clark, Graham Towers, and W.A. Mackintosh (special assistant to Clark at the time) in late 1943 and filed the following summary of their views:

> [U]nderlying the whole post-war problem is the difficulty re income and corporation taxes and succession duties. For the period of the war, the Dominion has exclusive jurisdiction by agreements with the provinces which expire one year after the end of the war. Unless the [Rowell-]Sirois recommendations can be carried through and the B.N.A. [British North America] Act amended to give Ottawa exclusive jurisdiction in this field, the brain trusters see nothing ahead but frustration and impotence. The richer provinces will come back into these tax areas. The weaker provinces will have to do so, once the duality of taxation is re-established. The Dominion will be hamstrung on its whole post-war policy—since it will not be able to impose the taxation required to finance post-war reconstruction. If it did, the weaker provinces would be ruined.[49]

In hindsight, it appears that the federal government could have solved this problem by making equalization payments to the poorer provinces, in the form of either the national adjustment grants recommended by the Rowell-Sirois commission or equalization as eventually implemented in 1957, which would have allowed those provinces to avoid excessively high tax rates. These options, however, were evidently not on the federal agenda.

The EAC recommended that a federal-provincial conference should be convened to discuss the Rowell-Sirois recommendations, with the aim of reaching a "satisfactory solution."[50] The stage was set for a reprise of the 1941 conference[51] as debate

48 EAC report of November 20, 1943, LAC, RG 19, vol. 4660, at 7.

49 Grant Dexter, memorandum of December 23, 1943, Queen's University Archives (herein referred to as "QUA"), Dexter Papers. Clark, Towers, and Mackintosh were part of Ilsley's inner circle (see supra note 35) and prominent members of the brain trust.

50 EAC report of November 20, 1943, supra note 48, at 14-15.

51 For a summary of the agenda, discussion, and outcome of the 1941 conference, see Campbell, supra note 1, at 650-54.

on the issue moved from the bureaucratic to the political level. As noted above, in November 1943, King had asked members of the Cabinet for their suggestions on post-war reconstruction policy in anticipation of the forthcoming session of Parliament. King's opinion was that Ilsley's response, set out in a letter of January 4, 1944,[52] "clearly had been prepared by Clark and others in the department."[53] However, as both Robert Bryce and J.L. Granatstein have observed,[54] Ilsley would not have accepted recommendations from his advisers that he did not understand and agree with; according to Bryce, he was a "fitting minister to match wits with Clark, Towers and Donald Gordon."[55]

In his response, Ilsley's central concern was maintaining the capacity of the tax system to deal with the anticipated post-war responsibilities of the federal government, and the principal issue he identified was the relationship with the provinces.[56] This he described as one of the "special difficulties" he faced. He said that the formulation of post-war policy "has been almost completely stopped because of the lack of certain key decisions in regard to this problem"[57]—that is, the problem of financing substantially higher post-war expenditures. Ilsley enumerated those costs: interest on the national debt, which, by the end of the war, would have increased several times over;[58] defence expenditures several times larger than those before the war; increases in the normal overhead costs of government; and "vastly increased" expenditures on "social security and social welfare activities."[59] The latter included "huge expenditures" for housing and construction projects, "substantial losses" in supporting floor prices for agricultural products, and unemployment relief assistance supplementary to unemployment insurance.[60] Ilsley also advised King that, in a matter of days, he would bring to Cabinet legislation for a system of family allowances.

Ilsley maintained that the financial demands on the federal government after the war could only be managed by the continuation of the tax system that had been created between 1939 and 1943:

52 Letter from Ilsley to King, January 4, 1944, LAC, RG 19, vol. 326.

53 Mackenzie King diaries, supra note 3, January 6, 1944.

54 Bryce, supra note 35, at 4; and J.L. Granatstein, *Canada's War: The Politics of the Mackenzie King Government, 1939-1945* (Toronto: University of Toronto Press, 1975), at 106 and 160.

55 Bryce, supra note 35, at 4. Donald Gordon was then the chair of the Wartime Prices and Trade Board, responsible for wage and price controls.

56 In its final report, dated November 17, 1943, the Committee on Reconstruction recommended calling a dominion-provincial conference "to reach a solution of the problems created by the disparity between responsibility and financial capacity." See LAC, RG 19, vol. 3977.

57 Letter of January 4, 1944, supra note 52.

58 He noted that the net national debt of $3.153 billion as at March 31, 1939 would reach $9 billion by March 31, 1944. By March 1946, it was $13 billion.

59 Letter of January 4, 1944, supra note 52.

60 Ibid.

> I am convinced (as are my advisers) that it is quite impossible for the Dominion government to manage annual expenditures and national debts of the magnitude indicated, if we have to go back to our pre-war taxing system. Whether it is generally realized or not, it is the Dominion-Provincial Taxation Agreements which have made it possible for us to finance the war.[61]

It was implicit in Ilsley's position that the predominant place of progressive income taxation and significant income taxation of corporations would remain in place. He had forcefully restated his commitment to progressive income taxation in his speech to the Trades and Labour Congress in 1943:

> During the war we have gradually built up the income tax in Canada to be a powerful instrument. We all agree that it is the fairest and the best tax. It is the best way of taxing on the basis of ability to pay. It is a foundation stone of social progress.[62]

Ilsley viewed the post-war fiscal challenges as at least equal to those in wartime.[63] In his letter to King dated January 4, 1944, he argued that maintaining the existing tax system was an absolute prerequisite to meeting post-war challenges:

> In short, unless the Dominion retains exclusive control in the present income and corporation tax fields (and preferably also secures control of the succession duty field) we will find it quite impossible to solve Canada's post-war financial and economic problems. This is a strong statement but I do not think it is exaggerated.[64]

Ilsley was not unaware of the political difficulties raised by this course of action. He went on to say that the EAC had identified but underestimated those difficulties, and that settling the financial and constitutional relations with the provinces would have to wait a year or more. In the interim, and assuming continuance of the existing financial arrangements, the federal government could proceed with family allowances, unemployment assistance, and enhancement of the old age pension (postponing a universal contributory scheme until constitutional amendment was possible) and with a program of public works projects. This would "increase the Dominion's prestige" and "furnish the electorate with concrete information as to the issues involved in any ultimate settlement."[65]

King used Ilsley's letter of January 4 as the basis for the Cabinet discussions that followed on the policy agenda to be presented at the forthcoming session of Parliament. The Cabinet began discussing the proposals on January 6. King noted that it

61 Ibid.

62 Ilsley, supra note 34, at 9-10.

63 "When related to the conditions and psychology that will then prevail, our post-war financial job will be even more difficult than the one which we have had to face during the war." Letter of January 4, 1944, supra note 52.

64 Ibid.

65 Ibid.

reached a "sort of general understanding" on the proposals, but the "[t]he terrible problem is, of course, that of the divided jurisdiction."[66] On January 11, Cabinet approved the establishment of the new departments necessary for the reconstruction plan[67] and agreed on the necessity of a conference with the provinces. Notwithstanding Ilsley's reservations, a date in the spring of 1944 was proposed. The single most important component of the plan, family allowances, was discussed at length on January 13[68] and approved.

The Speech from the Throne, as finally settled, promised plans for "the establishment of a national minimum of social security and human welfare . . . as rapidly as possible," subject to the requirement of "further consultation and close cooperation with the provinces."[69] Health insurance and contributory old age pensions would proceed only when provincial agreement was reached.[70]

THE CABINET COMMITTEE ON THE DOMINION-PROVINCIAL CONFERENCE

In January 1944, Arnold Heeney, the Cabinet secretary, wrote to the provincial premiers suggesting a conference,[71] and the following month, the Cabinet established a committee to oversee the federal government's preparations. The committee would be chaired by T.A. Crerar and included Ilsley, Louis St. Laurent (the minister of justice), J.G. Gardiner (the minister of agriculture), Norman McLarty (the secretary of state), and Humphrey Mitchell (the minister of labour).[72] In addition, the relevant parliamentary assistants were to form a "supervisory" committee, chaired by Brooke Claxton, and there was to be an advisory committee of officials to be chaired by Clifford Clark. The ubiquitous Alex Skelton[73] was to serve as secretary of each committee.

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66 Mackenzie King diaries, supra note 3, January 6, 1944.

67 Responsibility for implementing the reconstruction plan was to be shared among three new departments: Reconstruction, Veterans Affairs, and National Health and Welfare. See Mackenzie King diaries, supra note 3, January 11, 1944.

68 As discussed above, Ilsley missed most of that meeting because of a speaking engagement in Toronto, and Clifford Clark was brought in, in his stead, to explain and defend the proposal.

69 Canada, House of Commons, *Debates*, January 27, 1944, at 2.

70 Ibid. Ilsley resisted implementation of the health insurance proposal unless there was prior agreement with the provinces. King agreed: "[I] insisted on agreements being reached with the provinces first of all" and approved Ilsley's position as "what obviously it was the duty of the Finance Minister to guard." Mackenzie King diaries, supra note 3, January 24, 1944. The following day, Clark advised King that Ilsley would be relieved by the inclusion of the requirement for provincial agreement. Ibid., January 25, 1944.

71 Letters from A.D.P. Heeney to the provincial premiers, January 13, 1944, LAC, RG 19, vol. 4014. George Drew, the premier of Ontario, had previously suggested a conference on reconstruction, post-war employment, and financial relations.

72 Letter from A.D.P. Heeney to T.A. Crerar, February 14, 1944, LAC, Claxton Papers, MG 32, vol. 141.

73 Skelton had been deeply involved in the January 1941 Dominion-Provincial Conference.

From the beginning, Ilsley had mixed feelings about the conference. Following the February 14 Cabinet meeting, King noted that he "was astonished to hear Ilsley say that the conference would probably be the death of us though he was the one who advocated the necessity for it."[74] At the first meeting of the Cabinet committee on the conference, on February 17, Ilsley stated that he

> believed that the provinces would make very large demands for financial assistance in one form or another but that they would not be prepared to surrender the proposed tax fields to the Dominion and that the Conference would consequently result in a stalemate.[75]

King's diary entries following a Cabinet meeting on February 24 suggest that Ilsley's pessimism may have been in part a product of mental exhaustion.[76] At the meeting, according to King, Ilsley "was almost on the point of breaking completely." When they met after the meeting, Ilsley "began nearly to collapse, saying that the strain had become too great for him." King feared that "another day might break him down completely" and suggested that he take a month's vacation.[77]

Ilsley's comment on the likely outcome of the conference signalled his intention to yield no ground in negotiating post-war tax arrangements with the provinces. He had already shown how determined he could be in pursuing principled solutions to the challenges he faced. In reshaping the tax system in the earlier part of the war, he had fought, successfully, to achieve a number of significant tax policy objectives—reliance on highly progressive and equitable income taxation, avoidance of inflation, and an equitable division of the tax burden on the provinces through the tax rental agreements. His refusal to compromise[78] was supported by public opinion at the height of the war crisis. He must have suspected that the provinces would be less pliant in the flush of victory, but, as will be seen, he again fought stubbornly for what he had concluded was the correct policy.

Ilsley's general reluctance to compromise annoyed King. When Ilsley resisted the suggestion that the 1944 budget could be framed as including tax reductions, King noted that "[h]is whole mind is in the direction of being consistent ad infinitum."[79] King's concern was in building consensus, and that might require cutting the policy

74 Mackenzie King diaries, supra note 3, February 14, 1944.

75 Minutes of Cabinet Committee on Dominion-Provincial Conference, February 17, 1944, LAC, Claxton Papers, MG 32, vol. 141.

76 Ilsley had difficulty dealing with stress, and the unrelenting pressures of wartime Ottawa and a punishing workload led him to the verge of a nervous breakdown on several occasions.

77 Mackenzie King diaries, supra note 3, February 24, 1944. Ilsley subsequently spent part of March and April in California with his brother, Philip.

78 Except perhaps for the promise, when the tax rental agreements were negotiated in 1941, to allow the provinces to re-enter the income and corporation tax fields after the war.

79 Mackenzie King diaries, supra note 3, June 22, 1944. In August 1944, on the eve of the provincial election, taxi drivers in Quebec City went on strike to protest wartime restrictions on taxi fares.

cloth to fit the political realities: "a consistent course might become a wrong course."[80] In fact, both Ilsley and King had the same overall goal—marshalling public support for the wartime financing and inflation control measures—but they differed in their approach. Ilsley had consistently defended those policies on principled grounds, backed by his own reputation for austerity, integrity, and "telling it like it is." In the crisis of 1940-41, this approach had been successful. Among the public at large, Ilsley was probably the best-known and most popular member of the government. Was his dogged adherence to the same approach in 1943-1946, in the face of opposition that he himself anticipated, a failure of political judgment or an act of political courage? The answer perhaps is that it was both. In any event, Ilsley's anticipation of provincial resistance was prescient. His policy position placed him on a collision course with the larger provinces.

The agenda for the initial meeting of the Cabinet committee on the conference (presumably prepared by Skelton) set out the proposed preparatory work for the conference.[81] This fell into two main areas: framing the federal government's aims and proposals, which would constitute the agenda for the conference itself, and collecting background information and statistics that would support the federal position. The agenda suggested that in order to assist in the "popular goals of full employment and high income," a number of constitutional amendments were essential, including provision for federal occupancy of the personal income tax, corporation tax, and succession duty fields; federal responsibility for contributory old age pensions and a "major portion" of health insurance costs; and federal power to implement treaties in areas of provincial jurisdiction. The agenda suggested that the federal approach should be to offer "such favourable financial terms" as would induce the provinces to agree, while still allowing them to "improve education, discharge their remaining welfare responsibilities," and make public works investments. Finally, it proposed preparation of a comprehensive memorandum setting out the content and basis for the federal position.

At the initial meeting on February 17, 1944, the committee authorized Claxton and Skelton to prepare such a draft memorandum and to proceed with the background studies.[82] The committee, however, decided that proposals for constitutional amendment should be kept to an absolute minimum, notwithstanding Crerar's fear of the "endless controversy" that would result if the "allocation of tax powers was

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Ilsley resisted any weakening of wage controls, despite pleas from the provincial Liberal leader that it would affect the outcome of the election. King referred to Ilsley's "customary obstinate stand" and commented that "a man who acts like Ilsley does in these matters, no matter how conscientious he may be, has not the political judgment which would justify recommending him for the position of leadership. His attitude has been the same from the day we began to discuss apples as they might affect his constituency." Ibid., August 7, 1944.

80 Mackenzie King diaries, supra note 3, June 22, 1944.

81 Agenda for meeting of February 17, 1944, LAC, Claxton Papers, MG 32, vol. 141.

82 Minutes of meeting of February 17, 1944, LAC, Claxton Papers, MG 32, vol. 141.

not clearly and finally settled."[83] In particular, St. Laurent was concerned about overreaching by the federal side. For health reasons, Ilsley did not attend another meeting of the committee until May 1. In the meantime, St. Laurent continued his criticism of broad constitutional amendment.[84] By June 1944, the proposed conference had been postponed, at least until the fall. The committee discussed timing at its August 3 meeting and concluded that the possibility of success would be greater if it avoided a "pre-election atmosphere"; by September, the decision had been taken to postpone the conference until after the next general election, which was expected to be called for the spring of 1945.[85] In the meantime, Ilsley had prepared and delivered the 1944 budget.

THE JUNE 26, 1944 BUDGET

By comparison with the previous three budgets that Ilsley had brought down, the budget of June 26, 1944 was relatively straightforward. It included increases in a number of credits and allowances for individuals[86] and a variety of concessions for corporate taxpayers,[87] none of which had a material fiscal impact. For the first time since 1939, spending was expected to decline.[88] In pre-budget discussions, the Cabinet had decided that family allowances (which were anticipated to have a net budgetary cost of about $200 million) would not go into effect until July 1, 1945, after the next election.[89] This facilitated the repeal of the refundable tax imposed on individuals in 1942. The refundable tax was in reality a form of compulsory saving,[90]

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83 Ibid.

84 See minutes of March 16, 1944, LAC, Claxton Papers, MG 32, vol. 141, where St. Laurent criticized the "appearance of grasping for power for its own sake."

85 See minutes of August 3, 1944 and September 29, 1944, LAC, Claxton Papers, MG 32, vol. 141.

86 Including credit for medical expenses incurred outside Canada, dependant allowances for in-laws and illegitimate children, and the deduction of alimony payments.

87 Including limited carryback and carryforward of losses, double depreciation allowances to encourage conversion of war industries, deductions for current research expenditures, tax credits for certain oil wells, lower excess profits tax for startup businesses, and a one-time 5 percent increase in base standard profits for the purposes of the excess profits tax.

88 Projected expenditure of $5.152 billion for 1944-45 was $170 million less than actual spending in 1943-44, and actual expenditure of $5.246 billion for 1944-45 was about $77 million less than in 1943-44: see appendix table 1, and Canada, Department of Finance, 1944 Budget, Budget Speech, June 26, 1944.

89 See Mackenzie King diaries, supra note 3, June 13, 1944. See also Cabinet Conclusions for June 13, 1944, supra note 38, where the Cabinet agreed with Ilsley's position that "war requirements were greater than ever" and that exemptions should be left untouched. At that meeting and the meeting of June 15, 1944, there was final discussion and approval of the family allowance legislation. There is no record of any opposition or reservation by Ilsley with respect to family allowances other than in King's diary entry.

90 The tax raised over the two years that the measure was in effect (a total of $269 million) was returned to taxpayers, with interest, in 1948 and 1949. For a more detailed discussion of the origins, purpose, and politics of the refundable tax, see Campbell, supra note 1, at 661.

and it was difficult to administer because several other forms of saving, including mortgage principal payments and certain life insurance and annuity premiums, could be used as offsets. This produced a flood of requests for administrative rulings and additional offsets, adding to the administrative burden of the Department of National Revenue.

Aside from the issue of administrative complexity, Ilsley also favoured abolition of the refundable tax rather than outright tax reductions (through increased exemptions) because, for him, tax reductions were inconsistent with the continued financial effort that he believed was still necessary for the war effort. The Cabinet, grasping at an opportunity to take political credit, equated abolition with reduction of tax. Ilsley strongly resisted such characterization and at one point threatened to resign over the issue, on the basis that such claims were a repudiation of his fiscal policy.[91] King insisted that eliminating the refundable tax would give relief to taxpayers and that the government should take political credit for this rather than rely on Ilsley's technical explanations. In a diary entry for June 22, 1944, he noted:

> Ilsley came back by saying that he did not want to create the impression that we could afford any relief of taxation at this stage of the war and kept arguing on comparisons with the U.S. and Britain. However, the whole business seemed so complicated that even he could not explain the comparisons except by a statement so involved that anyone listening to it would become impatient. I tried to have him see that anything that was not easily and quickly explained would be worse than nothing. I told him it was absolutely necessary to keep the human side before the public.[92]

King then stressed the importance of presentation and insisted that Ilsley bring to Cabinet the portion of his draft speech dealing with the proposal. When this occurred the following day, King found the draft politically wanting:

> [I]t gave no clear statement of the desire to effect relief to those who were experiencing hardships. . . . [T]here was no phrase in it that could be used as headlines in the press or which M.P.s [members of Parliament] or [the] public could take as the purpose in view that most of it was an effort at explanation so long in detail as to be confusing and irritating.[93]

After some discussion, Ilsley agreed that his draft "could be recast."[94] He did not, however, retreat on his underlying position.

The same conflict between King and Ilsley over competing approaches arose in respect of the last-minute addition to the budget of complete exemption of farm machinery from tariffs. Ilsley appears to have objected to choosing one category among many on purely political grounds:

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91 See Mackenzie King diaries, supra note 3, June 22, 1944.

92 Ibid.

93 Ibid., June 23, 1944.

94 Ibid.

> Ilsley keeps raising the question of how far we are to go. It appears impossible to do certain things unless pressure comes from some other direction. The answer to that is sufficient to [sic] the day is the evil thereof. Even if it did cause the manufacturers to vote against us, it would save them from voting for the C.C.F. as they apparently did in Saskatchewan.[95]

What King viewed as rigidity and a stubborn adherence to consistency in the face of political reality was a constant source of frustration to him and must explain, at least in part, his dislike of Ilsley. Nevertheless, King recognized Ilsley's value to the government. This is evident in King's assessment of the budget speech delivered by Ilsley on June 26. He noted that Ilsley's presentation was "very good," reflecting an emphasis on tax relief (which, King acknowledged, Ilsley had been "led to emphasize") while not "[yielding] up any of his ground of the importance of all [on] the home front doing their part and continuing to make the necessary financial sacrifice."[96] King's overall judgment was that

> the statement was an exceptionally fine one, very statesmanlike, sound, far-reaching and in many respects exemplary. When he concluded, I made it [sic] a point of going to his seat and warmly congratulating him before the House. He has fought a very big battle.[97]

The Conservative response to the budget was predictable criticism of increases in non-war-related expenditures, along with demands that compulsory saving be retained and the basic exemption levels for income tax be raised.[98] The CCF also preferred retention of compulsory savings, with higher exemptions and higher corporate taxes.[99] Ilsley's reply was that raising exemptions would cost more than eliminating compulsory savings, make inflationary pressures worse, increase the incentive for absenteeism, and largely benefit higher-income taxpayers.[100]

DEVELOPING THE RATIONALE FOR THE FEDERAL POSITION AT THE CONFERENCE

With the conference postponed until after the election, meetings of the Cabinet committee on the conference largely ceased until the early spring of 1945. The committee members and staff, however, proceeded with their preparation of voluminous background material and public finance statistics for inclusion in the federal brief,[101]

95 Ibid.

96 Ibid., June 26, 1944.

97 Ibid.

98 Canada, House of Commons, *Debates*, June 29, 1944, at 4337-43 (William E. Rowe).

99 Ibid., June 29, 1944, at 4348-51 (M.J. Coldwell).

100 Ibid., July 11, 1944, at 4714-23 (J.L. Ilsley).

101 See Progress Report of the Secretariat, September 29, 1944, LAC, Claxton Papers, MG 32, vol. 141 (herein referred to as "the Progress Report").

together with a detailed memorandum, written by Skelton, setting out the proposed federal position and its rationale. A draft of the memorandum dated September 29, 1944 identified the objective of post-war planning as sustaining and raising the standard of living by expanding consumption.[102] "Full employment and high income" was the key to a "better life for all."[103] Maintaining consumption at high levels depended on a more equitable distribution of income, and this could be achieved through a comprehensive social security program, including unemployment assistance for those ineligible for unemployment insurance. As Skelton noted, when the poor were guaranteed a high degree of economic security, they were more likely to increase their spending on consumption, rather than accumulate "excessive" savings or engage in "sterile hoarding."[104] In addition, countercyclical spending on a shelf of preselected public works (particularly those in the transportation and resource development fields) was necessary to stimulate demand. All of this would be largely financed by the federal government, which also required revenue to service the greatly expanded national debt. Provincial spending on existing education programs and social services, and on investments that were "distinctly provincial and local in nature," was also required.[105]

To achieve these ends, the federal government required exclusive possession of the personal income tax, corporation tax, and succession duty fields,[106] so that it would receive the cyclically fluctuating items of revenue (as well as having responsibility for cyclically fluctuating expenditures such as unemployment assistance). The provinces would have reduced and more predictable expenditures, and would receive grants and subsidies from federal revenues to provide a revenue stream similar to that under the tax rental agreements, but with the added advantage that the flow of funds would not fluctuate with the business cycle. Skelton somewhat disingenuously described the proposed arrangement as "the financial requisite for real provincial autonomy."[107] He also proposed special assistance for the poorer provinces in the form of "varying ratios of grants and subsidies"[108] and special federal rehabilitation and development projects.

102 Memorandum attached to the Progress Report, supra note 101.

103 Ibid., at 4.

104 Ibid., at 5-6.

105 Ibid., at 12.

106 Skelton added that along with exclusive responsibility, the federal government would undertake "major reforms" and "intensive exploitation" of these tax fields: ibid., at 14. As discussed below, this aspect of Skelton's proposal was not adopted. It is interesting to note that the principal concern of both the federal and the provincial governments was to raise sufficient revenue to finance the growing demand for government services. There was little suggestion (apart from opposing arguments by some Conservative MPs) that spending should be reduced. The common assumption was that spending would have to rise significantly with corresponding exploitation of the available tax fields.

107 Memorandum attached to the Progress Report, supra note 101, at 12-13.

108 Ibid., at 13.

To compensate the provinces, Skelton proposed that they be provided with "considerably more financial margin" in the form of grants at least equivalent to the existing tax rental payments, plus net succession duty revenues, or about $100 to $110 million annually, inflated to reflect increases in national income.[109] The memorandum proposed the division of the grant moneys among the provinces in the ratio of 50 percent on a per capita basis and 50 percent pro rata to personal income tax collections in the province.

These financial proposals, with relatively minor changes, were to form the basis of the federal position at the conference. They reflected the growing influence of Keynesian countercyclical economic theory in the Department of Finance and at the Bank of Canada, and a conviction that only the national government could deal with national problems. Even if the provinces did not agree, the federal government could carry out much of its agenda unilaterally. Skelton suggested that the provinces were in a weak position to oppose the financial proposals; faced with a federal offer to "buy the provinces out on very generous terms,"

> [i]t would be extremely difficult for any provincial government to justify to its own people the rejection of a very favourable cash transfer from the Dominion in favour of double taxing their own people to raise a smaller amount.[110]

His theory was to be tested in due course.

Skelton produced an expanded and, in some respects, revised version of the memorandum, dated March 8, 1945.[111] In it, he advanced four reasons for avoiding a return to the pre-war fiscal system:[112]

1. Reliance on indirect taxes rather than progressive income taxes created levies on costs and the creation of impediments to production and investment. Because wealth created in one province might be taxed in another province, the poorer provinces were forced to levy taxes at very high and destructive rates.[113] Even at these rates, those provinces could not provide adequate services and flirted with insolvency; consequently, they had little real financial autonomy.

109 Ibid., at 14-15.

110 Ibid., at 17.

111 See letter from T.A. Crerar to members of the Cabinet committee, March 8, 1945, enclosing a copy of the revised memorandum, LAC, Claxton Papers, MG 32, vol. 143. The memorandum is also found in RG 19, vol. 109.

112 Revised memorandum, supra note 111, at 30-32.

113 The poorer provinces perennially complained that their resources were exploited by corporations based in Ontario and Quebec, which sucked the profits out to their head offices. They also complained, more generally, that federal policies such as the National Policy had harmed the prairie and maritime provinces to the benefit of central Canada.

2. Countercyclical fiscal policies were required to counteract fluctuations in the levels of employment and income:

   > Government expenditures, and more especially the relationship between expenditures and revenue, have become the balance-wheel of the economy. With government outlays, even under normal circumstances, rising to as much as one-third of the national income, they have necessarily become a dominant factor in the economic system.[114]

   Further, unlike levels of exports or private investment, government expenditures were "most readily subject to control and direction towards influencing the level of employment."[115]

   Skelton also repeated his earlier argument that redistribution of income effected by progressive taxation and federal spending on programs such as family allowances or unemployment assistance and a public investment program would increase consumption spending and further stimulate the economy. The corollary of this argument was that the taxation sources that fluctuated the most in response to the business cycle should be in the hands of the federal government, "so that deficits . . . would be centralized in the authority which controls monetary policy"[116] and the revenue flowing from those sources would be available to finance the redistributive and stimulative expenditure program.
3. The pre-war system was inequitable because the poorer provinces were not able to provide services to their residents roughly comparable to those provided in the richer provinces without greatly disproportionate levels of taxation (and even then found it difficult to do so).
4. The pre-war system did not provide the provinces with a predictable and dependable flow of revenue adequate for their constitutional responsibilities.

These arguments were at the core of the federal position and underlay the proposals made by Ilsley when the long-delayed federal-provincial conference convened in mid-1945.

The specific policy proposals advanced in the March 8 memorandum had not changed greatly in the six months since Skelton submitted his initial draft.[117] The

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114 Revised memorandum, supra note 111, at 36.

115 Ibid.

116 Ibid., at 32.

117 See supra note 102 and the related text. However, Skelton also included in the March 8 memorandum suggestions for significant changes in personal and corporation income taxes. These were apparently Skelton's own views, not those of Finance; Bryce, in a marginal note to his copy of the memorandum wrote, with respect to the corporation tax changes proposed by Skelton, "Is this not entirely new to Dept. of Finance—why was it not cleared in any way . . . but why in hell is all this needed anyway—this is not to be given to the Conference." See LAC, RG 19, vol. 109. Skelton's proposals do not seem to have had any impact on subsequent policy decisions of the Department of Finance about the design of the corporate income tax.

personal income and corporation tax and succession duty fields would be exclusively occupied by the federal government in return for unconditional cash payments to the provinces. The latter would be "something more" than the tax rental payments and pre-war succession duty revenues. Skelton's estimate of $110 million in September 1944 had been raised to $120 million.[118] The payments would be increased in proportion to increases in national income.

Notwithstanding these "very generous" terms, Skelton conceded that Ontario, Quebec, and perhaps British Columbia might be better off rejecting the federal payment and imposing a 10 percent provincial corporation income tax; they would not, in his view, "freely surrender this bargaining point in the national interest."[119] Skelton believed that a dissenting province would have difficulty justifying such action to its residents, given that they would be faced with a provincial tax in addition to the federal corporation income tax and the possibility that certain desirable federal programs (for example, enhanced old age pensions) would be delayed, with the onus being put on the non-cooperating provinces. The federal government could also take the position that it was not bound indefinitely by its promise in 1941 to lower corporation income tax rates by 10 percentage points on expiry of the tax rental agreements, and it could hold out the threat of increased federal taxes "to carry out a desirable national programme."[120] Skelton suggested that, in the last resort, notwithstanding that its "public position should be a strong one," the federal government should agree to "purchase" the corporation tax field from the provinces with the proceeds of a 10 percent tax imposed and collected at the federal level.[121] Succession duties could be similarly purchased. The total additional cost of this final position was estimated to be about $25 million.[122]

Skelton was personally optimistic that the federal government would emerge victorious.[123] After interviewing Skelton and others involved in planning for the conference, Dexter prepared a memorandum noting their views on the government's position. He summarized Skelton's comments as follows:

> Dominion-provincial relations—outlook bleak but not hopeless. True that election would probably weaken Dominion government. . . . True W.L.M.K. never put up a fight. But the kind of proposition he had in mind didn't require spunk. The Dominion

118 Together with the statutory subsidies under the Constitution Act, 1907, 7 Edw. VII, c. 11 (UK), section 1, the actual amount would be about $140 million.

119 Revised memorandum, supra note 111, at 41.

120 Ibid., at 42.

121 Ibid.

122 Ibid., at 43.

123 A number of officials in the Department of Finance shared this view. Indeed, Kenneth Eaton suggested that Skelton had "underestimated the bargaining power of the Dominion." Memorandum from Kenneth Eaton to Skelton, February 16, 1945, LAC, RG 19, vol. 109, at 12.

> should offer to buy out all or any provinces, and leave the offer lie. The weaker provinces would take it and the stronger would soon weary of their course.[124]

W.A. Mackintosh (who was then acting deputy minister of finance, at a time when Clark was ill) thought that, correctly presented, the government's proposals should be acceptable to the provinces because their merits were clear:

> Finance is the necessity and agreements would suffice. Given the right to place the burden fairly, the country can face the future and meet the problems. Denied the right, the country is hamstrung. It should be presented in this way—not centralization but rationalization of taxation. Moreover rationalization would place the provinces in a sounder position.[125]

In Clark's view, provincial cooperation was essential:

> [I]t is tax agreements or chaos.[126]

Dexter had also spoken to Ilsley, whom he found in "appalling physical condition" owing to his recurrent "nervous problem." This may account, at least in part, for the negativity of Ilsley's remarks as recorded by Dexter:

> Dominion-provincial relations—pretty well hopeless. He saw it this way. After the election if they are still in office King will call a conference and put up a proposition. It doesn't matter much what it is. The provinces will turn it down. The tax agreements will be terminated as soon as the war is over and the Dominion will vacate and cut its corporation taxes down to 30 per cent. Things will then go on as prewar. Just have to do the best possible under these conditions.[127]

Notwithstanding Ilsley's pessimism, there is no indication that he had moved from his consistent position on federal-provincial financial relations or that he had abdicated the leadership role to the brain trust and other officials in the East Block[128] involved in drafting the government's proposals.

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124 Frederick W. Gibson and Barbara Robertson, eds., *Ottawa at War: The Grant Dexter Memoranda, 1939-1945* (Winnipeg: Manitoba Record Society, 1994), at 497, quoting from Dexter's memorandum of March 1, 1945.

125 Ibid., at 498.

126 Ibid., at 500.

127 Ibid., at 497.

128 Most of the senior officials involved had offices in the East Block of the Parliament Buildings and were often referred to in terms of that connection (for example, "the East Block boys").

PREPARATIONS FOR THE CONFERENCE, JUNE AND JULY 1945

The general election was held on June 11, 1945, returning the King government with a reduced majority and opening the way for the long-delayed conference with the provinces. In a letter to Bruce Hutchison, a journalist in Victoria, Dexter reported that Ilsley had wanted the conference to proceed immediately, so that he could reflect its conclusions in the 1945 budget.[129] King preferred a date in the fall, and they had compromised by settling on August 6-10. Ilsley foresaw an initial one-week session at which the respective governments would present their proposals and appoint a number of continuing intergovernmental committees to carry out further detailed work. The conference would then reconvene in October. The budget would be brought down in the meantime, on the assumption that the existing federal-provincial arrangements would continue.

Dexter reported that Ilsley continued to worry about the conference, anticipating resistance from the provinces on the financial proposals. The minister's strategy was to put indirect political pressure on the provinces:

> [Ilsley] doesn't believe the dominion can strong arm the provinces. Ottawa must be patient and succeed by persuasion, aiming arguments over the head of the provincial governments at the electors of the provinces. . . . The great thing, he thinks, is to present a bang up programme based on the transfer of the taxing power. The Dominion must show the country what can be done if the provinces will co-operate.[130]

Dexter listed six main proposals identified by Ilsley: unemployment insurance (already "in the bag" but requiring partial federal funding), family allowances, unemployment assistance, a contributory old age pension plan, health insurance, and a "well integrated [plan] of public works in case unemployment develops."[131] "[The] idea is to show the cost and the need for a free shot at the income and [corporation] taxes."[132] A backup plan would be needed in case of failure; in that case, "[a]ll the gew gaws [would] of course go out the window"[133]—including, presumably, contributory pensions and health insurance.

Ilsley's plan was to repeat the tactic that had worked in 1941. At the January 1941 Dominion-Provincial Conference, Ontario, Quebec, and British Columbia had rejected implementation of the Rowell-Sirois recommendations but, in the face of the war emergency, had accepted, however ungraciously, the tax rental arrangements.[134]

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129 QUA, Dexter Papers, Dexter to Hutchison, June 21, 1945.

130 Ibid.

131 Ibid.

132 Ibid.

133 Ibid.

134 See Campbell, supra note 1, at 652-54.

Ilsley's position in 1941 was strengthened by the absence of any coherent alternative plan from the provinces. His strategy reflected his approach to politics generally—to take a well thought out position, argue it on principled grounds, and refuse to compromise. Ilsley had already paid a price on this account. The nervous stress that led to his repeated near-breakdowns was caused, as King and other observers noted, in part by his unyielding and principled defence of wage and price controls.[135] The coming battle with the premiers was to take a similar toll.

The format of the conference and the government's strategy for securing the provinces' agreement to its proposals were discussed at a meeting of the Cabinet committee on June 20, 1945. It was decided that the federal government would take control of the agenda by placing detailed proposals before the conference at the opening session, which would then be referred to a number of federal-provincial committees for detailed consideration. In the agenda for the Cabinet committee meeting, Skelton suggested that the federal government submit its proposals at the outset and give the provinces the opportunity to also submit proposals or make statements. Skelton continued:

> No attempt should be made at this stage to reach agreement on either general principles or details, but an attempt only should be made to reach *an agreement to consider the Dominion's proposals* and any alternatives.[136]

The committee, at Ilsley's suggestion, prepared a draft letter of invitation to the premiers,[137] stating that the federal government intended to put proposals to the conference, that the provinces would have equal opportunity to do likewise, and that committees would be established to consider "the major proposals presented and any alternatives." The wording made it clear that the agenda was to be driven by the federal proposals.

Other matters dealt with at the June 20 meeting included confirmation that the conference was to open on August 6 and that C.D. Howe (the minister of munitions and supply), Brooke Claxton, and J.A. MacKinnon (the minister of trade and commerce) had been added to the committee.[138] Ilsley also noted that the 1946 budget would be brought down on the assumption that no agreement with the provinces would be reached.

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135 And, in particular, almost constant conflict with the combative minister of agriculture, J.G. Gardiner, over farm product prices. See Dexter memorandum of November 1, 1943 in Gibson and Robertson, supra note 124, at 446-47.

136 Agenda for Cabinet committee meeting of June 20, 1945, at 2, LAC, Claxton Papers, MG 32, vol. 141 (emphasis in original).

137 See minutes of the June 20, 1945 meeting, LAC, Claxton Papers, MG 32, vol. 141. The letter to the premier of Ontario dated June 21, 1945 is found in the same volume.

138 Replacing Crerar, who did not run in the 1945 election and was subsequently appointed to the Senate, and Norman McLarty, who left the Cabinet at the same time as Crerar.

In late July 1945, the federal government prepared a long and detailed brief setting out its proposals. The portion dealing with financial arrangements[139] repeated in substance the objectives contained in Skelton's memorandum of March 8:[140] reorganization of the tax system to (1) encourage business investment, (2) enable the federal government to engage in countercyclical fiscal policy, (3) ensure a minimum standard for services in all provinces, and (4) provide a "dependable" financial base for the provinces. Attainment of these objectives required exclusive federal occupancy of the personal income and corporation tax and succession duty fields, which in turn would serve a fifth objective—to make it easier for Canada to enter into bilateral tax treaties with other countries.[141] The brief also contained a statement that went to the heart of the federal position and identified what was to be the core issue in federal-provincial financial relations for the next several decades:

> [The federal government] will clearly need to make full use of taxes on personal incomes, corporations and estates. Moreover, its revenue needs will be so great that duplication of these taxes by other governments would seriously restrict enterprise and output and would jeopardize Canada's full employment programme.[142]

Implicit in the federal position was the assertion that federal spending priorities were more important than provincial fiscal needs—the same argument successfully made in 1941 but now applied to peacetime. This was reflected in the initial federal offer to replace the tax rental payments of 1941. The provinces would receive an unconditional payment of $12 per capita, adjusted for the increase in the gross national product (GNP) since 1941.[143] This would result in minimum aggregate payments of $138 million annually (compared to actual provincial receipts of $125 million in 1945 from tax rental payments, the statutory subsidies, and succession duties). Increases in GNP since 1941 would, however, increase this amount substantially.[144] The brief does not provide the basis for arriving at the $12 per capita amount, but the preliminary report of the Committee on Financial Arrangements established by the Cabinet committee on the conference indicates that the amount was calculated by averaging the existing federal subsidies and tax rental payments to the provinces plus provincial

139 Memorandum of July 26, 1945, at 1-11, LAC, RG 19, vol. 110.

140 See supra note 111 and the related text.

141 This issue provoked virtually no discussion at the conference, and in subsequent years, provincial taxing powers provided no real obstacle to the development of Canada's tax treaty network.

142 Memorandum, supra note 139, at 5.

143 The proposal in Skelton's memorandum of March 8, 1945, which was repeated in a memorandum of June 15, 1945 (LAC, Claxton Papers, MG 32, vol. 141), that the payment be made in the ratio of 50 percent per capita and 50 percent pro rata to personal income tax collections in the province, had been abandoned.

144 The memorandum, supra note 139, at 9, estimated that, using GNP for 1944, the total would be $207 million.

succession duty revenues and increasing the resulting amount of $11 as required "to reduce the range of increase in population or per capita income within which Ontario or British Columbia would receive its irreducible minimum amount."[145]

In a memorandum to Dexter written in September 1945 (after the initial session of the conference), Hutchison (who had close ties to the BC government) reported that the $12 per capita amount was "based on a general average of the cost of government throughout all the provinces."[146] The offer therefore assumed that the provinces would remain at their pre-war revenue and spending levels, expressed as a proportion of GNP. In particular, they would be denied access to the tax fields that now accounted for a substantially higher proportion of the national income than in 1939 and also yielded revenue that tended to increase faster than national income. Moreover, while the federal proposals would relieve the provinces of some expenses, they effectively assumed that other provincial responsibilities such as education, transportation and other infrastructure, and many social services would remain, in relative terms, more or less at pre-war levels. This was not an assumption shared by, at least, the larger provinces, and it set the stage for a confrontation that confirmed Ilsley's foreboding.

THE DOMINION-PROVINCIAL CONFERENCE, AUGUST 6-10, 1945

The federal delegation to the conference included all 20 Cabinet ministers and 55 public officials. The provincial delegations included varying numbers of ministers[147] and, in all, 77 officials, of whom 25 were from Ontario. These numbers reflected the size and detail of the federal proposals as well as the lack of depth in the public service of most of the provinces. Ontario was the exception, and that province was eventually to produce the most substantial and comprehensive alternative to the federal plan.

Mackenzie King's opening statement set out the federal government's objectives in very general terms:

> [W]e are asking the provinces to go into partnership with the Dominion in a broad programme for the development of our national heritage, and the promotion of the welfare of the Canadian people.[148]

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145 Preliminary Report of the Committee on Financial Arrangements, July 14, 1945, LAC, RG 19, vol. 109, at 7. The committee was chaired by W.A. Mackintosh and included both Skelton and Bryce.

146 Letter from Hutchison to Dexter, dated "Sept/45," with memorandum attached, QUA, Dexter Papers.

147 Ranging from eight from Ontario to three from Prince Edward Island. See Canada, *Dominion and Provincial Submissions and Plenary Conference Discussions* (Ottawa: King's Printer, 1946) (herein referred to as "Conference Discussions"), at vii to xi.

148 Ibid., at 6.

King's statement was followed by statements by each of the premiers.

George Drew, the premier of Ontario, presented a vigorous defence of "decentralization of a large measure of authority" and strong provincial governments.[149] In particular, he defended the fiscal independence of the provinces:

> Any arrangement . . . which provided for a centralized collection of the greater part of the tax requirements of provincial governments and made them mere annuitants of the central government would place the provincial governments under the control of the central government to an extent that meetings of the . . . legislature would become almost meaningless because of the limitations within which they would be called upon to legislate.[150]

Drew also pointed to an imbalance in provincial and federal taxing powers, which he attributed to a fundamental weakness in the BNA Act: while the powers of the provinces were well defined and had been extended by the courts, the federal government had increasingly occupied the direct taxation field to which the provinces were limited. Confederation was, however, based on the "implicit understanding that the Dominion Government will leave the field of direct taxation open to the provinces of such an extent as will make it possible" for them to carry out their constitutional obligations.[151] Tax-sharing agreements were needed that would "leave to the provincial governments that independence and vigor which enables them to carry out the obligations which have been imposed upon them, and which will be imposed upon them in even greater degree in the years ahead."[152]

In a diary entry, King commented that Drew "spoke very well."[153] He does not seem to have appreciated, at that point, the fundamental challenge that Drew had raised to the federal position. The federal financial offer gave to the provinces a stable source of revenue but one that was essentially static. Ontario's tax rental payment under the federal proposals, in relation to the GNP, would be no greater than its revenues from corporation taxes and succession duties in relation to the GNP in 1939.[154] As Skelton had pointed out, Ontario might well have been able to raise as much or more revenue by reimposing corporation taxes alone. The federal proposal implied a more active and dominant federal presence, managing the economy through countercyclical budgeting and the shelf of public works, providing for major welfare programs (unemployment assistance, old age pensions, and family allowances), and promoting and partially financing health insurance and other

149 Ontario statement, ibid., at 9.

150 Ibid., at 11.

151 Ibid., at 12.

152 Ibid.

153 Mackenzie King diaries, supra note 3, August 6, 1945.

154 And in fact may have been somewhat smaller, given the element of equalization inherent in the fixed per capita payment proposed.

health-related programs. This reflected both a pan-Canadian or nationalist view—providing similar benefits to Canadians in all provinces—and a conviction that provincial boundaries were irrelevant or an impediment to economic management and prosperity in the modern world. Drew challenged this view in principle in his opening address, and Ontario was to subsequently challenge the fiscal implications of the federal view, particularly the denial of access to the revenue potential of the previously rented tax fields, so clearly revealed in the financing of the war effort.

While it is tempting to project into the past more recent challenges to federal power by Quebec, in 1945 Ontario was the principal champion of provincial rights.[155] With the exception of an extended plea for more funding from New Brunswick's premier, John McNair, and references to social credit theory by the premier of Alberta, Ernest Manning, the opening statements of the other premiers were brief statements of good intention. In a revealing interview with Bruce Hutchison in September 1945, however, Premier John Hart of British Columbia essentially echoed Drew's criticism.[156] Indeed, he went further, discounting the countercyclical budgeting theory that was one of the federal government's chief arguments:

> It purports to be part of a scheme of full employment . . . tied to all sorts of social reforms . . . to provide the more abundant life for everyone and ample jobs. It is nothing of the sort. The federal government has no full employment policy.[157]

As reported by Hutchison, Hart's view was that

> [t]he scheme, in fact, is part of a plan to centralize power in Ottawa, reduce the power of the provinces and hand the control of the country, through finance, to the bureaucrats and the East Block boys who are talking generally through their hats, as proved in this scheme. [Hart] is opposed to the scheme on this broad ground of centralism which does not have the excuse of being part of any real full employment plan.[158]

In a more practical vein, Hart pointed out that the fixed per capita payment proposed, based on averaging the costs of government over all the provinces, did not

155 While the premier of Quebec, Maurice Duplessis, praised decentralization and the compact theory of Confederation, he presented no systematic or reasoned attack on the federal position, or any real alternative, unlike Ontario, as discussed below. See Conference Discussions, supra note 147, at 20-21, for Duplessis's opening remarks.

156 Memorandum attached to letter from Hutchison to Dexter, supra note 146. Hart was not the only premier critical of the presumed influence of the brain trust; Nova Scotia premier Angus L. Macdonald spoke of the "lurking fear" of the "tremendous power" of the civil servants and said that he "would not want to have anything to do with a provincial government if Dominion-provincial policy was to be framed by high civil servants in the Department of Finance or in the Bank of Canada." See letter from Macdonald to T.A. Crerar, April 19, 1946, QUA, Crerar Papers, box 122.

157 Memorandum, Hutchison to Dexter, supra note 156.

158 Ibid.

provide enough money for a high-cost province like British Columbia and would yield substantially less than the province would realize by exploiting the income tax and succession duty fields itself. Hart predicted that

> once the public understands the loss involved, it will revolt against it. The federal government's plan to sell this pup as a full employment measure etc. has fallen flat.[159]

To Hutchison's suggestion that the provincial government would be "lynched from the lamp posts then entwined with flowers outside his window" if it reimposed its pre-war taxes, Hart replied that "the people would rather pay taxes to the province instead of sending them east and in a fight between the two governments would favor their local government."[160] This was very different from the political situation in 1941 and did not bode well for the federal position.

Hart's alternative was very similar to that later put forward by Ontario. The provinces would receive a percentage of the income taxes and succession duties collected in the province and thus share in the revenue potential of progressive income taxation. For the poorer provinces, this would be supplemented by unilateral federal payments similar to those proposed by the Rowell-Sirois commission.[161]

Following the presentations by the premiers, each of the federal ministers then read into the record the relevant portion of the federal brief to the conference.[162] The federal financial proposals, read in by Ilsley, repeated the position and proposals previously set out in the memorandums prepared for the Cabinet committee.[163]

The premiers then presented, or were given the opportunity to present, their proposals. The most substantive presentation, by Premier Stuart Garson of Manitoba, was a long endorsement of the federal position. (Perhaps not surprisingly, Garson was to become the federal minister of justice in 1948.) Saskatchewan's presentation, by Premier T.C. (Tommy) Douglas, was sympathetic to the federal position; Alberta's Premier Manning merely presented a list of topics to be discussed. The premiers of Ontario (Drew) and Quebec (Maurice Duplessis) presented no substantive proposals at this stage of the discussions.

A Co-ordinating Committee, consisting of St. Laurent, Howe, Ilsley, and the nine provincial premiers, was constituted and met on August 9 to receive further explanation of the federal proposals. On August 10, the Co-ordinating Committee agreed to adjourn and resume discussions on November 26; in the meantime, the federal and any provincial proposals would be studied further. The full conference

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159 Ibid.

160 Ibid.

161 For further discussion of the positions of British Columbia and Ontario, as well as other provinces that presented formal briefs, see the text below at note 174 and following.

162 Federal government proposals, Conference Discussions, supra note 147, at 55-118. The proposals had been released to the public a few days earlier.

163 Ibid., at 111-18.

then adjourned, with agreement to reconvene at some date after November 26. Ilsley had delayed presenting the 1945 budget in anticipation of the results of the conference. The adjournment then forced him to bring down the budget without those results.

THE OCTOBER 12, 1945 FEDERAL BUDGET

The October 12, 1945 budget began the fiscal transition to peacetime but, like the 1944 budget, proposed no significant changes to the structure of the tax system or to tax rates. In the budget speech, Ilsley reviewed the war finance policy, including the "pay-as-you-go" policy adopted in 1939,[164] and once again committed the government to significant reliance on the personal income tax:

> [T]here is no doubt that the personal income tax in the post-war period will continue to occupy a major place in our taxation structure. The extent and the nature of the requirements of the government will necessitate dependence on the personal income tax as a major element in the taxation system.[165]

In the absence of an agreement with the provinces, Ilsley rejected "hasty and irretrievable steps in the modification and reorganization of our tax structure."[166] Total expenditures in 1945-46 were only marginally lower[167] than in the previous year, with declining war and demobilization expenses being largely offset by increased debt charges and family allowance payments. The war exchange tax[168] was abolished and reductions made in sales taxes. Personal income taxes were reduced by 16 percent in a full year and by 4 percent in the remaining portion of 1945.[169] To eliminate the duplication of benefits for higher-income individuals who were already receiving the tax credit for dependent children and would also receive a family allowance, a tax was imposed on family allowance benefits, beginning at 10 percent for families with income exceeding $1,000 and increasing to 100 percent for families with income exceeding $3,000.

The excess profits tax was amended to remove the tax from many small businesses,[170] and the excess profit rate was reduced from 100 percent to 60 percent

164 Canada, Department of Finance, 1945 Budget, Budget Speech, October 12, 1945, at 1. See Campbell, supra note 1, at 638-42, for discussion of the 1939 budget.

165 1945 Budget Speech, supra note 164, at 9.

166 Ibid., at 6.

167 About $100 million; see appendix table 1.

168 Imposed on non-sterling imports to conserve US dollar reserves.

169 The reduction in personal income tax payable applied to the aggregate of normal tax, graduated tax, and investment surtax.

170 The minimum standard profit base was increased from $5,000 to $15,000, and the basic 15 percent tax on sole proprietorships and partnerships was eliminated (leaving them subject to the excess rate).

(including elimination of the 20 percent refundable portion).[171] The reductions were expected to result in $107 million in lost revenue in the remaining portion of the 1945-46 fiscal year, and in a full year $327 million (divided between roughly one-third from the sales and excise tax reductions and the balance from the personal and corporate income tax reductions).[172]

The 1945 budget, in its revenue and expenditure profile was the last of the war budgets. The rapid decline of defence expenditures transformed the federal fiscal position after 1945. The principal effect of declining war expenditures was to eliminate the federal deficits (and consequential borrowing) so that, while total federal revenue declined, there was no material change in federal tax revenues. Ilsley's concern to "protect the Treasury," to use King's phrase, did not easily yield to political pressure. The Liberal caucus wanted a $2,000 tax-free allowance for MPs. Facing relentless pressure from the caucus and from King, Ilsley would initially concede only $1,500, then $1,800, and conceded $2,000 only after pressure from the full Cabinet.[173]

THE CO-ORDINATING COMMITTEE MEETINGS OF NOVEMBER 26-30, 1945 AND THE PROVINCIAL RESPONSE

The Co-ordinating Committee met again from November 26 to 30, 1945.[174] British Columbia, Alberta, and Nova Scotia presented formal briefs at the meetings. Ontario, Saskatchewan, New Brunswick, and Manitoba presented briefs after the November meetings but before the next series of meetings from January 28 to February 1, 1946, and Nova Scotia submitted a further brief. At the meetings, British Columbia appears

171 As a result of these changes, corporations with annual profits of $15,000 or more were subject to the 18 percent corporation income tax, the minimum 22 percent excess profits tax rate, and a 60 percent tax on profits generally in excess of 116⅔ percent of standard base profits.

172 In the result, total revenue from income tax and succession duties was about $100 million lower in 1945-46 than in 1944-45.

173 See Mackenzie King diaries, supra note 3, September 27, 1945 and September 28, 1945; and Cabinet Conclusions for September 28, 1945, supra note 38.

174 There does not appear to be a record of the November meetings of the Co-ordinating Committee. (The official report of the conference contains only Mackenzie King's opening statement, copies of the formal briefs submitted by some of the provinces, and written responses by the federal government.) The Co-ordinating Committee established an Economic Committee, consisting of three officials (usually a mixture of elected and appointed officials) from each government, to report back to the Co-ordinating Committee after the year-end. The Economic Committee was chaired by the senior federal representative, Brooke Claxton, and Skelton was to act as secretary. (See Cabinet Conclusions, supra note 38, minutes of the meeting of November 29, 1945, and a press release dated November 30, 1945, LAC, Claxton Papers, MG 32, vol. 142.) The Economic Committee met six times between December 4 and 14, principally attempting to project the effect of the federal proposals on provincial budgets. No conclusions were recorded in the minutes of the committee. See LAC, Claxton Papers, MG 32, vol. 142.

to have proposed an arrangement that would combine the sharing of tax fields and a per capita payment.[175] Ontario refused to disclose its position,[176] but it was assumed to be similar. The federal concern was that the revenue of the richer provinces would grow faster than the per capita grants to the poorer provinces, the agreements would need frequent renegotiation, and "the dominion would not be so well fixed to do its job."[177] Dexter suggested that Skelton had toyed with a plan along the lines of the BC proposal, combining provincial taxes imposed at 1941 rates and a $7 per capita payment.[178]

The formal provincial responses fell into two groups. Saskatchewan, Manitoba, New Brunswick, and Nova Scotia accepted the federal proposals for exclusive federal possession of the personal income and corporation tax and succession duty fields, but rejected the proposed rental payments as inadequate; all four provinces specifically asked for some form of special-needs subsidy to compensate for their limited fiscal resources relative to the other provinces. The positions taken by Alberta, British Columbia, and Ontario were quite different. None sought special-needs subsidies or equalization for itself; Ontario and British Columbia sought greater access to revenue from the taxes proposed to be rented, and Alberta sought both more money and a greater degree of autonomy in tax matters. The arguments presented by the provinces in both camps are summarized in the text that follows.

Nova Scotia sought assurances that the federal government would withdraw from areas of the direct taxation field that it had occupied for much of the war—principally gasoline, electricity, and amusement taxes—and that it would not enter any new areas of that field.[179] Nova Scotia also asked how the $12 per capita figure had been determined and whether some form of equalization had been considered, in the form of either grants such as those proposed by the Rowell-Sirois commission or some kind of pooled sharing of the tax fields proposed to be rented. The federal government responded that a grant of a fixed per capita amount for all provinces

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175 See Dexter's memorandum of December 9, 1945, reporting a conversation with W.A. Mackintosh, QUA, Dexter Papers. The proposal apparently was for 5 percent sharing—presumably, 5 percent of the revenue from the rented fields. The poorer provinces would receive proportionately larger cash payments.

176 "Apparently, at the talks of the experts so far, the Ontario boys have succeeded in keeping all their cards face down." Dexter's memorandum of December 9, 1945, supra note 175, at 4.

177 Ibid., at 5.

178 Memorandum of December 20, 1945, QUA, Dexter Papers, at 5.

179 See Nova Scotia brief (dated November 28, 1945), Conference Discussions, supra note 147, at 215-18. Nova Scotia's premier, Angus Macdonald was particularly concerned about federal occupancy of the minor direct tax fields. In a letter to T.A. Crerar dated January 16, 1946, he asked what guarantee Nova Scotia had that the federal gasoline tax would not eventually drive the province out of the field and complained that "if the same policy be pursued in other respects, [the] Provinces in a few years will find themselves in a position where they will be nothing more [than] recipients of grants from the Dominion Government with all their taxing powers gone." QUA, Crerar Papers, box 122.

would be "equitable" and had "the advantage of simplicity and definiteness."[180] Nova Scotia replied that the federal position was "unsatisfactory" and suggested special fiscal-need grants as proposed by the Rowell-Sirois commission.[181] In an earlier letter to Dexter, Premier Angus Macdonald had suggested:

> One of the weaknesses of the Dominion proposals is that they simply follow the Confederation plan of subsidies based on population. In fact, there is nothing new in the Dominion proposals. The subsidy is greater, but the principle remains the same. Nova Scotia is presumed to be able to get along on the same basis as Ontario. This was a fundamental weakness I think of the Confederation pact, and therefore must be regarded as a weakness in the Dominion proposals.[182]

The Saskatchewan brief was a lengthy and sophisticated commentary on every aspect of the federal proposals.[183] Its comment on the fiscal proposals[184] followed Nova Scotia's in suggesting needs-based federal grants rather than payments based largely on population. Saskatchewan also preferred a Rowell-Sirois-type of national adjustment grant, but it was prepared to accept per capita rental payments provided that there were supplemental needs-based grants and guaranteed floor prices for farm products and crop insurance, to provide economic security for farmers.

New Brunswick echoed Nova Scotia's concerns about federal incursions into direct taxation fields traditionally occupied by the provinces, and asked for a larger per capita fixed payment and a special-needs subsidy.[185]

Manitoba accepted the federal proposal for occupancy of the major tax fields, which "would make possible a practical arrangement for the equalization of the revenue sources of the different provinces."[186] Like Nova Scotia, Manitoba called for supplemental subsidies based on special needs and for the province to have an "available field of taxation" to "preserve provincial autonomy."[187]

As noted above, Alberta, British Columbia, and Ontario raised different objections to the federal proposals, and suggested different approaches to revenue sharing, though they were united with the other provinces in resisting federal appropriation of provincial direct taxation fields.

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180 Federal response delivered in writing, December 5, 1945: see Conference Discussions, supra note 147, at 219-20.

181 Reply, January 26, 1946; see Conference Discussions, supra note 147, at 315-17.

182 Letter from Angus L. Macdonald to Dexter, November 1, 1945, QUA, Dexter Papers.

183 See Saskatchewan brief (dated January 9, 1946), Conference Discussions, supra note 147, at 249-309. The quality of the brief presumably reflected the superior level of competence in the Saskatchewan public service—an advantage that served the province well in negotiating with its partners in the Canadian federation.

184 Conference Discussions, supra note 147, at 253-56.

185 See New Brunswick brief (dated January 24, 1946), ibid., at 311-13.

186 See Manitoba brief (dated January 26, 1946), ibid., at 318-26 (quoted text at 320).

187 Ibid., at 322.

Alberta anticipated "very substantial increases in revenue from corporation tax and income tax in the normal course of our internal development," sought an increase in the proposed per capita rental payment to $16, and echoed the call of other provinces to halt further federal incursions into traditional provincial direct taxation fields.[188] Alberta also sought to retain control of its corporation taxes as a means of controlling its internal economic development.[189]

British Columbia took the position foreshadowed in Premier Hart's interview with Bruce Hutchison in September 1944.[190] The proposed federal per capita payment did not reflect the productive capacity of the provincial tax base, and the province would be substantially better off re-entering the rented tax fields. British Columbia therefore suggested federal payments at a minimum equalling the yield that the rented tax field would have produced at the rates in force when last levied by the province. The BC brief made no mention of fiscal needs payments to the poorer provinces.

Ontario's brief provided the most substantial challenge to the federal position.[191] As a backdrop to its counterproposals, Ontario advanced, as Drew had done at the August conference, a robust defence of the federal system and the importance of diffusing power as a means of defending democratic government and protecting civil and property rights. The brief noted the inability of the provinces to deal separately with national economic problems such as unemployment and regional disparity; however, it called, not for federal leadership, but for federal-provincial cooperation:

> [N]one of these presents any insuperable difficulty under a Federal System in which there is effective and continuing cooperation between the Dominion and provincial governments. . . . The Federal System can meet all these problems by becoming in fact as well as in name a fully cooperative partnership.[192]

The brief also stressed the role of the Ontario government in economic development, particularly in transportation and hydroelectric infrastructure, education, and social services, implicitly challenging a dominant federal role in the economy.

It followed that provincial financial needs ranked on a par with those of the federal government and the federal proposals consequently fell short. Like British Columbia, Ontario would receive less under the proposed rental payments than its occupancy of the rented fields would produce, calculated by reference to the 1945 Ontario budget. With the passage of time, the disparity would widen because of the

188 See Alberta brief (dated November 26, 1945), ibid., at 207-13 (quoted text at 209).

189 Ibid., at 211. Alberta also proposed that provincial corporation taxes should be deductible against federal corporation taxes and that the province's proceeds from such taxes should be deducted from any federal rental payments or subsidies.

190 See British Columbia brief (dated November 26, 1945), Conference Discussions, supra note 147, at 201-5.

191 See Ontario brief (dated January 8, 1946), ibid., at 225-48.

192 Ibid., at 231.

progressive nature of personal income tax and succession duties[193] and the fact that the profits of corporations "[had] risen in greater ratio than their gross production."[194] Acceptance of the federal proposals would undermine the fiscal autonomy of the province and its ability to carry out its constitutional functions.[195]

Unlike British Columbia, Ontario presented a detailed alternative to the federal proposals, the main features of which were as follows:

1. The federal and provincial governments would impose personal income and corporation taxes at rates determined by each government. The taxes would, however, be imposed using a common tax base and would be collected by the federal government as agent of the provinces.[196] Further, a fairer system of allocating corporate profits among the provinces would be employed.
2. Only the provinces would impose succession duties, but they would do so under uniform provincial statutes that would resolve jurisdictional disputes.
3. A portion (10 percent) of personal income taxes, corporation taxes, and succession duties would be placed in a "national adjustment fund," from which payments ("provincial adjustment grants") would be made to the provinces, based on fiscal need. The grants would be administered by a continuing federal provincial coordinating committee composed of the respective heads of government.[197]
4. The federal government should vacate and leave to the provinces a number of minor direct taxes,[198] refrain from entering new direct taxation fields in the future, and give the provinces priority in taxing mining and logging operations.

The Ontario proposals presented several significant challenges to the position that the federal government had taken.

The proposal that provincial income and corporation taxes be imposed on a common tax base and collected at the federal level neutralized federal arguments about

193 "Personal income tax and succession duty rates are progressive. As income and estate values increase, they become subject to higher rates of tax and the revenues therefrom tend to increase more rapidly." Ibid., at 237. The Ontario objections to the federal proposals are set out ibid., at 235-38.

194 Ibid., at 237.

195 See the 11-point summary of Ontario's objections, ibid., at 237-38.

196 As had been done during the 1930s in respect of the personal income taxes imposed by Ontario, Quebec, Manitoba, and Prince Edward Island.

197 The proposed coordinating committee was intended to be a permanent mechanism to deal with ongoing federal-provincial issues, determine the timing of proposed public investment projects, and generally exchange information between the two levels of government: see Ontario brief, Conference Discussions, supra note 147, at 239.

198 Taxes on gasoline, amusements, parimutuel betting, racetracks, security transfers, and electricity.

the complexity and cost of tax compliance. The proposal for uniform succession duty laws had a similar effect. The Ontario position largely ignored the Keynesian countercyclical budgeting arguments on which the federal proposals were based;[199] and, while Ontario accepted the concept of a shelf of public works timed to fit the business cycle, it disputed exclusive federal control. Finally, the proposal for an adjustment fund addressed directly the most obvious defect in the federal proposals—the lack of an effective equalization mechanism. The absence of such a mechanism not only caused dissatisfaction among the poorer provinces, but also placed much more weight on the federal demand for exclusive possession of the personal income and corporation tax fields. Ilsley's consistent argument, in 1941 and in 1945, was that the poorer provinces would have to impose very high rates of tax, and this would make it difficult for the federal government (in the absence of the war emergency) to effectively engage in countercyclical fiscal policies by constraining the rates of tax it could impose. An effective equalization policy would allow the poorer provinces to impose taxes at rates close to those of the richer provinces and avoid the very high rates that would inhibit federal fiscal policy. This shortcoming was to be rectified definitively in 1957; Ontario in a sense opened the door in 1946 by offering a portion of its own revenues for the purpose.

The Ontario response also belied Skelton's rather facile optimism that public pressure would force the larger provinces to agree to the federal proposals. Ontario clearly was prepared to opt out (and in fact did) and reimpose at least some provincial taxes, notwithstanding any political risks.[200]

199 Complete provincial autonomy in the imposition of the major progressive taxes was diametrically opposed to the federal stance. While it is difficult to identify with certainty the source of the skepticism shown by some provinces about Keynesian countercyclical fiscal theory (see supra note 157 and following, and the related text, with respect to British Columbia), it is surely of some significance that Harold Innis, probably the leading Canadian economist of his generation (who had at times advised Ontario), rejected Keynesian theory. In a letter to Angus Macdonald between sessions of the conference, he wrote, "I do not think centralization of taxing authority in these fields will tend to promote employment and prosperity throughout Canada. . . . [The federal policy makers] have been carried away by their enthusiasm for the possibilities of the Bank of Canada, by Keynes and Hansen, by their own bureaucratic interests and by the necessities of a war programme."

In particular, he warned Macdonald of the long-term effects on the maritime provinces: "Uniform monetary measures will not [accrue] to the advantage of all regions. . . . [F]ull employment is apt to mean prosperity on the St. Lawrence and the continued steady drain of population and revenues from the maritimes." Nova Scotia Archives and Record Management, Angus L. Macdonald Papers, letter of February 13, 1946, vol. 898.

200 This is consistent with Hutchison's assessment of the reaction of British Columbia voters: "He [Hart] is quite right about the B.C. public attitude, quite right that the B.C. people will not take this deal or anything else like it. . . . No government in this province could consider it." Hutchison, memorandum, QUA, Dexter Papers.

THE CO-ORDINATING COMMITTEE MEETINGS, JANUARY 28-FEBRUARY 1, 1946[201]

On January 29, 1946, Ilsley, despite nervous exhaustion,[202] presented a revised federal proposal to the Co-ordinating Committee, in response to provincial complaints that the initial plan did not provide sufficient revenue.[203] At a Cabinet meeting on January 18, 1946, Claxton had reported for the Cabinet committee on the conference that the Economic Committee had concluded that "the financial proposals were the focal point of discussion and presented greater difficulties [than the public investment and social security proposals]."[204] Claxton thought there was a "reasonable chance" that all provinces but Ontario would accept the new offer and that Ontario would eventually be forced to change its position if modifications were made to "the extent of the payments to be made rather than to basic principles."[205] A committee was established, consisting of Clark, Towers, Mackintosh, and Skelton, to report to Cabinet on possible modifications to the original proposals.[206]

The committee's recommendations were presented and approved at a Cabinet meeting on January 23.[207] Under the revised federal proposal, the initial per capita payment would be increased, from $12 to $15, with provision for future adjustments in proportion to increases in the GNP from 1942.[208] The calculation of the payment in any year would be based on the average population and GNP for the preceding three

201 No formal record of the meetings was kept, but the conference secretariat noted the "chief points" as "rough minutes." A copy is in LAC, Claxton Papers, MG 32, vol. 143.

202 On January 17, Ilsley told King that he "was finding it increasingly difficult to do any work" but that he owed it to King and his colleagues to "stick on, through this session, no matter how hard it was going to be." Mackenzie King diaries, supra note 3, January 17, 1946.

203 See minutes, supra note 201, at 4-5; and a more complete summary following, ibid., at 21. Some members of the Cabinet wished to discuss the Ontario proposal first, but Ilsley, St. Laurent, and King persuaded their colleagues to present the revised federal proposal first. See Mackenzie King diaries, supra note 3, January 29, 1946.

204 Cabinet Conclusions, supra note 38, minutes for the meeting of January 18, 1946.

205 Ibid. King, perhaps less sanguine than Claxton, noted, "I can see it is going to be a very difficult week." See Mackenzie King diaries, supra note 3, January 18, 1946.

206 Ibid.

207 Cabinet Conclusions, supra note 38, minutes for the meeting of January 23, 1946.

208 King noted that the "committee of experts, Clark, Mackintosh, Skelton, etc., have found it necessary to make an increase in the amount the Dominion should be prepared to pay; if agreement is to be reached with the provinces to increase from 12 to 15 millions the amounts to be given the provinces in lieu of their surrendering some sources of taxation. This was a compromise as between demand for 18 millions." See Mackenzie King diaries, supra note 3, January 23, 1946. In referring to "millions," King appears to have confused the proposed per capita amounts with the total rental revenues that a province might receive; the provinces were presumably asking for $18 per capita. King also voiced his misgiving about making "one government the taxing power and the other governments the spending power," particularly because the "taxing business is the unpopular end"; however, he concurred with the recommendation. Ibid.

years.[209] Further, the payment for a province would never be less than the greater of 150 percent of a province's existing tax rental payments and $2 million.[210]

Ilsley estimated that the provinces would receive almost $200 million, compared to $125 million under the existing agreements and statutory subsidies. At the January 29 meeting of the Co-ordinating Committee, under questioning from the provinces, he repeated previous assurances that existing federal commodity taxes would not be increased, but refused to withdraw from that tax field unless the federal government received compensation. He also made no concession when Drew suggested that Ontario would reconsider its position if succession duties were left to the provinces.[211]

King met with Ilsley, St. Laurent, Claxton, Clark, and C. Fraser Elliott (the commissioner of income tax) before the January 30 session to discuss the line that Ilsley should take in the meeting. He was concerned that it was too rigid in "irrevocably" insisting on federal occupancy of the succession duty field (a position he ascribed to Clark and Towers) but was reassured by Ilsley that "nothing was irrevocable."[212] Claxton and St. Laurent told King after the day's session that Ilsley's position (his repeated refusal to agree to federal withdrawal from the minor direct tax fields or to provincial occupancy of the succession duty field) was influenced by the view of Clark and Towers that they "could not map out the budget unless we had absolute control of the whole field of taxation."[213] At that point, King felt that a settlement was possible on the following day if the federal side promised no further encroachment on provincial tax fields absent a national emergency. This did not happen, and King was increasingly critical of what he saw as inflexibility in the position taken by Ilsley and the Department of Finance. He confided to his diary in connection with the refusal of Ontario and Quebec to give up succession duties:

> Discussions largely on succession duties. Quite apparent neither Ontario nor Quebec will give up this field. Personally I do not blame them. I find myself very strongly of the position that Ont. and N.S. are taking, namely, that provinces should be left with certain definite fields of taxation, the dominion ditto, and subsidies reduced to as small a margin as possible. The finance dept. behind which is the Bank of Canada, have completely changed the generally accepted procedure which has been to keep as largely as possible the spending authority responsible for the tax-raising. I think their effort is in the direction of centralization of financial control. That may be desirable from the point of view of more effective administration, etc. from Ottawa's end, but politically it will not be possible I believe for a long time to come.[214]

209 The minimum payment would never be less than $15 per capita based on the 1942 population.

210 These provisions were directed, respectively, at British Columbia and Prince Edward Island and had the effect of doubling the minimum payments to those provinces under the August 1945 federal proposals.

211 Minutes, supra note 201, at 9.

212 Mackenzie King diaries, supra note 3, January 30, 1946.

213 Ibid.

214 Ibid., January 31, 1946.

King also suggested, with the support of the minister of national revenue, J.J. McCann, that the provinces should have exclusive occupancy of electricity and gasoline taxation. Clark objected, and King did not press the point on the grounds that Clark (who had just returned to work after a long illness) was "in very poor shape. . . . He is liable to break down completely at any moment. Ilsley is not far from the same position."[215]

King's misgivings evidently had some effect. At the January 31 meeting of the Co-ordinating Committee, Ilsley raised the possibility of a federal commitment not to raise the minor direct taxes except in an emergency (Drew and Duplessis thought this "too indefinite")[216] and agreed to consider continued provincial succession duties with an offsetting lower per capita payment. At that point, the federal ministers thought that all of the provinces would agree to vacate the personal income and corporation tax fields. On February 1, King suggested to the premiers that an adjournment was necessary for the federal government to consider the succession duty issue, and Drew's suggestion that the committee adjourn until April 25 was accepted. Ilsley summarized the outstanding issues as "whether some arrangement could be worked out by which the provinces which wished could continue to share the succession duty field, and whether the Dominion was prepared to make a commitment with respect to the remaining tax fields."[217] He concluded by warning the provinces that the dominion was not a "financial supplicant" and that the objectives of the federal proposals were "economic rather than fiscal."[218]

Consideration of the succession duty issue continued. On March 6, Dexter had talked to Ilsley (and to Mackintosh at about the same time) and reported that at the brain trust meetings on the conference, St. Laurent had argued that Quebec had special rights to succession duty jurisdiction because of its distinct legal system.[219] Dexter described the federal thinking as follows:

> I gather from Bill [Mackintosh] that all hope of the Dominion gaining exclusive possession of succession duties is now gone. The new line is to exact due compensation from the provinces out of the proposed subsidies and for the Dominion, itself, to remain in the field. St. Laurent seems favorable to this but the boys have their fingers crossed. The Clark-Towers proposition now is that the Dominion agree to have this tax field shared by both jurisdictions. The Dominion, however, will deduct from its payments to each province, the amount which the province collects in succession duties. This would offer the maximum deterrent as it is thought unlikely that a province would choose to tax for money which it could obtain as a gift from Ottawa.[220]

215 Ibid.

216 Minutes, supra note 201, at 17.

217 Ibid., at 28.

218 Ibid.

219 Memorandum of March 6, 1946, QUA, Dexter Papers. "St. Laurent shocked the lads by basing his argument on the treaty of Paris, 1763."

220 Memorandum, supra note 219.

Ilsley may have been less hopeful—Dexter reported that "Ilsley just glooms about this."[221] Ilsley's concern persisted. On April 12, King confided to his diary that

> Ilsley stated seriously a day or two ago he saw no hope of our reaching agreement on financial matters with the provinces and had come to the conclusion we were giving far too much money to them. He used the expression in dealing with this situation of increasing expenditures and trying to reduce taxation, he was like a man in a fog; did not know just where he was at all. This is about the position he is in with the financial worries he has now to contend with.[222]

As discussed below, others in the Cabinet shared Ilsley's pessimism that the provinces would accept the revised proposals.

RECONVENING OF THE CONFERENCE, APRIL 29-MAY 3, 1946

The Cabinet met on April 23 to prepare for the resumption of the meeting of the Co-ordinating Committee. Ilsley did not think that provincial demands could be met. As King noted in his diary, "[Ilsley] did not see how it was going to be possible to balance these budgets and at the same time make any reduction in taxation; also keep up vast expenditures on social services."[223] King complained that "we have all been pushed into this new method of financing for which I think Keynes perhaps has been mainly responsible in influencing governments."[224] His impression was that Cabinet was doubtful that a settlement with the provinces would be reached when the conference reconvened.[225]

The Co-ordinating Committee met, as agreed, on April 25 and 26[226] and decided that the full conference would reconvene on April 29 to consider the revised federal proposals in a public session.[227] On April 27, the Cabinet once again discussed concessions to the provinces in respect of the minor tax fields, but Ilsley resisted any arrangement that would not compensate the federal treasury for any concessions: "[H]e said he felt terrible to think he would be leaving to his successor a position that was impossible to meet."[228] The only substantive change in the revised proposals

221 Ibid.

222 Mackenzie King diaries, supra note 3, April 12, 1946. The expenditures that Ilsley referred to were apparently the costs of the social welfare programs proposed by the federal government at the conference. See ibid., April 11, 1946.

223 Ibid., April 23, 1946.

224 Ibid.

225 Ibid.

226 There does not appear to be any record of these meetings. King noted that St. Laurent answered various questions posed by the provinces, and Ilsley set out the federal position in more detail. "It was clear he was very tired." Ibid., April 25, 1946.

227 See the report of the Co-ordinating Committee, April 29, 1946; Minutes, supra note 201, at 381.

228 Mackenzie King diaries, supra note 3, April 27, 1946.

was to accommodate provinces that wished to continue imposing succession duties. The tax rental payments to such provinces would be reduced by the yield of the province's duty at 1946 rates, and the duty paid would be fully credited against a taxpayer's federal succession duty liability to a maximum of 50 percent of that amount. The effect was to allow each level of government an equal share of succession duties without double taxation. The federal government also undertook not to enter the real estate and automobile licensing tax fields, and not to increase its taxes on gasoline, amusements, and parimutuel betting. It refused to withdraw from the latter fields without appropriate compensation from the provinces.[229]

When the conference reconvened, the revised federal proposals were presented, as described above. Drew followed immediately with a variation of the original Ontario proposal.[230] Under the revised plan, Ontario would rent the personal income and corporation tax fields for payments that, together with federal withdrawal from succession duties, and from the taxes on gasoline, electricity, and parimutuel betting, would approximate the yield that the province would have realized if it had continued to impose the personal income and corporation taxes.[231] In addition, Ontario wanted increased federal spending on pensions and reimbursement for foreign exchange losses on provincial and municipal borrowing. Drew repeated the proposal for a national adjustment fund for equalization purposes.

Duplessis followed Drew with a disjointed attack on the federal proposals, which relied largely on the compact theory of Confederation,[232] and proposed no particular alternative. It was clear that Quebec would not accept the federal plan. Macdonald then presented Nova Scotia's position, which was typical of the views expressed by the poorer provinces but argued more tenaciously by Macdonald, notwithstanding his longstanding friendship with Ilsley. Nova Scotia was willing to rent the three tax fields (personal income and corporation taxes and succession duties) but insisted on the federal government's vacating of the gasoline, amusements, and parimutuel betting fields; it also requested an adjustment grant along the Rowell-Sirois lines.[233] The responses of the other provinces were broadly similar: they were prepared, at least in principle, to rent the three tax fields,[234] but all wanted more, in one form or another, from the federal government.

229 Specifically, the Cabinet authorized withdrawal of the federal taxes on gasoline and amusements, but only if compensated by reduced federal rental payments or reductions in federal social security spending. See Cabinet Conclusions, supra note 38, minutes for the meeting of April 27, 1946.

230 Minutes, supra note 201, at 391-408.

231 Based on an algebraic formula taking into account population and national income growth.

232 According to Duplessis, the federal proposals would be the death-knell of Confederation. See minutes, supra note 201, at 414.

233 Ibid., at 416-20.

234 Saskatchewan, Manitoba, and Alberta stated their willingness explicitly; British Columbia, Prince Edward Island, and New Brunswick, implicitly.

After the session, King met with Ilsley, St. Laurent, Howe, Clark, and Skelton and suggested that the provinces be given sole occupancy of the minor taxes in return for lower fixed payments. Clark objected that the federal government needed "all the fields to be able to meet what will be required in the way of taxes."[235] King blamed the bureaucrats for overcommitting to expenditures and noted that "Ilsley is too worn and tired and sensitive to expect anything from him [Clark] in the way of seeing other sides of the situation."[236] A similar meeting followed the April 30 session, and King repeated his suggestion. Clark again resisted, backed by Ilsley.[237]

Ilsley replied to the premiers on May 1, flatly rejecting any further enrichment of the federal proposals on the basis of the fiscal needs of the federal government:

> We came to the conclusion after checking up the total cost of the enormous commitments that we are undertaking under these proposals and the enormous cost of our ordinary commitments that we could not, having in mind our responsibility to the taxpayers who pay taxes to us—we came to the conclusion last week and I so stated in the Co-ordinating Committee, that we could not expand the proposals of the dominion any further so far as cost is concerned.[238]

He followed with a long discussion of the various costs that would be assumed by the federal government under the various social security proposals and the ongoing ordinary expenditures at the federal level, together with the reductions in taxes made and contemplated.[239]

Finally, Ilsley summarized his reasons for federal occupancy of the three major tax fields. First, taxes on income and business profits tapped the wealth produced by the nation as a whole, the distribution of which among the provinces was determined by historical factors, trade patterns, and national policies. Accordingly, it was fairer for these sources of income to be taxed at the national level and the proceeds used for national benefit. Conversely,

> it was unfair for provincial and local governments to utilize these major taxes on incomes and profits, which vary so widely between provinces. . . . In this modern world, fairness requires national taxation of income.[240]

Second, income and profit-based taxes were not suitable for the provinces because they were unstable and fluctuating, whereas the federal government, with its greater

235 Mackenzie King diaries, supra note 3, April 29, 1946.

236 Ibid.

237 Ibid., April 30, 1946: "Clark holds out very strongly . . . and Ilsley follows suit." The meeting also "outline[d] in a way" Ilsley's speech for the following day.

238 Minutes, supra note 201, at 499. LAC, RG 19, vol. 109 contains the Department of Finance calculations of the amounts involved.

239 Including removal of the excess profits tax. Ibid., at 500-1.

240 Ibid., at 505.

borrowing capacity, was able to accommodate such fluctuations. Third and most important, exclusive federal occupancy was necessary for the national employment and economic policy. This was the countercyclical budgeting argument: "social justice" required the greatest possible use of the progressive taxes, and economic management dictated that those taxes be imposed at the federal level, so that one province could not, for example, raise taxes at a time when economic conditions required reduced taxation.[241] Ilsley also repeated the prior federal position that it would vacate the minor tax fields only if compensated.[242]

King was unusually positive about Ilsley's presentation:

> Ilsley made this morning, I thought, an exceptionally fine speech. Indeed, I have heard him make no better speech. It is something that I think all Finance Ministers will in years to come have to take account of. I told him afterwards that I had never heard him speak as well. He spoke largely without notes, very carefully, discreetly, and persuasively. I felt, when he was through, I did not care how the conference went—that our position had been correctly placed on record.[243]

The remainder of the conference was marked by a series of confrontations, principally between Ilsley and Drew. The flavour of those discussions is reflected in the opening words of Drew's reply to Ilsley on May 1:

> I shall do my utmost to be as restrained as I can under circumstances which I think invite anything but restraint. This has been an amazing presentation and I hope that every province here realizes that the veil is off and that the speech by Mr. Ilsley, which has just terminated, is a bald declaration by the dominion government that we can either take it or leave it, and that their promises, in fields ordinarily occupied in the past by the provinces, are to be redeemed by us although we were not consulted when the promises were made and new appetites created.[244]

241 Ilsley conceded that succession duties were less important but insisted on federal taxation, if not sole occupancy. One novel argument that he advanced was that the information gained by officials of the Department of National Revenue in collecting succession duties resulted in higher income tax collections. Ibid., at 506-7.

242 Ibid., at 499. Ilsley's consistent refusal to make concessions on the minor tax fields, which were the principal obstacle to agreement with the provinces other than Ontario and Quebec, were not only criticized by King. Blair Fraser, the well-connected Ottawa correspondent for *Maclean's* magazine, commented after the conference that "many people in the Ottawa camp feel the Federal Government's big fumble was in failing to establish clearly enough the division between the provinces who differed with it only slightly and those basically opposed," pointing out that seven provinces had accepted in principle and disputed only "relatively minor details." *Maclean's*, June 1, 1946, at 15.

243 Mackenzie King diaries, supra note 3, May 1, 1946. The strain on Ilsley was intense: "Ilsley said he had worked until two last night. He had felt, before going to bed, like a man who was nearly beside himself, and that the best he could do was to shoot himself. He was terribly depressed." Ibid.

244 Minutes, supra note 201, at 514.

Duplessis followed, stating that

> [t]he federal proposals cannot but lead definitely to centralization. The power to legislate is dependent upon the power to levy taxes and the federal proposals practically take away from the provinces the power to levy taxes.[245]

He proposed a "clear, brief, positive and transitional agreement" for rental of personal income and corporation tax fields, the content of which was unclear but which was incompatible with Ilsley's proposals. Duplessis concluded with the threat that "if the Ottawa proposals are in the nature of take it or leave it, I will leave it and take my train back to Quebec."[246]

At the opening of the session on the following day, May 2, St. Laurent defended the federal proposals and, in particular, defended Ilsley from the criticism that he had been too rigid:

> [T]here does come a time when the amount which a responsible federal minister can agree to seeing transferred from federal collections to provincial expenditures must be considered and a line has got to be drawn. That is the point and the only point on which rigidity was manifested by the Minister of Finance. I think the Canadian public owe a debt of gratitude to the Minister of Finance for the rigidity which is to be found in his character. If there was not that rigidity in his character, this country after the six years it has gone through, would not be in the position in which it is in today.[247]

Drew then announced that Ontario would accept a rental payment for personal income and corporation taxes of $12 per capita but only in connection with federal withdrawal from succession duties, and the gasoline, electricity, and other minor excise taxes.[248] Ilsley estimated that the Ontario proposal, applied to all the provinces, would cost the federal government at least $100 million annually.[249] The session ended without resolution.

The following day, May 3, Ilsley set out in detail the cost of the Ontario proposal—$102 million in lost tax revenue and $17 million or more in increased federal spending on pensions and foreign exchange premiums—and refused any further concession.[250] Duplessis stated flatly that the federal proposals were unacceptable

245 Ibid., at 529.

246 Ibid., at 531.

247 Ibid., at 551. King remarked in his diary that "St. Laurent spoke for Ilsley in opening the morning's proceedings." See Mackenzie King diaries, supra note 3, May 2, 1946.

248 See minutes, supra note 201, at 570-1. Drew also proposed that the federal government improve and pay for enhanced pensions for the elderly and the blind, and reimburse the provinces and municipalities for foreign exchange premiums on borrowing.

249 Ibid., at 574; see also the more detailed calculation put forward by Claxton, ibid., at 581.

250 "I say that the Dominion government is not prepared to incur further financial costs." Ibid., at 587.

and left the meeting to return to Quebec.[251] At the end of the afternoon session, Ilsley closed the conference, stating:

> [I]t is quite obvious that to arrive at an agreement will be impossible this afternoon. The Premier of Quebec is not here, and in any event there is a very wide gap between the points of view that have been expressed and the decisions that have been taken, with the result that agreement at the moment is found to be impossible. . . . As the Prime Minister reminds me, I must proceed at once with the preparation of the budget.[252]

Ilsley's suggestion that the conference then adjourn *sine die* was accepted. The Cabinet carried out a post mortem on the conference on May 6. King indirectly criticized Ilsley for rigidity—the "rigidity of Clark and Towers"—in not making concessions to the provinces.[253] When Ilsley reminded King that he had approved the federal brief for the conference, King responded, typically, that his approval was "completely conditional," containing little in the way of "actual commitment."[254] King also failed to note that the Cabinet had considered and approved each modification to the original proposal.

THE JUNE 27, 1946 BUDGET

Ilsley brought down the 1946 budget on June 27. It was, as he said in the budget speech, the first wholly post-war budget.[255] Projected expenditures were expected to be little more than half of those in the previous year at $2.769 billion, reflecting a decline in war and rehabilitation expenditures from about $4 billion in 1945-46 to about $1.3 billion.[256] Revenues were anticipated to be $2.51 billion, producing a projected deficit of $259 million. Although the need for massive borrowing had disappeared, ongoing expenditure and tax levels were to be far greater than pre-war levels, and the primacy of income taxation established during the war remained. While, as discussed below, personal and corporation income taxes were reduced, their total share (together with succession duties) of federal revenue was projected only to decline from about 62 percent to 57 percent of total tax revenue. The transformation of the tax system effected between 1939 and 1945 was not to be reversed.

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251 "From Quebec I shall expect a call to which I will gladly answer; a call for sincere cooperation with the federal government and with the provincial governments, on a solid, frank and fair basis, with a view to achieving the aims of Confederation and of improving, if appropriate, the means and methods available to us to achieve these aims. For this purpose, again I repeat the door is open, but as it would be undignified to remain on the door-step, I will expect a call in my office in Quebec City." Ibid., at 601.

252 Ibid., at 624.

253 Mackenzie King diaries, supra note 3, May 6, 1946.

254 Ibid.

255 Canada, Department of Finance, 1946 Budget, Budget Speech, June 27, 1946, at 1.

256 Actual expenditures in 1946-47 amounted to $2.634 billion, of which $1.314 billion was war-related (including expenditures on veterans). See appendix table 1.

In response to the failure to reach agreement with the provinces and the pending expiry of the tax rental agreements,[257] Ilsley proposed changes that both honoured the commitment given in 1941 to reduce post-war taxes so as to allow provinces to re-enter the rented fields and left the door open for provinces that wished to continue the rental arrangement.

The basic rate of tax on corporate profits was reduced from 40 percent to 30 percent, as agreed in 1941.[258] To allow non-agreeing provinces to reimpose a corporation income tax without necessarily causing double taxation, Ilsley proposed that, so long as some provinces did not agree to rent their tax fields, agreeing provinces would impose a 5 percent tax on corporate profits (on the same tax base as the federal tax and collected by the federal government). The proceeds of the tax would be deducted from their rental payments. A non-agreeing province could then impose a 5 percent corporation income tax without imposing on its residents a higher tax rate than that applied in other provinces.

Personal income taxes were reduced, and residents of a non-agreeing province that imposed its own personal income tax would be allowed a credit for provincial income tax paid against federal tax payable, to a maximum of 5 percent of the federal tax.

The succession duty proposal from the conference was repeated: a resident of a non-agreeing province would be entitled to a credit against federal succession duty payable, to a maximum of 50 percent of the federal tax.

The effect of these proposals was that a non-agreeing province could impose income taxes and succession duties at rates of 5 percent of federal personal income tax, 5 percent of corporate profits, and 50 percent of federal succession duty rates without additional burden on its taxpayers.

For the agreeing provinces, the same rental offer last made at the conference was available.

Along with the reduction of personal income taxes, the rate structure was simplified. Exemptions were increased,[259] and the flat-rate war tax and graduated tax were replaced with a single graduated schedule, ranging from 22 percent on the first $250 of taxable income to 85 percent on income in excess of $250,000.[260] For business taxpayers, in addition to the changes in the corporation income tax described above, the tax on excess profits was reduced from 20 percent to 15 percent, to be eliminated entirely at the end of the 1946-47 fiscal year, and the tax remaining after the 1945 reductions was removed immediately from partnerships and sole proprietorships.

257 In most cases, on March 31, 1947. See supra note 13.

258 The combination of an 18 percent corporate income tax rate and a basic flat rate of 22 percent under the excess profits tax was replaced by a 30 percent corporate income tax rate.

259 The individual exemption was increased from $660 to $750 and the married exemption from $1,200 to $1,500.

260 The investment income surtax remained at 4 percent; the threshold was raised from $1,500 to $1,800. The tax credit for dependent children and the tax on family allowances that had been imposed in 1945 were replaced by a deduction of $100 for a child eligible for the family allowance and a deduction of $300 for other dependants.

Once again, Ilsley stated his belief that the "income tax is the fairest and best tax on which to rely for the bulk of our revenue."[261]

Ilsley also addressed growing public concern about perceived heavy-handedness in the administration of tax by proposing the establishment of a Tax Appeal Board to provide a convenient and inexpensive avenue of appeal on matters of fact and law (with further appeal to the Exchequer Court). That concern also extended to the numerous circumstances in which ministerial discretion could be exercised.[262] Ilsley announced that an interdepartmental committee had already begun "a much-needed re-writing of the entire statute"[263] (which eventually produced the 1948 Income Tax Act) and that the committee had been instructed to "explore carefully the possibility of reducing the number of discretions."[264]

By the time he delivered the 1946 budget, Ilsley's health was precarious. The stress and resulting nervous exhaustion that had plagued him since at least 1943 had returned with a vengeance, and he had on several occasions told King he could not carry on. King relied heavily on Ilsley and was reluctant to let him go. Immediately following the budget, he arranged for Douglas Abbott to deal with the budget resolutions in Parliament and with the ongoing discussions with the provinces. In July, King appointed Ilsley as the Canadian representative on the United Nations Relief and Rehabilitation Administration Council, effectively to give him a European holiday. However, by early December Ilsley's wife, Evelyn, had called Claxton to say that Ilsley "would have a complete breakdown if he did not get out at once."[265] Within a week, he had been moved to the Justice portfolio, replaced as minister of finance by Douglas Abbott.

CONCLUSION

Ilsley's attempts to perpetuate the tax rental arrangements effectively ended his tenure as finance minister; they were, in some ways, "a bridge too far." Abbott continued the negotiations with the provinces, further minor concessions were made, and seven of the nine provinces eventually entered into new tax rental arrangements in 1947; Ontario and Quebec remained outside. Over the following decade, the tax rental system continued to evolve in the face of unceasing provincial demands for more revenue. In 1962, the provinces resumed the imposition of income taxes at rates of their choosing, in an arrangement in some ways similar to the Ontario proposal of 1946.

Had the federal government's proposals in 1945-46 been fully accepted, or successfully imposed, and maintained subsequently, they would have produced a much more fiscally centralized Canada. The attempt failed for a number of reasons.

261 Supra note 255, at 18.

262 For example, see Canada, Senate, *Final Report of the Special Committee of the Senate on Taxation (Part One)* (Ottawa: King's Printer, 1946). The proposed Tax Appeal Board would not have jurisdiction to review the exercise of ministerial discretion.

263 Supra note 255, at 17.

264 Ibid., at 27.

265 Mackenzie King diaries, supra note 3, December 2, 1946.

Skelton's initial suggestion for constitutional amendments was rejected by King and St. Laurent (and would likely have failed in any event), leaving the fundamental mismatch between growing provincial responsibilities in the health, education, and welfare areas and the provinces' traditional revenue sources. The federal government could address certain aspects of these areas through direct spending on income support programs like old age pensions and family allowances; but, for the rest, it would have to use conditional grants.[266]

More fundamentally, the federal proposals lacked sufficient political support. King's unease during the conference reflected his acute sensitivity to public opinion; the ability of the Ontario and Quebec governments to refuse tax rentals and reimpose provincial taxes[267] without significant political cost proved him right. As noted above, by 1962, federal-provincial fiscal arrangements more closely resembled the Ontario proposals of 1946 than the federal proposals of 1945-46. The institution of equalization payments in 1957 had effectively removed the risk that poorer provinces would impose taxes at rates high enough to frustrate federal fiscal policy.

It is also unclear whether complete federal control over progressive taxes and rates was necessary for management of the economy. Regardless of the value or merits of Keynesian theory, Canadian governments have generally been able to respond to economic downturns with stimulative spending on a cooperative basis (witness 2008) notwithstanding significant levels of provincial income taxation.

The continuing features of the Canadian taxation system for which Ilsley was responsible—primary reliance on progressive income taxation, imposed broadly on the population and collected at the source, and significant corporate income taxation, coordinated with provincial taxation—have remained unchanged since the 1940s.[268] While the transformation was initially effected using the existing statute, by 1946, an entirely new and revised statute was in preparation,[269] so that a technical transformation followed the substantive changes. No finance minister before or since has presided over changes so far-reaching in Canadian tax and fiscal policy. And while Ilsley's failure to fully realize the federal goals in 1946 may be attributable to the "rigidity" that King complained of, his pursuit of a principled policy result in a prolonged national crisis is surely one of the more edifying episodes in Canadian political history. He was, as King admitted, a man of "fine integrity."[270]

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266 Conditional grants had been rejected by the Rowell-Sirois commission and were generally considered to be a less-than-perfect solution.

267 Corporation taxes were reimposed immediately at rates equal to or higher than the 5 percent "tax room" given in the 1946 budget in both Ontario and Quebec, without political price. Quebec reimposed personal income taxes in 1954.

268 When the provinces began imposing their own taxes directly on income (as opposed to levying a percentage of the federal tax), they followed the principal design and policy features of the federal income tax.

269 Ultimately enacted as the Income Tax Act, SC 1948, c. 52.

270 Mackenzie King diaries, supra note 3, March 21, 1946.

APPENDIX TABLE 1 Federal Revenues and Expenditures, Canada, 1939-40 to 1947-48, in Thousands of Dollars and as a Percentage of Total Revenues or Expenditures

	Revenues															Expenditures		
Fiscal year	Customs duties		Sales tax		Total excise tax		Personal income tax		Corporate income tax		Succession duties		Non-tax revenues		Total	War expenditure		Total
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	$	%	$
1939-40	104,301	18.6	141,121	25.1	166,028	29.5	45,407	8.1	77,920	13.9			73,392	13.1	562,094	118,291	17.4	680,794
1940-41	130,757	15.1	184,536	21.3	284,167	32.9	103,535	12.0	155,561	18.0			81,579	9.4	864,551	752,045	60.6	1,241,983
1941-42	142,392	9.6	246,553	16.6	453,425	30.6	296,139	20.0	321,004	21.6	6,957	0.5	102,911	6.9	1,483,458	1,339,674	71.3	1,879,988
1942-43	118,963	5.3	250,478	11.2	488,712	21.8	534,138	23.8	802,551	35.8	13,273	0.6	116,079	5.2	2,240,344	3,724,249	85.1	4,377,972
1943-44	167,882	6.1	339,256	12.3	638,619	23.1	813,435	29.4	780,097	28.2	15,020	0.5	133,283	4.8	2,765,018	4,587,023	86.2	5,322,254
1944-45	115,091	4.3	404,109	15.0	543,065	20.2	767,755	28.6	742,209	27.6	17,251	0.6	145,471	5.4	2,687,334	4,418,446	84.2	5,245,612
1945-46	128,877	4.3	326,253	10.8	496,910	16.5	691,586	23.0	712,030	23.6	21,447	0.7	160,804	5.3	3,013,185	4,002,949	77.9	5,136,228
1946-47	237,355	7.9	328,073	10.9	579,024	19.3	694,530	23.1	687,490	22.9	23,576	0.8	160,870	5.3	3,007,876	1,314,798	49.9	2,634,227
1947-48	293,012	10.2	383,012	13.3	640,758	22.3	659,828	23.0	591,161	20.6	30,828	1.1	177,771	6.2	2,871,746	634,421	28.9	2,195,626

Source: Canada, Department of Finance, 1944 Budget, Budget Speech, June 26, 1944, appendix, at 41-79; 1945 Budget, Budget Speech, October 12, 1945, appendix, at 29-70; 1946 Budget, Budget Speech, June 27, 1946, appendix, at 45-86; 1947 Budget, Budget Speech, April 29, 1947, appendix, at 25-56; 1948 Budget, Budget Speech, May 18, 1948, appendix, at 62-79; and 1949 Budget, Budget Speech, March 22, 1949, appendix, at 46-65.

As the war progressed, mounting was the belief that allied unity was the paramount issue transcending the plight of victims of Soviet aggression. By 1943, American determination to support the free Baltic States was fading.Â In America, the President and his advisers had adopted the view that post-war Europe should be a matter of discussion at a peace conference rather than an item of contention among reluctant allies who were fighting for their individual existences. However, Roosevelt was aware that Stalin would have some demands regarding territorial claims in Europe. In March of 1943, Roosevelt and Eden discussed prospective Soviet claims, and the Baltic States were part of the conversation. It was reported that