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Current Tax Reading

Co-Editors: Bev Dahlby, Tim Edgar, Jinyan Li, and Alan Macnaughton*

The Canadian Tax Foundation gratefully acknowledges the contribution of Bev Dahlby, who is retiring from his position as co-editor of Current Tax Reading. Professor Dahlby joined the feature as co-editor in 2011. Drawing on his wealth of research experience on the efficiency effects of taxation and fiscal federalism, as well as his work as a policy adviser, he wrote many valuable and insightful reviews of the current literature on the economics of taxation. On behalf of the Canadian Tax Journal*'s readers, the Foundation extends its warmest thanks for his work on the feature.*

Ian W.H. Perry, Dirk Heine, Eliza Lis, and Shanjun Li, *Getting Energy Prices Right: From Principle to Practice* (Washington, DC: International Monetary Fund, 2014), 183 pages, ISBN 978-1-48438-857-0

Increasing concerns about the environmental impacts of fossil fuels, as well as the fiscal pressures on governments in the aftermath of the global financial crisis, have pushed the taxation of fossil fuels up the policy agenda. Since the work of A.C. Pigou, economists have advocated for the imposition of excise taxes on goods that have harmful externalities, so that their prices reflect the true social costs of production and consumption. Although the authors of this volume caution that much work needs to be done to fill in the data gaps, they provide policy advice that ranges from the general principle of imposing corrective taxes to detailed computations of the appropriate tax rates for 156 countries. It is an ambitious undertaking, to say the least.

Following a brief introduction and summary, in chapter 2 the authors provide an overview of the fossil fuel consumption patterns across countries; the emissions of carbon dioxide (CO_2), sulphur dioxide (SO_2), nitrogen oxide (NO_2), and fine particles ($PM_{2.5}$) from burning fossil fuels; statistics on road congestion and traffic deaths; and excise tax rates on motor fuels in Organisation for Economic Co-operation (OECD) countries in 2010. It will not surprise most readers to learn that Canada and the United States have among the lowest excise taxes on gasoline (approximately $0.28 and $0.11 per litre, respectively) while Mexico provides a $0.13 per litre subsidy (all

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figures are in 2010 US dollars). The authors note that many developing countries subsidize fossil fuel consumption (to the extent of $490 million in 2011). These subsidies promote excessive consumption of fuel and aggravate environmental damage. They are also regressive because only 3 percent of the subsidy accrues to the bottom 20 percent of the income distribution in developing countries.

Chapter 3 makes the case for carbon pricing. Taxing fossil fuels makes carbon-free sources of power generation (such as wind, solar, and hydro) more competitive, creates incentives to reduce emissions intensity by shifting from coal to natural gas or nuclear power, creates incentives to adopt energy-saving technologies, and reduces transportation and home and industry heating demands. Although other policies, such as subsidies for renewables and the regulation of efficiency standards for buildings and appliances, could also be adopted, only carbon pricing uses all of these adjustment mechanisms in reducing environmental damage. Furthermore, the revenues generated by fuel taxes can be used to reduce distortionary income and payroll taxes, thereby increasing incentives to work, save, and invest. Selective tax cuts can also help to alleviate adverse distributional effects of fuel taxes in developed countries. Although emission-trading systems (ETSs) can also be effective mechanisms for putting a price on CO_2 emissions, the authors clearly favour fuel taxes because of the difficulty in establishing the appropriate cap on emissions and because price volatility reduces incentives for investment in clean technology. (In recent years, carbon prices in European trading systems have fluctuated between €5 per ton and €30 per ton.) With regard to the congestion and non-CO_2 emissions from the transportation sector, the authors acknowledge that

> the ideal fiscal system for motor vehicle transport would involve charging motorists for each kilometer driven, and the charge would be scaled according to factors affecting the congestion, accident, local pollution, and possible road damage costs imposed on others by that kilometer driven, and a fuel tax component would be retained to address carbon emissions.[1]

But until the widespread adoption of metering technologies that are based on the global positioning system, taxing fuels remains the best way to reduce road congestion and non-carbon emissions.

Chapter 4 contains a survey of the measurement of the environmental damage caused by fossil fuel use. The most disappointing aspect of the book is that the literature on marginal damage caused by CO_2 emissions is not reviewed in detail. This is a complex and controversial topic, with major differences in the estimates based on the discount rate that is applied to the damage from future climate changes, the status of global warming, and the geographic region where these changes occur; however, the marginal damage from emitting an additional ton of carbon into the atmosphere is the crucial variable in determining the appropriate carbon taxes. Unfortunately, the

1 At 49.

authors simply adopt $35 per ton *for illustrative purposes*, noting that the appropriate carbon tax is roughly proportional to the marginal damage. While the lack of detailed discussion of the marginal damage from CO_2 emissions is regrettable, it is offset by a very detailed treatment of the theory and the empirical evidence concerning the marginal damage from local air pollution from fossil fuels. Computations of damage from local air pollution depend on the amount of the pollutants inhaled by the population, which in turn depends on such factors as population densities; wind patterns; the mortality risks of the population, which varies with the age and health of the population; and the dollar value of increased health care costs and loss of life. The discussion in this chapter is particularly interesting because of the importance of coal-fired power generation in China and China's emerging concerns about the health problems associated with the emissions.

In chapter 5, the authors provide estimates of the congestion, accident, and road damage costs from automobile transportation. For congestion costs, the authors use 60 percent of the average market wage to value time spent on long automobile journeys, which is based on the average after-tax wages rate. Because of the income differences among the 156 countries in the study, there are substantial differences in the cost of congestion. For example, China's estimated congestion cost is $0.05 per kilometer, compared with $0.064 per kilometer in the United States; although travel delays in China are on average higher than in the United States, the value of time lost in congestion in China is much lower. The value of time lost in congestion is the most important component of congestion costs because increased fuel use from stop-and-go traffic adds only about 5 percent to the overall congestion costs. Obviously, traffic congestion is a local phenomenon, and the authors use city-level data bases on traffic congestion to determine country averages. This may lead to underestimates of the costs in some urban areas and gross overestimates in small urban centres and rural areas. Local variations in congestion costs have implications for the level of government that should be responsible for these charges, a subject that is ignored in this study.

The authors bring the theoretical frameworks for calculating external damages and the data on these costs together in chapter 6 to estimate the corrective taxes for coal, natural gas, gasoline, and diesel fuel, as well as the additional revenues that governments could gain from imposing these taxes and the health and environmental benefits that would be achieved. For coal, the carbon component of the corrective tax is $3.30 per gigajoule (GJ), or 66 percent of the average world price of coal in 2010, based on the illustrative $35 per ton marginal damage figure adopted by the authors. The carbon component of the corrective coal tax is assumed to be the same for all countries because it is based on the global damage caused by climate change. The local pollution component, based on emissions of SO_2, NO_2, and $PM_{2.5}$, brings the total tax to an average of $5.00 per GJ in Canada.[2] The corrective taxes for coal

2 These and other figures are taken from the data base that can be downloaded from the IMF website at http://www.imf.org/external/pubs/ft/survey/so/2014/pol073114a.htm.

are \$4 per GJ for Mexico and \$8.70 per GJ for the United States. There are even larger variations among countries that are not signatories to the North American Free Trade Agreement: \$57 per GJ for Bulgaria, \$33 per GJ for Ukraine, \$22 per GJ for Israel, and \$15 per GJ for China. These figures indicate that the local pollution costs from coal-fired power generation are substantially higher than the marginal damage from CO_2 emissions, unless the marginal damage is well over \$100 per ton. The taxes on coal would create strong incentives to adopt control technologies that are estimated to reduce local pollution damages, and therefore the non-carbon component of the corrective taxes, by 75 percent. They would also create an incentive for switching to cleaner fuels, most notably natural gas for power generation.

The CO_2 emission from natural gas is 55 percent of that for coal per GJ of energy, and the corresponding corrective carbon tax for natural gas is \$2 per GJ. Local area pollution costs are also lower with natural gas, and the total corrective tax for natural gas in Canada is estimated at \$2.21 for power generation and \$2.10 for domestic home heating. To put the latter tax rate in perspective, residential consumers in Calgary are paying about \$4.50 per GJ for natural gas. Therefore, the corrective tax would represent a 45 percent increase in the price of natural gas for homeowners, assuming full forward shifting of the tax. Overcoming the backlash from imposing this level of tax on the price of home heating would be a major challenge for policy makers. As in the case of coal, there are variations in the corrective taxes for natural gas for power generation across countries with, for example, a \$2 per GJ tax for Mexico and a \$3.10 per GJ tax for the United States. A tax that is 50 percent higher in the United States than in Canada would undoubtedly raise alarms over the competitiveness of the US utilities, and perhaps industry in general, as a result of higher US electricity prices. For China, the corrective tax for natural gas used in power generation is estimated as \$3.20 per GJ, which corresponds to the much lower level of local pollution damage from natural gas than from coal. Regardless whether these taxes are adopted in China, a switch from coal to natural gas would bring huge health and environmental benefits to the Chinese population.

The estimated corrective gasoline excise tax for Canada is \$0.55 per litre. The carbon component is only \$0.08 per litre or 15 percent of the total corrective tax. However, the congestion component is \$0.38 or 70 percent of the total corrective tax, while accidents represent 11 percent, and local air pollution 4 percent, of the total tax. The corrective gasoline tax for the United States is estimated to be lower than in Canada, at \$0.43 per litre because congestion costs are estimated to be higher in Canada than in the United States, although the accident cost component is lower. The authors' calculations also indicate that the corrective tax on diesel fuel in Canada should be higher than on gasoline, at \$0.64 per litre. The current excise taxes on gasoline in many European countries, such as Germany and the United Kingdom, exceed the estimated corrective taxes by about 30 percent.

The authors also estimate the increase in tax revenues that could be achieved if countries implemented the corrective fuel taxes, assuming that the price elasticities of demand for fuel is 0.50. For Canada, they estimate that the additional revenue would be equivalent to 1.4 percent of the gross domestic product, or approximately

Cdn $26.5 billion. More than half of this additional revenue would come from the taxes on gasoline and diesel fuel. This fiscal dividend could be used to increase spending, lower taxes, or reduce debt. The corrective fuel taxes would also reduce energy-related CO_2 emissions by 15.4 percent in Canada, 22.3 percent in the United States, and a whopping 34 percent in China.

There are many caveats and potential refinements to the methodology and data that the authors have used to calculate the corrective fuel taxes and their effects on revenues. However, the main findings in the report—that coal prices are significantly below their true social cost in terms of CO_2 emission and local air pollution; that CO_2 and local air pollution from natural gas are modest compared with CO_2 pollution and local air pollution from coal, although the corrective tax rate would still be relatively high; and that higher motor fuel taxes are warranted in North America, mainly to reflect the costs of traffic congestion, accidents, and local air pollution—are likely to be amenable to further refinements in data and methodology. This report is a major contribution to applied environmental policy and significantly advances the case for higher fuel taxation in Canada and most other countries.

B.D.

Tamara Larre, "Misguided Inferences? The Use of Expressio Unius To Interpret Tax Law" (2014) 51:3 *Alberta Law Review* 497-524

In this article, Larre provides a thorough review and critique of the use of the canon of statutory interpretation *expressio unius est exclusio alterius* in Canadian income tax case law. Commonly translated as "implied exclusion," this Latin maxim may be invoked to support an inference that the failure of legislation to include a reference to a particular item is deliberate. As Larre emphasizes, implied exclusion should be distinguished from *generalia specialibus non derogant*, another canon of statutory interpretation. Commonly translated as "implied exception," this Latin maxim may be invoked to support the priority of a specific legislative provision over a more general provision when two such provisions conflict. Larre argues that these two canons of statutory interpretation have often been confused in Canadian income tax case law. More importantly, she also argues that even when invoked correctly, the canons have all too often been relied on as an intellectual shortcut to justify a desired result and avoid the difficulties of a textual, contextual, and purposive approach to interpretation.

Larre's case analysis is organized on the basis of two general categories that have been identified by Ruth Sullivan[3] as involving an implied exclusion argument. One category consists of instances in which the legislative drafter fails to include comparable items in an enumerated legislative list. Another category consists of instances in

3 Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, ON: LexisNexis, 2008), at 244.

which the legislative drafter fails to follow a particular pattern of reference. If items are left off a list or otherwise excluded, Larre suggests that implied exclusion reasoning is equivalent to a textual reading of the Income Tax Act[4] when a single provision is at issue. She argues that in these instances a purposive analysis should be considered to determine whether the purpose of the provision would be better served by extending it to the particular item that is excluded. When the question is whether a general provision should be applied in light of a specific provision that nearly applies to an item, Larre argues that a textual, contextual, and purposive analysis should be undertaken for both provisions. With a handful of exceptions, her review of the relevant case law reveals a failure to integrate the canon of implied exclusion with a deeper inquiry into context and purpose. Moreover, she finds that implied exception is all too often invoked when implied exclusion would be correct. She offers a series of considerations for interpreters in an effort to integrate the canon of implied exclusion with a textual, contextual, and purposive interpretative approach, while also distinguishing between implied exclusion and implied exception.

With instances of non-parallel drafting, Larre's review of the relevant case law reveals a somewhat clearer willingness to engage in a textual, contextual, and purposive interpretive exercise, rather than relying on implied exclusion to conclude that the difference in drafting suggests a difference of application. She suggests that the complex nature of the Act requires the kind of deeper analysis associated with a textual, contextual, and purposive interpretive exercise, rather than the simple assumptions that the drafter has knowledge of every provision and non-parallel drafting is intended to signal a difference of application. Again, she provides a set of considerations that can guide courts in integrating implied exclusion argumentation with the deeper interpretive exercise she argues is critical to a coherent interpretation of the Act.

T.E.

Nick Pantaleo, Finn Poschmann, and Scott Wilkie, *Improving the Tax Treatment of Intellectual Property Income in Canada*, C.D. Howe Institute Commentary no. 379 (Toronto: C.D. Howe Institute, April 2013), 20 pages, available at www.cdhowe.org/pdf/commentary_379.pdf

Preferential income tax treatment for revenue attributable to a range of intellectual property appears to have become the latest fashionable policy idea intended to attract the location of what are perceived to be desirable, and mobile, economic activities focused on the exploitation and commercialization of research and development (R & D). Tax preferences for eligible expenditures have long been provided to encourage the undertaking of basic R & D by businesses and are referred to in some of the

4 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this feature are to the Act.

literature as "push factors."[5] The provision of preferential treatment for revenue from intellectual property is perhaps a logical extension of these standard tax preferences, focused on encouraging the commercial development and exploitation of the fruits of basic research by businesses. Tax preferences with this focus are referred to in some of the literature as "pull factors,"[6] and recent legislative initiatives by some continental European countries, as well as the United Kingdom, are colloquially referred to as "patent box regimes."[7]

Despite a generous set of tax preferences for expenses associated with basic R & D, Canadian-based businesses continue to underinvest in R & D relative to businesses based in other countries. Given this underinvestment and the current interest in patent box regimes, it is perhaps not surprising that the adoption of such a regime in Canada is seen by some as an appealing policy initiative. The co-authors of this C.D. Howe commentary, two senior Canadian tax practitioners (Pantaleo and Wilkie) and the vice-president for research at the C.D. Howe Institute (Poschmann), articulate two principal arguments in support. One is a standard tax competition argument focused on an increasing mobility of the location of R & D activities, including the exploitation of developed or acquired intellectual property. The other argument focuses on spillover effects that are supposedly associated with the location of activities intended to commercialize R & D. This argument is particularly important since it suggests a targeted tax preference for associated revenue rather than a reduction in Canada's general corporate tax rate, which tends to be seen as a more desirable policy instrument in the sense that it can attract mobile business activities generally. The authors develop their two arguments for the adoption of a patent box regime in Canada in a largely speculative manner. They canvass related empirical evidence for the preferential income tax treatment of expenses incurred for basic R & D and attempt to extrapolate this evidence to activities intended to develop, exploit, and commercialize the product of basic R & D.

Even accepting the authors' somewhat sweeping case for a patent box regime, the Canadian context presents a unique consideration that they acknowledge but, unfortunately, do not address in detail. Because of subparagraph 95(2)(a)(ii), Canada arguably has one of the most generous residence-country exemption systems in the world for repatriated foreign earnings. Very broadly, this provision allows a range

5 See, for example, Kenneth J. McKenzie, *Giving with One Hand, Taking Away with the Other: Canada's Tax System and Research and Development*, C.D. Howe Institute Commentary no. 240 (Toronto: C.D. Howe Institute, October 2006). See also Mark Parsons, *Rewarding Innovation: Improving Federal Tax Support for Business R&D in Canada*, C.D. Howe Institute Commentary no. 334 (Toronto: C.D. Howe Institute, September 2011).

6 Ibid.

7 United Kingdom, HM Treasury and HM Revenue & Customs, *Consultation on the Patent Box* (London: HM Treasury and HM Revenue & Customs, June 2011), reviewed in this feature (2011) 59:4 *Canadian Tax Journal* 915-36, at 915-17.

of tax-deductible payments to be made by a foreign affiliate of a Canadian corporation to another foreign affiliate and maintain exempt surplus status, provided that the payment is associated with the earning of active business income in a treaty country. Such status also requires that the intermediate foreign affiliate be resident in a treaty country and therefore able to include the amount received in its exempt surplus, which can be repatriated to the Canadian corporation free of Canadian corporate income tax. Although an exemption may be justified when a substantial level of corporate income tax might be expected to be paid to the country of residence of the intermediate foreign affiliate, this is often not the case as a result of Canada's extensive treaty network, which includes some countries that apply low tax rates on the relevant revenue. This generous exempt surplus treatment for intragroup payments, including payments for intellectual property, means that Canada operates a de facto patent box regime that seems to be quite competitive with the formal patent box regimes of other countries, both in the sense that the applicable tax rate is at most minimal and in the sense that the availability of preferential treatment is largely unconstrained by any targeting requirements that are a feature of formal regimes.

The authors' brief review of some data regarding the transfer of Canadian patents internationally can be interpreted as consistent with Canada's generous exempt surplus system. As the authors note, the data show a consistent increase over the course of the past three decades in the number of Canadian patents transferred internationally. They suggest that this trend could be consistent with either a non-tax or a tax motivation, although the fact that the destinations of the transferred patents have been shifting to tax havens and patent box jurisdictions is more consistent with a tax motivation. The authors prefer the adoption of a patent box regime as a policy instrument to arrest the outflow of Canadian patents. In fact, they recommend the adoption of a federal tax rate of 7.5 percent, which is one-half of the current federal rate of corporate income tax. This lower rate would be limited to qualifying income, which would require that all, or substantially all, enumerated revenue streams be associated with the continuing commercial exploitation of intellectual property in Canada. The authors do not, however, provide any detail about how they arrive at this preferential rate. Presumably, the rate available under a patent box regime would have to be less than that otherwise available through tax-driven structuring intended to maximize the benefits of Canadian exempt surplus treatment. It is notable therefore that the authors suggest that a patent box regime would be desirable primarily because of a saving in compliance costs associated with the de facto regime, which can be obtained currently through tax structuring.

Extrapolating from UK projections of the revenue cost of a patent box regime, the authors estimate that the steady state annual federal revenue loss from the adoption of such a regime in Canada would be approximately $1 billion. They suggest that some of this loss could be offset by gains attributable to spillover effects captured by a suitably targeted patent box regime. They also suggest that a reduction in the amount of existing preferences for eligible R & D expenses could mitigate the revenue loss. They do not indicate, however, what treatment would be applied to payments for intellectual property that are ineligible for patent box treatment. One obvious possibility would be taxation at the general corporate tax rate, when the payments are received either directly or indirectly through an intermediate foreign affiliate. In the case of ineligible payments received indirectly, current taxation would require revision of the existing exempt surplus and foreign accrual property income legislation, but could provide a measure of additional revenue.

T.E.

Daniel N. Shaviro, *Fixing US International Taxation* (New York: Oxford University Press, 2014), 223 pages, ISBN 978-0-19-935975-2

The title of this book is somewhat misleading, at least to the extent that it suggests a review and analysis of the entire set of US rules governing the taxation of income from inbound and outbound direct investment, as well as inbound and outbound portfolio investment. The book actually focuses almost exclusively on the US deferral with foreign tax credit system for the taxation of business income from outbound direct investment. Although all other major OECD countries have adopted exemption systems for this particular type of cross-border income, the United States remains deadlocked over the reform alternatives of exemption and current taxation with foreign tax credits. Shaviro, a professor and prolific author at the New York University School of Law, presents a compelling national welfare argument as the basis for breaking out of the deadlock. There is, however, almost no consideration of the US interest as a capital-importing source country and only the briefest mention of the OECD base erosion and profit-shifting (BEPS) initiative.[8] The US controlled foreign corporation (CFC) rules in subpart F of the Internal Revenue Code and sourcing rules generally are discussed as second-order design details within the context of the basic rule choice for the treatment of business income from outbound direct investment. Yet even with a somewhat narrow focus, Shaviro provides much in his analysis that is relevant to exemption systems, and his book should be of interest for non-US readers.

Shaviro articulates a national welfare argument for the repeal of the US foreign tax credit system. In terms of incentive effects, he emphasizes that a credit for foreign taxes provides a 100 percent marginal reimbursement rate up to the amount of the foreign tax credit limit when the reimbursement rate drops to zero. Within the bounds of the limit, US multinational corporations (MNCs) are thus insensitive to the payment of foreign taxes. Shaviro argues that from a national welfare perspective foreign taxes are no different from any other expense of a US MNC since taxes

8 Organisation for Economic Co-operation and Development, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013), reviewed in this feature (2013) 61:2 *Canadian Tax Journal* 541-62, at 546-47; and Organisation for Economic Co-operation and Development, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013).

paid to a foreign government do not add to US national welfare. The provision of a deduction for foreign taxes, consistent with the treatment of other expenses, would ensure the same incentive effect. In this respect, he observes that an exemption system is in fact an implicit deductibility system for foreign taxes, albeit with a zero tax rate in the residence country. This national welfare argument in favour of repealing the foreign tax credit exists in addition to a perceived unnecessary compliance and administrative cost associated with the foreign tax credit system. Shaviro's principal argument is unique to the US foreign tax credit system, since there are considerable administrative and compliance costs associated with the definition of the boundaries of exempt treatment under an exemption system.

Shaviro similarly reviews the deterrent effects of deferral, with the primary such effect being the lockout of foreign earnings to avoid US tax on repatriation. He spends some time reviewing the new view of dividend taxation, which in the cross-border context posits that a repatriation tax would be irrelevant under certain conditions and the behaviour of US MNCs would be unaffected. However, he acknowledges that the required conditions for the new view are absent, and the US repatriation tax induces a lockout effect. This effect exists in addition to the same effect attributable to differences in corporate tax rates, which is arguably a much more substantial cause of lockout that persists under exemption systems.

Shaviro characterizes the US deferral with foreign tax credit system as an "iron box" because any attempt to improve the incentive associated with one of these features exacerbates the deterrents of the other. For example, the elimination of deferral would address the lockout effect but would make US MNCs less sensitive to the payment of foreign taxes up to the foreign tax credit limit. However, the elimination of or the placement of restrictions on the availability of foreign tax credits would reduce the marginal reimbursement rate at the cost of exacerbating the lockout effect of deferral. This dilemma leads Shaviro to his principal policy recommendation—that is, current US taxation of foreign-source business income of US MNCs at a positive tax rate that is less than the general corporate rate imposed on US-source income. He correctly observes that in principle there is no policy reason why the residence country rate on such income must be zero, as it is under exemption. Indeed, he argues that the optimal rate is likely to be positive, although it is probably lower than the full US rate on domestic-source income because of the overwhelming empirical evidence that outbound direct investment complements domestic investment, rather than substitutes for it. His policy recommendation includes the elimination of foreign tax credits in favour of the deductibility of foreign taxes, with a much lower marginal reimbursement rate as a function of the low rate applied to business income from outbound direct investment.

The elimination of both deferral and foreign tax credits would permit US policy makers to break free of the iron box. As Shaviro recognizes, however, a critical empirical issue for his proposal is the choice of a positive tax rate on business income from outbound direct investment. In the absence of any such evidence, he can only speculate on the upper and lower boundaries of the desired rate. At the lower boundary would be a minimalist rate of a few percentage points. As Shaviro observes, this approach is characteristic of some existing exemption systems, as well as a recently proposed system of exemption in the United States, that require a minimal inclusion of 5 percent of repatriated earnings. The resulting minimal tax rate is usually justified as a means to wash out the misallocation of expenses against domestic-source income. At the higher rate boundary, he tentatively suggests a rate in the 8 to 10 percent range, with his preferred minimal rate being 5 percent. He recognizes that in addition to the state of empirical ignorance regarding this necessary rate choice, US treaty obligations may constrain the range of choice because of the standard requirement to provide relief for source-country taxes in the form of either exemption or foreign tax credits. In the event of adoption of his preferred move to the current taxation of business income from outbound direct investment with deductibility of foreign taxes, Shaviro briefly makes the case for the need of a transitional tax on locked-out foreign earnings.

In his final chapter, Shaviro canvasses a range of second-order policy issues that do not require the adoption of his recommended alternative to the US deferral with foreign tax credit system. The more interesting and problematic of these issues, highlighted by the OECD's BEPS project, is the use of tax havens as vehicles for income shifting. Shaviro observes that low levels of foreign taxes suggest both shifting of income out of source countries and shifting of domestic income out of the United States by US MNCs, which he refers to as a "tagging issue." Shaviro argues that US policy makers should want to address the latter but not necessarily the former, since avoidance of foreign taxes is the correct incentive for US MNCs assessed in terms of national welfare. However, an inability to distinguish between the type of income being shifted leaves the extension of the CFC rules to tax all tax haven income, using some form of minimal tax requirement. Shaviro considers alternatives such as a US minimum tax on accrued earnings without regard to deferral, but he concludes that these alternatives are complex and not entirely satisfactory. He suggests limiting the CFC rules to passive income, with deflected business income from source countries addressed only in extreme cases of shell affiliates.

Interestingly, Shaviro also suggests following what he considers to be the practice of exemption countries of taxing royalties in full, although this is a formality for some countries, including Canada. He prefers full taxation to the practice under the US deferral with credit system, which allows foreign taxes to shelter royalty income through mixing income and credits. Shaviro would also apply current taxation to income from foreign portfolio investment generally with deductibility only for foreign taxes. This recommendation is consistent with his emphasis on deductibility rather than creditability and is premised on the empirical assumption that such investment is mobile and therefore substitutes for domestic investment, albeit there remains a well-recognized home country bias. Finally, Shaviro would reduce corporate residence electivity by moving beyond an exclusive reliance on place of incorporation under US tax law to the adoption of a central management and control alternative test. He also provides brief discussions concerning interest expense allocation rules and the use of formulary apportionment as an overlay on sourcing results, rather than an arm's-length transfer-pricing inquiry.

Two chapters following an introduction describe the current US international tax rules and the associated policy issues. Shaviro's policy recommendations are first developed in this context and are more fully articulated in two chapters that critique the academic policy literature, which he labels "the battle of the acronyms." Readers may be familiar with much of this literature and the well-known standards of capital-export neutrality, capital-import neutrality, national neutrality, capital ownership neutrality, and national ownership neutrality. It has long been recognized that the kind of analysis found in this literature is of limited use because of its tendency to focus narrowly on a single behavioural margin. Shaviro's critique of this literature is thus of more academic than practical interest. In fact, this portion of the book is much more important for its provision of a broad conceptual framework for his policy recommendations and, in particular, his use of the literature on the efficiency cost of funds as the basis for the imposition of a positive residence-country tax rate on income from outbound direct investment. The final chapter also includes some discussion of movement to a progressive consumption tax or conduit treatment of all business entities as fundamental reforms in the cross-border context. Because practical policy considerations constrain either alternative, the discussion is similarly of academic interest only.

T.E.

Michael Blackwell, *Do the Haves Come Out Ahead in Tax Litigation? An Empirical Study of the Dynamics of Tax Appeals in the UK*, Oxford University Centre for Business Taxation Working Paper 13/20 (Oxford: Oxford University Centre for Business Taxation, November 2013), 33 pages, available at www.sbs.ox.ac.uk/ideas-impact/tax/publications/working-papers

This paper adds to the empirical legal literature on tax litigation and is particularly important for its focus on the United Kingdom, where only Blackwell has explored this type of research.[9] The focus of the analysis is a data set, compiled by the author, of UK tax appeals from decisions of the special commissioners during the period 1981-2009. Blackwell categorizes tax litigants, including Her Majesty's Revenue and Customs (HMRC), as either "repeat players" or "one-shotters."[10] The former category consists of HMRC and large corporate taxpayers. The latter category consists of individuals and small businesses. As a repeat player, HMRC is seen to have an advantage over individuals and small businesses that is attributable to factors such as specialized expertise, economies of scale, and bargaining credibility. HMRC is also seen to be concerned with the precedential value of a case and not just its outcome.

9 See Michael Blackwell, "Variation in the Outcomes of Tax Appeals Between Special Commissioners: An Empirical Study" [2013] no. 2 *British Tax Review* 154-74.

10 This conceptual framework is based on Marc Galanter, "Why the Haves Come out Ahead: Speculations on the Limits of Legal Change" (1974) 9:1 *Law and Society Review* 95-160.

Because large corporate taxpayers are repeat players, the advantaged position of HMRC may be reduced in litigation against these taxpayers, who may also enjoy an advantaged position because of a strong bargaining position associated with the size of their contribution to the revenue.

Blackwell statistically tests six different hypotheses that are posited to follow from the categorization of taxpayers as either repeat players or one-shotters and HMRC as a repeat player. Although the results are not always statistically significant, he finds that the majority of appeals are decided in favour of the Crown, but this finding is more attributable to taxpayers appealing cases in which they have low prospects of success than to the Crown being overly cautious about which cases it appeals. He also finds that permission to appeal tends to screen out unmeritorious appeals, with the effect being most pronounced at the House of Lords, where permission is difficult to obtain and taxpayers win the majority of their appeals. The identity of Crown counsel is found to have no effect on outcomes, while the identity of counsel for taxpayers is found to have an effect. Perhaps somewhat surprisingly, this effect is found to be more attributable to aggressiveness and risk aversion of legal advice than it is to quality of argumentation. Finally, Blackwell finds that HMRC is more likely to appeal losses against large corporate taxpayers than against individuals, while large corporate taxpayers are also more likely to appeal losses against the Crown. The first finding is particularly interesting, given the recent controversy in the United Kingdom surrounding the perceived preferential treatment of certain large corporate taxpayers, including Vodafone and Goldman Sachs.

T.E.

Allison Christians, "Avoidance, Evasion, and Taxpayer Morality"
(2014) 44:1 *Washington University Journal of Law and Policy* 39-59

Lee A. Sheppard, "Twilight of the International Consensus: How Multinationals Squandered Their Tax Privileges" (2014)
44:1 *Washington University Journal of Law and Policy* 61-78

On April 1, 2013, Washington University School of Law held a colloquium, "Conceptualizing a New Institutional Framework for International Taxation." This issue of the *Washington University Journal of Law and Policy* includes an edited transcript of the remarks of participants at the colloquium along with these two articles. A third article in the issue was reviewed previously in this feature.[11]

The author of the first article, Allison Christians, is the holder of the H. Heward Stikeman Chair in Tax Law at McGill University. She argues that the political gains

11 Adam H. Rosenzweig, "An Antigua Gambling Model for the International Tax Regime" (2014) 44:1 *Washington University Journal of Law and Policy* 79-101, reviewed in this feature (2014) 62:3 *Canadian Tax Journal* 907-26, at 909-13.

realized by the conflation of international tax evasion and international tax avoidance by tax justice and civil society groups come with significant potential costs. These groups have arguably performed an important public service by exposing both evasion and avoidance to the light of popular policy discourse, but, as Christians observes, they have used the rhetoric of morality to equate the two, which avoids a necessary engagement with a very different analysis of the legal obligations of taxpayers. Christians suggests that an implicit premise of this course of action is that the difference between illegal tax evasion and legal tax avoidance cannot be properly articulated within the law. Punishment is then meted out randomly on the basis of judgments about taxpayer behaviour in the court of public opinion rather than within the sphere of deliberative law making. She argues that a convincing case can be made that governments have the required tools within the legal system to control behaviour that is considered to be inappropriate and that following this course of action, with its admittedly messy exercise in legal line drawing, ultimately leads to a more coherent system characterized by a greater consistency of application monitored through judicial review.

Christians emphasizes, however, that the political work of tax justice and civil society groups is most effective as a complement to the law-making process when it is focused on the need for transparency to enable the public monitoring of legislation. She calls for an increased challenge of two systemic tax governance traditions. One is the disproportionate influence of well-resourced special interest groups in both domestic national settings and the international setting through the OECD. The other is the confidentiality that is accorded to taxpayer information. Christians suggests that interest group behaviour can be monitored more effectively by demanding greater accountability and public access to information regarding the interaction of government officials and private sector actors and lobbyists. She believes that these initiatives would be most effective in the context of the OECD's tax policy work. With respect to confidentiality of taxpayer information, Christians acknowledges that there is a case for favouring confidentiality over public disclosure for individuals, but she believes that the same argument does not extend to corporations. She concludes that the international tax evasion and tax avoidance problem could motivate governments to reform tax disclosure laws in the direction that she suggests.

The author of the second article, Lee Sheppard, is well known to many readers as a contributing editor at Tax Analysts, publisher of *Tax Notes International* and *Tax Notes*. In fact, this article is a version of an earlier article published in *Tax Notes International*.[12] Sheppard argues that the OECD BEPS initiative, which is intended to preserve the existing international tax consensus, may actually upset it in the long run. More particularly, Sheppard asserts that US multinationals will have to pay more

12 Lee A. Sheppard, "The Twilight of the International Consensus" (2013) 72:1 *Tax Notes International* 7-12.

tax to source countries as a result of the BEPS initiative, but the national legislative product of this initiative will ultimately prove untenable, leading to an inevitable move to a system of formulary apportionment based on sales. She develops her argument through a survey of the issues that are the focus of BEPS, while speculating on the political considerations that will constrain any fundamental rethinking of the existing international tax consensus.

T.E.

Antony Ting, "iTax—Apple's International Tax Structure and the Double Non-Taxation Issue" [2014] no. 1 *British Tax Review* 40-71

Ting uses the tax-driven structuring of Apple's European operations as a case study of profit shifting by multinational enterprises (MNEs) that, in the extreme, results in the non-taxation of cross-border income by source and residence countries (referred to as "double non-taxation"). The structure used by Apple was the subject of recent US congressional hearings, which revealed that Apple had successfully avoided US$44 billion in taxes from 2009 to 2012. These hearings in the United States also focused on the cross-border tax planning of Microsoft and Hewlett-Packard, while the House of Commons Public Accounts Committee in the United Kingdom held hearings investigating the tax planning of US-based MNEs Google, Amazon, and Starbucks as their planning affected UK-source jurisdiction to tax. The author selected Apple's structured tax planning as an illustrative case study both for its simplicity and for the wealth of information revealed by the US congressional hearings into the role of the United States as the country of residence of Apple's parent corporation and the effect on European and Asian countries as source countries providing markets for Apple's sales. Ting uses the label "iTax" in the title of the article to refer to the cross-border tax structure implemented by Apple for its European and Asian market sales, with the "i" branding the kind of innovation that is frequently characteristic of Apple's products. The label also refers, however, to what he believes is a need for innovative policy thinking to address the double non-taxation issue illustrated by the Apple case study.

After providing a brief description of Apple's tax structure, Ting reviews in some detail the features of the relevant income tax systems that, in combination, provided the double non-taxation result. Some of these features are unique to the US income tax system and are the focus of tax planning by US-based MNEs only; but some are also found in the income tax systems of other countries and are exploited by MNEs based in these countries, including Canada. A unique feature of the Apple structure is the use of holding corporations incorporated in Ireland but managed in the United States. Under US tax law, which uses a place-of-incorporation test exclusively to determine corporate residence, the fact that the Irish-incorporated holding companies were managed from the United States does not make them resident in the United States. Under Irish tax law during the relevant period, the same holding companies were not considered to be resident in Ireland because Irish law used a test of central management and control exclusively to determine corporate residence. The holding companies were thus neither resident in the United States nor resident in Ireland. The Irish government has since changed its law to provide that a corporation incorporated in Ireland is considered Irish-resident if its central management and control is exercised from another country.

Before this change in Irish law, the inconsistency in the US and Irish corporate residence rules ensured that royalty and licensing income payable from Apple subsidiaries in Europe and Asia was not subject to any residence-country tax. Deductibility of the payments in computing source-country tax by these subsidiaries also ensured that any source-country tax was avoided, while the use of a cost-sharing agreement for R & D projects entered into between Apple's US parent corporation and the Irish holding companies resulted in a disproportionate amount of the royalty and licensing payments accruing to the companies. Limited application of the US CFC rules, along with the check-the-box regime for entity classification purposes under US law, meant that the payments were not taxable to Apple's US parent currently as passive income deflected from its subsidiaries in Europe and Asia to the Irish holding companies.

Ting emphasizes that the US government has for some time, and somewhat transparently, accepted the kind of tax-driven structuring used by Apple and other US-based MNEs, with the apparent goal of enhancing US welfare at the expense of source-country tax jurisdictions. Indeed, other capital-exporting countries, including Canada, have adopted similar positions with similar effects through their domestic tax law for similar reasons. Countries also appear willing to accept erosion of their source tax bases to compete for desirable inbound investment. This policy status quo was upset, of course, by tax justice and civil society organizations based primarily in the United Kingdom. By exposing a range of tax-structured cross-border investments to public scrutiny, the associated policy issue became a political issue that was amplified by government budget constraints caused by the need to bail out the financial sector in the wake of the financial crisis of 2007-9. The resulting political imperative led to the initiation of the BEPS project by the OECD, as mandated by the G-20 group of countries. In addition, the European Commission recently opened investigations into the transfer-pricing arrangements of Apple, Starbucks, and Fiat Finance and Trade to determine whether they constitute prohibited state aid provided by Ireland, the Netherlands, and Luxembourg, respectively.

Although Ting embeds his analysis in the BEPS project, the timing of the publication of this article did not permit a detailed analysis of any of the results of that project, which are only now becoming available in the form of discussion documents that address various aspects of BEPS. Ting does offer some interesting policy thinking that could be followed by both residence and source countries, assuming that they are committed to addressing the double non-taxation issue that is often the result of cross-border tax planning. For residence countries, his suggested policy initiatives are somewhat standard and will presumably be the focus of the OECD BEPS project to some extent. In particular, he suggests that CFC legislation be extended to require current recognition of business income that is deflected as a tax-deductible payment to a low-tax third country. For the United States uniquely, this policy initiative would require the repeal or substantial revision of the check-the-box regime for entity classification in a cross-border context. He also suggests that cost-sharing agreements for intangibles be strengthened to prevent profit shifting. For source countries, Ting recommends a country-by-country income-reporting requirement for MNEs, which is an idea that has received considerable recent approbation. A more provocative proposal from a source-country perspective is Ting's suggestion that the conventional separate-entity approach to intragroup transactions be ignored in certain circumstances. Unfortunately, he does not provide much guidance concerning these circumstances, indicating only that the holy grail of "economic substance" could be invoked in the name of the prevention of BEPS.

T.E.

Chloe Burnett, "Intra-Group Debt at the Crossroads: Stand-Alone Versus Worldwide Approach" (2014) 6:1 *World Tax Journal* 40-76

The allocation of interest expense deductions as a base erosion technique is the focus of action item 4 of the OECD BEPS project.[13] The Department of Finance has been active in recent budgets on this policy front, introducing the foreign affiliate dumping rules in section 212.3, while also amending the thin capitalization rules in subsections 18(4) to (8). Other countries have similarly been legislatively active, but, as Burnett observes, no international consensus has emerged regarding a best practice approach to restricting interest expense deductions in a cross-border context. She suggests that the wide variety of legislative approaches results in high compliance costs and potential double taxation as well as double non-taxation. She provides a useful conceptual framework for assessing various approaches. Burnett argues that a "worldwide ratio approach" to the limitation of interest expense deductions is the best practice approach that countries should be moving toward.

Burnett defines a worldwide ratio approach as an interest expense allocation method that "considers the total third-party debt of the multinational group and compares this to, or allocates it amongst, the subsidiaries in the multinational's various jurisdictions."[14] As she points out, this approach can be implemented by limiting debt at the subsidiary level, both intragroup and third-party, to the amount of third-party leverage of the multinational group, with a denial of interest deductions on the excess. Alternatively, the same result can be realized by ignoring intragroup debt

13 Organisation for Economic Co-operation and Development, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013), action 4, "Limit Base Erosion Via Interest Deductions and Other Financial Payments."

14 At 42.

and explicitly allocating third-party debt of the multinational group among the group members in proportion to the third-party leverage ratio of the group. Burnett asserts that the allowable interest rate can be determined either by using a standard transfer-pricing analysis or by extending the worldwide ratio approach to use the multinational group's average interest rate on third-party debt, with interest expense accounted for after netting out the interest income of the group. She contrasts the worldwide ratio approach with what she refers to as a "stand-alone approach," which sets the permissible debt allocation level using a standard transfer-pricing inquiry focused on how much debt a group member could otherwise borrow if it were a stand-alone entity, rather than a member of the particular multinational group. A third approach used by some countries, and characteristic of Canada's thin capitalization rules, is to set a fixed maximum leverage ratio independent of either the actual leverage ratio of a particular multinational group or a hypothetical leverage capacity assessed on the basis of the unique facts of a group member.

Burnett rejects a fixed ratio approach as an unnecessarily blunt limitation that suffers from problems of overinclusiveness and underinclusiveness. She does not believe that the presumed compliance and administrative cost savings associated with such an approach justify its poor targeting. She argues that a worldwide ratio approach is theoretically preferable on the basis of three propositions. One proposition, which is empirical, is that intragroup debt is a close or perfect substitute for equity and can be readily substituted to take advantage of differences in tax treatment. A second proposition, which is also empirical, is that a multinational group's choice of location of its third-party debt is responsive to tax considerations. The third proposition, which is more normative in content, is that a multinational group should have the same leverage and interest rate throughout the jurisdictions in which it operates. Burnett suggests that a stand-alone approach is defensible only if a multinational group member has an identifiable arm's-length amount of debt, and an intragroup loan has an identifiable arm's-length price. She criticizes this proposition because of the substantial tax-electivity that it provides for multinational groups through selective leveraging up of group members to the maximum justifiable debt. As she emphasizes, this "could standard" means that the potential leverage for particular group members can be higher than the group's third-party leverage ratio, given the observed phenomenon of spare debt capacity and the wide range of positions that are plausible under the proposition that a multinational group member has a unique arm's-length amount of debt and an arm's-length price.

Burnett concludes that a worldwide ratio approach is not only theoretically justifiable but also administratively feasible, drawing on the examples of the debt allocation limitations in Australia, Germany, and New Zealand as legislative templates. She recognizes, however, that inconsistent financial accounting standards create an important practical problem. This inconsistency is significant because of the need to use financial accounting standards as the basis for measuring debt-to-asset ratios. She also usefully reviews some of the transitional issues that tax policy makers would need to address in moving to a worldwide ratio approach.

T.E.

Wolfgang Schön, "International Taxation of Risk"
(2014) 68:6/7 *Bulletin for International Taxation* 280-94

In this article, Schön draws on the extensive theoretical literature on taxation and risk taking to critically examine the focus on the allocation of risk as a basis for the allocation of the income of MNEs among taxing jurisdictions. He suggests that this literature highlights three principal reasons why tax policy makers would be interested in the taxation of risky investments as a source of revenue, after allowing for the recognition of losses. First, standard limitations-on-loss recognition result in asymmetric taxation of gains and losses, where gains are taxed in full. Second, economic rents may be disguised as returns to risk taking. Third, investors who are risk-averse demand a premium for bearing undiversifiable risk. Schön argues that in the international context MNEs may defensibly shift risk from a high-tax to a low-tax jurisdiction to moderate the impact of asymmetric gain and loss recognition. In principle therefore intragroup risk-transfer transactions should be respected for tax purposes. In this respect, Schön asserts that the focus of transfer-pricing practice on risk-bearing capacity is sensible as a proxy for the shift of the full upside and downside associated with a risky investment. He argues, however, that a focus on the control of risk is largely irrelevant in determining whether an intragroup transfer of risk should be respected, since a divergence between risk bearing and control of risk is commonly observed in dealings between independent parties as the transfer-pricing standard.

Schön then argues that the important tax policy distinction between risk transfer or allocation, on the one hand, and profit shifting by MNEs, on the other, can be found in the transfer of intangibles and the intragroup charging of risk premiums. With transfers of intangibles (including cost contribution arrangements), the ex ante approach of attempting to determine the adequacy of consideration provided by group members inevitably fails in the presence of asymmetric information on the part of MNEs and tax administrators. The asymmetric information leads to undervaluation, which hides the misallocation of economic rents as defensible allocations of returns to risk taking. Schön concludes that this type of profit shifting can be addressed only by adopting an ex post adjustment for tax purposes, using, for example, a commensurate-with-income standard. With risk premium, he suggests that the separate-entity approach to income allocation among MNE group members should be rejected by ignoring any intragroup charges that take this form. The basis for this proposition is the fact that the shareholders of a parent corporation in a corporate group bear any undiversifiable risk associated with group investments. In contrast to an otherwise general relevance of risk allocation for income allocation purposes under the arm's-length standard, Schön observes that proposals to extend source-country taxing jurisdiction to any inbound sales or services would make risk allocation generally irrelevant, which is the case with the current menu of income apportionment formulas offered in the literature.

T.E.

Michael Devereux and Rita de la Feria, *Designing and Implementing a Destination-Based Corporate Tax*, Oxford University Centre for Business Taxation Working Paper 14/07 (Oxford University Centre for Business Taxation, May 2014), 22 pages, available at www.sbs.ox.ac.uk/ideas-impact/tax/publications/working-papers

In much of the tax policy literature, a cash flow corporate tax is regarded as the preferred reform alternative to existing corporate income tax systems. By providing immediate expensing of all expenses, a cash flow corporate tax taxes economic rents only—that is, returns to capital in excess of (1) normal or time-value returns and (2) returns for bearing undiversifiable risk. The extensive literature advocating a cash flow corporate tax tends to focus on two principal design issues. One is the use of an allowable deduction for imputed returns on corporate equity as an alternative to the current expensing of capital expenses. The other is the tax treatment of corporate returns to shareholders and corporate creditors. These design features are characteristically fleshed out in an entirely domestic context. In the cross-border context, some of the policy literature suggests the adoption of a destination basis rather than the continued use of residence and source jurisdiction to tax. In this respect, a corporate cash flow tax would operate similarly to a value-added tax (VAT) or a goods and services tax (GST). An important difference, however, between consumption taxes and a cash flow corporate tax is the treatment of labour costs, which are deductible under a cash flow corporate tax but are not deductible under VAT and GST systems. This paper fills an important gap in the literature by addressing in detail the legal and practical implementation issues associated with the use of a destination-based jurisdiction to tax.

The authors argue that the country of destination, as the nexus for taxing jurisdiction, could be identified under a cash flow corporate tax much more easily than under VAT and GST systems. Because VATs and GSTs are consumption taxes, these systems must use a range of proxies to identify the place of consumption. In contrast, a cash flow corporate tax is unconcerned with the identification of the place of consumption, since it is a tax on corporate profits and could be based largely on the single proxy of customer location to identify the country of destination. This single-proxy approach would be modified only in limited circumstances involving the provision of some services. Administratively, the authors suggest that a clearing-house approach proposed for EU VAT purposes could be modified for corporate cash flow purposes. This approach is necessary to establish appropriate enforcement of the destination basis and to ensure that countries in which goods and services originate are not in the position of providing rebates to producers and service providers because of the deductibility of labour costs in computing corporate profit.

The authors provide some discussion about the normative argument for adoption of the destination basis as the exclusive determinant of taxing jurisdiction, but their principal focus is the practical enforcement issues raised by a cash flow corporate tax applied in this manner. Ultimately, the case for a cash flow corporate tax depends on its efficiency properties, which are commonly emphasized in the policy literature.

The destination basis can be seen to realize many of the same standard efficiency properties. It is notable therefore that much of the same fundamental rethinking of jurisdiction to tax and enforcement addressed by Devereux and de la Feria is evident in the literature discussing a system of formulary apportionment of corporate income earned in a cross-border context. In particular, such a system invariably relies on the same taxing nexus, the location of sales, as one of the elements in apportionment formulas. Presumably, the authors do not discuss this obvious reform alternative to a destination-based corporate cash flow tax because of the efficiency properties of the latter, which are assumed to make it the best reform choice.

T.E.

Francis Weyzig, "The Capital Structure of Large Firms and the Use of Dutch Financing Entities" (2014) 35:2 *Fiscal Studies* 139-64

The use of Dutch holding companies as tax-advantaged conduit entities is well known. Weyzig seeks to empirically test the relationship between the use of Dutch holding companies and the degrees of leverage of large firms at both the consolidated and the subsidiary level throughout the European Union. More particularly, the author empirically tests the use of Dutch special purpose entities (SPEs) to avoid non-resident interest withholding tax. Dutch SPEs are tax-advantaged in this respect because of the inapplicability of non-resident interest withholding tax on their issued debt. Dutch SPEs can therefore be used as issuing vehicles for the publicly traded debt of an MNE held by non-resident tax-exempt investors who cannot make use of a foreign tax credit in their home jurisdiction for withholding tax at source. In addition, Dutch SPEs can be used by an MNE to avoid non-resident interest withholding tax that would otherwise apply on intragroup loans made directly by a non-EU group member to an EU subsidiary. This result is realized by interposing the Dutch SPE between the EU subsidiary borrower and a non-EU group lender in a back-to-back intragroup loan structure. Interest payments from EU subsidiaries to the Dutch SPE can benefit from the inapplicability of non-resident withholding taxes on interest paid between EU group members, while the interest receipts can be paid by the Dutch SPE to a non-EU group member without any Dutch non-resident interest withholding tax.

Weyzig defines a Dutch SPE in a manner that is consistent with the definition used for Dutch information-reporting purposes. This definition includes a Dutch-resident enterprise in which non-residents hold a direct or indirect participating interest and whose objective is the receipt of funds to be channelled to non-residents. The author tests four hypotheses using a constructed data set for the 1997-2005 period, consisting of 365 firm-year observations for 82 firms and 2,493 country-year observations based on 9,371 underlying subsidiary-year observations. He finds that the use of publicly issued debt at the firm level is associated with 13 percent higher debt financing relative to equity and that the use of a Dutch SPE is associated with yet higher debt financing. At the subsidiary level, the author finds that EU subsidiaries of large multinational firms are more leveraged, and that the use of Dutch

SPEs is again associated with yet higher levels of subsidiary leverage. However, the sensitivity of subsidiary leverage to host country statutory tax rates is found to be relatively low, which the author suggests is indirect evidence that large firms are more likely to shift debt from low-tax affiliates to subsidiaries in most or all EU countries, facilitated by the use of Dutch SPEs. An obvious policy lesson offered by the author is the need to consider uniform EU withholding taxes on interest payments to non-EU debtholders.

T.E.

Joseph J. Thorndike, *Their Fair Share: Taxing the Rich in the Age of FDR* (Washington, DC: Urban Institute Press, 2013), 349 pages, ISBN 978-0-87766-771-1

Ajay K. Mehrotra, *Making the Modern American Fiscal State: Law, Politics, and the Rise of Progressive Taxation 1877-1929* (New York: Cambridge University Press, 2013), 427 pages, ISBN 978-1-107-04392-3

These two books are examples of tax history at its finest. Ideally, they should be read together since each describes a different period in US tax history that saw the foundations laid for the modern fiscal state. Common themes are readily apparent, the most prominent of which is an emphasis on the income tax as a policy instrument to allocate a progressively greater tax burden to the wealthy but without necessarily seeking to redistribute wealth in any significant manner. Both authors emphasize the contested and historically contingent nature of events. They also emphasize some unintended consequences, such as the rejection of a national sales tax, the absence of which continues to be a defining feature of the US fiscal system.

Thorndike argues that the modern US fiscal regime originated in a series of policy decisions made during the Great Depression and the Second World War that have had lasting importance for the US state and society. The story is a familiar one of how the income tax, which was originally a class-based tax, became a mass tax as a result of the revenue imperative of the Second World War. However, Thorndike paints a rich picture of this development, emphasizing the role of ideas and political institutions in the transformation. Particularly interesting is his portrait of President Roosevelt's moralistic approach to tax policy, which was focused on the fiscal responsibilities of wealthy Americans. This attitude was reflected in a categorical rejection of a national sales tax as a wartime revenue measure. The different approaches of a set of lawyers and economists in the Roosevelt administration are another of Thorndike's themes. The New Deal lawyers, on the one hand, focused on tax avoidance and the need to raise rates at the highest income levels. The New Deal economists, on the other hand, viewed this approach as being too narrowly progressive and preferred to extend the income tax to the middle class, which would allow cuts to regressive consumption taxes as a means of realizing a measure of progressivity throughout the income scale.

Mehrotra's narrative unfolds during the late 19th and early 20th centuries, which saw populist and progressive movements to replace what was seen as an outdated tax system consisting of customs duties and excise taxes at the federal level and property taxes at the state level. Mehrotra characterizes this system as one of "indirect, hidden, disaggregated, and partisan duties and regressive excise taxes,"[15] which was replaced with a "professionally administered, graduated tax system"[16] with the income tax as its centrepiece. Driven by a new view of an activist state within a changed industrial society, the concept of ability to pay was championed by some leading public finance economists, including Edwin Seligman, as the conceptual basis for a freshly conceived tax system. Mehrotra argues that even though the New Deal and the Second World War were seminal events in the development of the modern US fiscal state, the developments of that era were ultimately built on the accomplishments of the late 19th and early 20th centuries.

T.E.

15 At 7.

16 Ibid.