CANADIAN TAX JOURNAL

REVUE FISCALE CANADIENNE

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Eytan Dishy and Chris Anderson

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Improving the Canada Revenue Agency's Delivery of Social Benefits—A Practitioner's Perspective

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Since its inception in 1945, the Foundation has published many books and articles on a wide range of subjects within its areas of interest. The Foundation seeks proposals for research projects that will

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For further information, please contact the director, as indicated above, or the co-chairs of the Canadian Tax Foundation Research Committee:

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Depuis sa fondation en 1945, la FCF a publié de nombreux livres et articles sur divers sujets dans ses champs d'intérêt. La FCF souhaite obtenir des propositions de projets de recherche qui :

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Pour plus d'information, veuillez communiquer avec le directeur, tel qu'il est mentionné plus haut, ou avec les co-présidentes du comité de recherche de la Fondation canadienne de fiscalité :

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■ ACTIVITÉS RÉCENTES ET À VENIR*

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JOURNÉE D'ÉTUDES FISCALES

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ONTARIO TAX CONFERENCE

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■ CANADIAN TAX JOURNAL

The *Canadian Tax Journal* publishes research in, and informed comment on, taxation and public finance, with particular relevance to Canada. To this end, the journal invites interested parties to submit manuscripts for possible publication as peer-reviewed articles, and it especially welcomes work that contributes to the analysis, design, and implementation of tax policies.

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Prospective contributors should submit a copy of the manuscript to the journal's editorial department. The preferred method of submission is by e-mail with an attached Word document. E-mail inquiries are welcome: write to CTFeditorial@ctf.ca. Contributors are responsible for providing complete and accurate citations to sources, a detailed abstract (200 to 400 words), and up to six keywords for indexing purposes.

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■ REVUE FISCALE CANADIENNE

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■ CANADIAN TAX FOUNDATION

The Canadian Tax Foundation is Canada's leading source of insight on tax issues. The Foundation promotes understanding of the Canadian tax system through analysis, research, and debate, and provides perspective and impartial recommendations concerning its equity, efficiency, and application.

The Canadian Tax Foundation is an independent tax research organization and a registered charity with over 12,000 individual and corporate members in Canada and abroad. For more than 70 years, it has fostered a better understanding of the Canadian tax system and assisted in the development of that system through its research projects, conferences, publications, and representations to government.

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La Fondation canadienne de fiscalité est un organisme indépendant de recherche sur la fiscalité inscrit sous le régime des œuvres de charité. Elle compte environ 12 000 membres au Canada et à l'étranger. Depuis plus de 70 ans, la FCF favorise une meilleure compréhension du système fiscal canadien et aide au développement de ce système par le biais de ses projets de recherche, conférences, publications et représentations auprès des gouvernements.

Les membres considèrent l'étendue et le détail de l'information offerte par la FCF comme une importante ressource. Ils apprécient également les autres services de la FCF qui facilitent leur travail quotidien dans le domaine de la fiscalité.

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— *Tax Dispute Resolution, Compliance, and Administration in Canada: Proceedings of the June 2012 Conference* (Members \$30; Non-Members \$195)

— Collections of papers delivered at regional and special tax conferences (British Columbia, Prairie Provinces, Ontario, and Atlantic Provinces) are available in USB format (Members \$445; Non-Members \$495).

FINANCES OF THE NATION — Review of expenditures and revenues and some budgets of the federal, provincial, and local governments of Canada. PDFs for the years 2002-2012 are available on the CTF website at no cost. In 2014, "Finances of the Nation" began to appear as a feature in issues of the *Canadian Tax Journal*.

MONOGRAPHS

2020. *Taxation of Private Corporations and Their Shareholders*, 5th edition, Rachel Gervais, John Sorensen, David Stevens, and Dave Walsh, eds. (Members and Non-Members \$170; Students \$70)

2019. *Funding the Canadian City*, Enid Slack, Lisa Philipps, Lindsay M. Tedds, and Heather L. Evans, eds. (\$40 each)

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The Permissibility of Surplus Stripping: A Brief History and Recent Developments

Eytan Dishy and Chris Anderson*

PRÉCIS

Le « dépeillement des surplus » vise à structurer les paiements reçus par un particulier d'une société comme des gains en capital plutôt que comme des dividendes, afin que les paiements soient imposés à un taux plus faible. Alors que les tribunaux canadiens ont généralement jugé qu'il n'y avait pas de mécanisme anti-dépeillement des surplus dans la Loi de l'impôt sur le revenu, dans des décisions récentes, la Cour canadienne de l'impôt et la Cour d'appel fédérale se sont prononcées contre des contribuables qui avaient effectué des opérations de dépeillement des surplus. Le présent article examine dans quelle mesure le dépeillement des surplus reste permis par la Loi et se penche, en particulier, sur l'application du paragraphe 84(2), de l'article 245 (la règle générale anti-évitement [RGAE]), et des dispositions anti-dépeillement des surplus aux articles 84.1 et 212.1. Dans leur évaluation de la possibilité d'avoir recours aux opérations de dépeillement des surplus, les auteurs passent brièvement en revue le contexte législatif pertinent et cernent divers thèmes qui ont émergé de la jurisprudence sur la RGAE et le paragraphe 84(2). Les auteurs concluent que, nonobstant les récentes décisions judiciaires, certaines opérations de dépeillement des surplus devraient rester permises.

ABSTRACT

"Surplus stripping" seeks to structure payments received by an individual from a corporation as capital gains rather than dividends, so that the payments are taxed at a lower rate. While Canada's courts have typically held that there is no anti-surplus-stripping scheme in the Income Tax Act, recent decisions of the Tax Court of Canada and the Federal Court of Appeal have found against taxpayers that have engaged in surplus-stripping transactions. This article considers the extent to which surplus strips remain permissible under the Act and, in particular, considers the application of subsection 84(2), section 245 (the general anti-avoidance rule [GAAR]), and the specific anti-surplus-stripping provisions in sections 84.1 and 212.1. In assessing the permissibility of surplus-stripping transactions, the authors briefly review the relevant legislative history and identify various themes that have emerged from the jurisprudence

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on GAAR and subsection 84(2). The authors conclude that, notwithstanding recent court decisions, certain surplus-stripping transactions should remain permissible.

KEYWORDS: SURPLUS STRIPPING ■ HISTORY ■ ANTI-AVOIDANCE ■ GAAR ■ STATUTORY INTERPRETATION ■ JURISPRUDENCE

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INTRODUCTION

“Surplus stripping” is a tax-planning strategy that involves the structuring of payments received by an individual from a corporation as capital gains rather than dividends, so that the payments are taxed at a lower rate. This article considers the extent to which surplus-stripping transactions are permissible under the Income Tax Act (Canada)¹ in the context of subsection 84(2), the general anti-avoidance rule (GAAR) in section 245, and the specific anti-surplus-stripping provisions in sections 84.1 and 212.1. In particular, we review the relevant legislative history and identify a number of themes that have emerged from the jurisprudence addressing the application of GAAR and subsection 84(2).² We also review the position of the

1 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.

2 There are many articles that have previously considered the application of GAAR and subsection 84(2) jurisprudence to surplus stripping. Some of the more recent articles include Alexander Demner and Kyle B. Lamothe, “The Future of Surplus Stripping,” in *2019 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2019), 4:1-99; Erin Swint, “Optimizing Extractions from Private Corporations,” in *2018 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2018), 13:1-62; David Baxter, Brandon Wiener, and Alexander

Canada Revenue Agency (CRA) on surplus stripping. We conclude that, notwithstanding recent court decisions, certain surplus-stripping transactions are still, and should remain, permissible.

LEGISLATIVE OVERVIEW

Although the history of surplus stripping in Canadian tax legislation stretches as far back as the 1920s,³ our analysis begins with the modern provisions of section 84.1, subsection 84(2), sections 212.1 and 212.3, and section 245.

Surplus Stripping for Canadian Residents

Subsection 84.1(1) was added in 1976 in respect of payments made after November 18, 1974.⁴ The stated purpose of the provision at the time it was introduced was “to prevent a resident individual from avoiding tax on surplus . . . by means of a non-arm’s length sale of shares . . . of one corporation to another.”⁵

The origin of subsection 84.1(1) can be traced back to the introduction of section 14 of the Income War Tax Act,⁶ which disallowed the conversion of a dividend into capital gains through the use of a second corporation acting as the first corporation’s agent. In 1945, the Ives commission described the purpose of section 14 of the Income War Tax Act as follows:

Were it not for this section, a person owning shares in Company A could cause to be incorporated Company B, and sell the shares to Company B at a price calculated by including the entire undistributed income of Company A. Company A could then declare a dividend equal to its entire undistributed income which would be tax free to

Demner, “Surplus Stripping—What’s Acceptable, What’s Not, and What Should Be?” in *2014 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 12:1-44; H. Michael Dolson and Jon D. Gilbert, “Accessing Surplus: What Works, What Doesn’t, What’s Left,” in *2014 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 9:1-57; Mark Meredith and Jacqueline Fehr, “Surplus Stripping: In the Eye of the Beholder,” in *2013 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2013), 14:1-29; Ron Durand and Lindsay Gwyer, “Surplus Stripping and Domestic Private Corporations,” in *Report of Proceedings of the Sixty-Fourth Tax Conference*, 2012 Conference Report (Toronto: Canadian Tax Foundation, 2013), 13:1-20; and Monica Biringier, “Surplus Stripping After Copthorne: Non-Resident Corporations,” in the 2012 Conference Report, *supra*, 14:1-2.

3 The first provision to address surplus stripping was section 14 of the Income War Tax Act, 1917, SC 1917, c. 28. In the subsequent decades, various provisions attempting to address surplus stripping have been introduced and repealed. For a more detailed history of surplus stripping prior to 1995, see H. Heward Stikeman and Robert Couzin, “Surplus Stripping” (1995) 43:5 *Canadian Tax Journal* 1844-60.

4 Subsection 84.1(1) was added by SC 1974-75-76, c. 26, section 47(1).

5 Canada, Department of Finance, Notice of Ways and Means Motion To Amend the Income Tax Act, March 31, 1977.

6 *Supra* note 3.

Company B under section 4(1)(n); Company B could use the money in part payment of the purchase price of the shares; and the original owner of the shares would thereby obtain free of tax, his proportion of the undistributed income of the company.⁷

Section 14 was repealed, along with many other specific anti-surplus-stripping rules that had been enacted in the 1920s, with the introduction of the 1948 Income Tax Act⁸ and the adoption of the “designated surplus” concept. The designated surplus concept was an attempt to stop individuals from converting taxable dividends into tax-free capital gains by selling a corporation with accumulated retained earnings to a non-arm’s-length company. The designated surplus rules were later repealed and were replaced with section 84.1.⁹

Current subsection 84.1(1) applies in respect of a non-arm’s-length transfer of shares of a corporation resident in Canada (“the subject corporation”) by an individual resident in Canada (“the transferor”) to another corporation with which the transferor does not deal at arm’s length (“the purchaser corporation”) where, immediately after the transfer, the purchaser corporation holds more than 10 percent of the share capital of the subject corporation.¹⁰ The application of subsection 84.1(1) results in a reduction of the paid-up capital (PUC) of the shares of the purchaser corporation (colloquially known as a “PUC grind”), such that the PUC is generally limited to the greater of (1) the PUC of the shares of the subject corporation (“the subject shares”), and (2) the adjusted cost base (ACB) of the subject shares to the transferor. If the transferor receives non-share consideration on the transfer, such as a promissory note, he or she will be deemed to have received a dividend from the purchaser corporation to the extent that the amount of such non-share consideration exceeds the greater of the PUC and the ACB to the transferor of the subject shares immediately before the disposition. To avoid double-counting, section 84.1 ensures that the amount of the deemed dividend is reduced by the amount of the PUC grind.

The Supreme Court of Canada noted in *Copthorne Holdings Ltd. v. Canada* that one purpose of the PUC grind in section 84.1 is to prevent the preservation of PUC where it would not achieve Parliament’s purpose of “allowing only for a return of tax-paid investment without inclusion in income.”¹¹

Two amounts are excluded from the transferor’s ACB of the subject shares for the purposes of section 84.1. The effect of these exclusions is to increase the amount of

7 Canada, *Report of the Royal Commission on the Taxation of Annuities and Family Corporations* (Ottawa: King’s Printer, 1945) (“the Ives commission”), at 55.

8 SC 1948, c. 52.

9 For a more detailed history of these legislative developments, see Dolson and Gilbert, *supra* note 2.

10 More specifically, subsection 84.1(1) requires that the purchaser and the subject corporation be “connected” within the meaning of that term set out in subsection 186(4).

11 *Copthorne Holdings Ltd. v. Canada*, 2011 SCC 63, at paragraph 96.

the PUC grind or deemed dividend under section 84.1, and thus reduce the amount that the transferor can withdraw as a tax-free return. First, value accumulated in the subject shares prior to 1972 is excluded from the transferor's ACB for the purposes of section 84.1. This exclusion recognizes the fact that capital gains were not subject to tax prior to 1972. Therefore, the crystallization of value accumulated before that time in respect of the ACB of those shares should not be available to strip the corporation of its assets. Second, section 84.1 was amended in 1985 to address the introduction of the lifetime capital gains exemption in section 110.6. The amendment provides that, for the purposes of section 84.1, the transferor's ACB is reduced to the extent that the lifetime capital gains exemption has been claimed in respect of a capital gain on a prior disposition of the subject shares by either the taxpayer or a non-arm's-length individual. The ACB resulting from these transactions is colloquially known as a share's "soft" ACB, while a share's ACB attributable to any other transaction is known as the share's "hard" ACB.

Surplus Stripping for Non-Residents of Canada

Section 212.1 is the sister provision to section 84.1, applicable to non-resident transferors. Section 212.1 was introduced in 1977 to preclude a non-resident from avoiding tax on dividends by way of a non-arm's-length sale of shares of a Canadian-resident corporation to another Canadian-resident corporation. Like section 84.1, section 212.1 was introduced to replace the designated surplus rules, which had been deemed to be overly broad for interfering with bona fide acquisition and reorganization transactions. Section 212.1 may operate to grind the PUC of the purchaser corporation shares issued to a non-resident transferor and deem the transferor to have received a dividend, which would be subject to withholding tax, in circumstances similar to those described in respect of section 84.1.

There are two notable differences between section 84.1 and section 212.1. First, section 212.1 applies where the transferor is a corporation or an individual. Second, section 212.1 does not recognize the transferor's ACB, such that the PUC grind in respect of the class of shares of the purchaser corporation and the amount of the deemed dividend to the transferor are calculated only with reference to the PUC of the shares of the subject corporation. The rationale for this exclusion is that, absent section 212.1, a non-resident vendor could increase its ACB through a gain recognition transaction that would not be taxable in Canada and, in doing so, effectively convert dividends subject to Canadian withholding tax into capital gains not subject to Canadian tax.

There have been two notable recent amendments to section 212.1. Subsection 212.1(4) provides an exception to the cross-border anti-surplus-stripping rule in subsection 212.1(1). Generally, subsection 212.1(4) allows the unwinding of a sandwich structure, where a Canadian-resident corporation ("Can Parent") holds shares of a non-resident corporation ("NR Co"), which holds the shares of a Canadian-resident corporation ("Can Subco"). Where subsection 212.1(4) is engaged, subsection 212.1(1) will not apply to the sale of Can Subco by NR Co to Can Parent.

Subsection 212.1(4) was amended in 2016¹² to bar the application of the exception in subsection 212.1(4) where a non-resident (1) owns, directly or indirectly, shares of Can Parent and (2) does not deal at arm's length with Can Parent. The 2016 amendment was made to prevent non-resident corporations with Canadian subsidiaries from reorganizing their corporate structure to qualify for the subsection 212.1(4) exception. However, the amendment has been criticized on the ground that it discriminates between non-resident purchasers and resident purchasers in the context of bona fide acquisition transactions and related post-acquisition reorganizations, and is therefore arguably contrary to the original purpose behind section 212.1, which was simply to "distinguish a normal sale from a sale which is part of a contrived scheme."¹³

In 2018, section 212.1 was further amended to include "lookthrough" rules with respect to partnerships and trusts, to ensure that the original rule cannot be thwarted by involving such conduits.¹⁴

Foreign Affiliate Dumping

The foreign affiliate dumping rules ("the FAD rules") in section 212.3 were introduced in 2012.¹⁵ These rules are extremely complex; therefore, this article provides only a brief overview of their application.

The FAD rules are generally designed to prevent a foreign corporation¹⁶ (a "non-resident parent") from using a corporation resident in Canada (a "CRIC") as an intermediary to invest in a foreign affiliate (a "non-resident Subco").¹⁷ One of the stated purposes of section 212.3 is to extend the "cross-border surplus stripping rule[s]" to cover transactions involving foreign affiliates¹⁸—for example, where a non-resident parent directly holds the shares of a non-resident Subco and transfers the shares to a CRIC. Where the acquisition of the shares of a non-resident Subco is

12 The legislative change was made in response to the decision of the Federal Court of Appeal in *Univar*, *infra* note 73.

13 Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, "Federal Budget 2016: Proposed Amendment to Back-to-Back Rules and Section 212.1," submission to the Department of Finance, July 25, 2016, at 24. See the appendix to the joint committee's submission for a fuller history of section 212.1 and, in particular, subsection 212.1(4).

14 For further details on the section 212.1 lookthrough rules, see Demner and Lamothe, *supra* note 2, at 12-14.

15 Bill C-45, Jobs and Growth Act, 2012, SC 2012, c. 31; royal assent December 14, 2012.

16 The 2019 federal budget proposed to extend these rules to generally apply where the foreign parent is a trust or a group of non-resident persons dealing with each other at arm's length. Canada, Department of Finance, 2019 Budget, March 19, 2019.

17 Canada, Department of Finance, *Explanatory Notes Relating to Income Tax* (Ottawa: Department of Finance, March 2012).

18 *Ibid.*

made with internal funds of the CRIC, the transaction can be a mechanism for a non-resident controlling shareholder (or shareholders) to extract earnings from a Canadian subsidiary free of Canadian dividend withholding tax.

The FAD rules are designed to prevent this cross-border surplus stripping by (1) deeming the CRIC to have paid a dividend subject to Canadian withholding tax to the extent of any non-share consideration paid to the non-resident parent by the CRIC and/or (2) causing a reduction in the PUC of the shares issued by the CRIC (which may result in a deemed dividend at some later date—for example, if the CRIC makes a return of capital).

Windups, Discontinuances, and Reorganizations

Subsection 84(2) applies

[w]here funds or property of a corporation resident in Canada have . . . been distributed or otherwise appropriated in any manner whatever to or for the benefit of the shareholders of any class of shares in its capital stock, on the winding-up, discontinuance or reorganization of its business.

Where subsection 84(2) applies, the corporation is deemed to have paid, and the shareholder is deemed to have received, a dividend to the extent that the fair market value (FMV) of the funds or property distributed exceeds the amount by which the PUC in respect of the affected class of shares of the corporation is reduced. Where the recipient shareholder is a non-resident, the deemed dividend arising on the application of subsection 84(2) is subject to part XIII non-resident withholding tax at a rate of 25 percent (subject to any applicable reduced treaty rate).

The history behind subsection 84(2) dates back to the Income War Tax Act, in which it existed in a relatively simple form as subsection 19(1). Subsection 19(1) of the Income War Tax Act was introduced to prevent the conversion of dividend income into capital gains by deeming any distribution of property on a windup, discontinuance, or reorganization of a business to be a dividend to the extent that the company had undistributed income on hand. In the 1948 Income Tax Act, the provision evolved to take the form of subsection 81(1), which contained most of the core elements present in subsection 84(2).¹⁹

The CRA has stated that it will seek to apply subsection 84(2) to surplus-stripping transactions that involve a windup, discontinuance, or reorganization of the business of a corporation.²⁰

Other Anti-Avoidance Rules

Currently, GAAR (section 245) is the primary significant provision in the Act that may address surplus stripping when none of the specific provisions referred to

19 For further details about the history of subsection 84(2), see Dolson and Gilbert, *supra* note 2.

20 See, for example, CRA document no. 2007-0224151E5, August 13, 2007.

above apply. Prior to the introduction of GAAR, a number of anti-surplus-stripping rules were enacted and subsequently repealed. The most prominent of these provisions was former subsection 247(1), and its predecessor, section 138A, which was first introduced in 1963. The purpose behind former subsection 247(1) and its predecessor was to provide the minister with discretion to close loopholes in order to prevent surplus stripping in circumstances not already blocked by existing legislation, and to act as a deterrent to those who would otherwise attempt to avoid tax by implementing stripping-stripping schemes.²¹ More specifically, former subsection 247(1) gave the minister discretion to recharacterize an amount received by an individual taxpayer as a deemed dividend where a transaction was structured to avoid section 84.1 or 212.1. The main target of the provision seemed to be situations in which the seller and the purchaser corporation did not deal at arm's length.²² The provision was designed to prevent the extraction of corporate surplus as a capital gain in such situations. In response to longstanding criticism, subsection 247(1) was redrafted in 1985 to remove the element of ministerial discretion. However, throughout the lifetime of former subsection 247(1), there was very little litigation concerning the substance of the provision.²³

GAAR was introduced with the 1987 tax reform in response to the Supreme Court of Canada's decision in *Stuart Investments Limited v. The Queen*.²⁴ This new provision was intended to limit what the court described as "the action and reaction endlessly produced by complex, specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction."²⁵

Former subsection 247(1) was repealed in 1988 with the introduction of section 245, since it was believed that GAAR would be sufficient to quell any impermissible surplus-stripping activity. Since 1988, the CRA has assessed various transactions under GAAR on the basis that taxpayers intended to avoid section 84.1 or 212.1. The courts have grappled with the application of GAAR to these various surplus-stripping transactions and, specifically, the scheme of the Act that is allegedly being abused by such transactions.

Before turning to the jurisprudence, it is relevant to mention the Department of Finance's most recent legislative attempt to subdue surplus-stripping activity. On July 18, 2017, the department announced proposals to amend section 84.1 and to introduce new section 246.1, with the purported aim of "prevent[ing] the surplus income of a private corporation from being converted to a lower-taxed capital gain

21 C.W. Primeau, "Surplus Stripping: The Departmental View" (1974) 22:5 *Canadian Tax Journal* 421-29, at 422.

22 Ibid.

23 For a detailed history of surplus-stripping legislation, see Stikeman and Couzin, *supra* note 3.

24 *Stuart Investments Ltd. v. The Queen*, [1984] 1 SCR 536.

25 Ibid., at 581; cited in Canada, Department of Finance, *Tax Reform 1987: Income Tax Reform* (Ottawa: Department of Finance, June 18, 1987), at 130.

and stripped from the corporation.”²⁶ The proposed amendment to section 84.1 provided that, in computing the hard ACB of a share, the transferor’s ACB would be reduced by the amount of any capital gain realized after 1984 in respect of a previous disposition by the transferor or by another individual not dealing at arm’s length with the transferor. Generally, proposed section 246.1 would have applied in a non-arm’s-length context and was intended to prevent the distribution of corporate surplus as a taxable dividend to a Canadian-resident individual where the individual would either pay no tax on the distribution or pay tax at the lower capital gains rate. The language of the new proposed section closely resembled that of former subsection 247(1).

In effect, the proposals acknowledged that GAAR does not prevent all surplus-stripping activities. The new measures were strongly criticized by the tax community as being overly broad and having unintended negative consequences for “legitimate commercial transactions.”²⁷ The minister decided not to proceed with the proposals, leaving GAAR as the main provision in the Act to address surplus stripping, other than the technical provisions outlined above.²⁸

REVIEW OF THE JURISPRUDENCE

The Application of GAAR: Canada Trustco

The Supreme Court of Canada in *Canada Trustco Mortgage Co. v. Canada*²⁹ stated that the application of GAAR, as set out in subsections 245(1) through (5), involves three steps.³⁰ First, it must be determined whether a tax benefit arose from the transaction or from a series of transactions that includes the transaction, in accordance with subsections 245(1) and (2). Second, it must be determined whether the transaction is an avoidance transaction, in that the transaction was not “arranged primarily for *bona fide* purposes other than to obtain the tax benefit,” in accordance with subsection 245(3). Where the taxpayer has undertaken a series of transactions resulting in a tax benefit, as is often the case in a surplus-stripping transaction, the existence of a single avoidance transaction within the series is sufficient for this second condition to be met.³¹ Third, it must be determined whether the avoidance

26 Canada, Department of Finance, *Tax Planning Using Private Corporations* (Ottawa: Department of Finance, July 18, 2017), at 15.

27 Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, “July 18, 2017: Part D of Taxation of Private Corporations—Converting Income into Capital Gains Proposals,” submission to the Department of Finance, October 2, 2017, at 28.

28 Canada, Department of Finance, “Targeted Tax Fairness Measures Will Protect Small Business Owners Including Farmers and Fishers,” *News Release*, October 19, 2017.

29 2005 SCC 54.

30 See *ibid.*, at paragraph 17.

31 *Copthorne*, *supra* note 11, at paragraph 40.

transaction is abusive, in accordance with subsection 245(4). The taxpayer has the burden of showing that there was no tax benefit or avoidance transaction; the minister has the burden of showing that there was an abuse.³²

In respect of the third step of the GAAR analysis, the Supreme Court stated that a two-part inquiry is required:

The first step is to determine the object, spirit or purpose of the provisions of the *Income Tax Act* that are relied on for the tax benefit, having regard to the scheme of the Act, the relevant provisions and permissible extrinsic aids. The second step is to examine the factual context of a case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue.³³

The Supreme Court further noted that

[t]he first part of the inquiry under s. 245(4) requires the court to look beyond the mere text of the provisions and undertake a contextual and purposive approach to interpretation in order to find meaning that harmonizes the wording, object, spirit and purpose of the provisions of the *Income Tax Act*. . . . In order to reveal and resolve any latent ambiguities in the meaning of the provisions of the *Income Tax Act*, the courts must undertake a unified textual, contextual and purposive approach to statutory interpretation.³⁴

As will be seen below, a court's determination of the object, spirit, and purpose of the various anti-surplus-stripping rules in the Act is often the single most important step in the GAAR analysis.

The Courts' Position on the Existence of an Anti-Surplus-Stripping Scheme

Since the introduction of GAAR, the jurisprudence addressing surplus-stripping transactions can roughly be divided into three periods. The first period began in 1997 with the first cases involving the application of GAAR in the context of surplus stripping. The courts were quick to conclude that an anti-surplus-stripping scheme existed in the Act. In coming to this conclusion, the courts considered a number of factors, including the legislative history of the government's response to surplus stripping and, in particular, the repeal of former subsection 247(1) with the introduction of GAAR. The second period began in 2005, soon after the Supreme Court's decision in *Canada Trustco*, and ended in 2011 with the Supreme Court's decision in *Coptborne*. During this period, with few exceptions, the courts backtracked from their previous position that the Act contained an anti-surplus-stripping scheme.

32 *Canada Trustco*, supra note 29, at paragraphs 63-64.

33 *Ibid.*, at paragraph 55.

34 *Ibid.*, at paragraph 47. See also *Coptborne*, supra note 11, at paragraphs 69-70.

Also, in considering the object, spirit, and purpose of sections 212.1 and 84.1, the courts gave these provisions a narrow interpretation. The third and final period began in 2011, following the decision in *Copthorne*, which contains the Supreme Court's most recent pronouncement on GAAR. The court noted in *Copthorne* that (1) although there is no anti-surplus-stripping scheme in the Act, there is a comprehensive PUC scheme designed to limit artificial increases in PUC that would otherwise allow taxpayers to extract surplus tax-free; and (2) sections 84.1 and 212.1 form constituent parts of this PUC scheme.³⁵ Most recently, the lower courts, and the Federal Court of Appeal in particular, have used broad language in articulating the scope of the PUC scheme set out in *Copthorne*.

Cases involving the application of GAAR to transactions designed to avoid sections 84.1 and 212.1 generally focus on the object, spirit, and purpose of the scheme that is supported by these provisions and whether the avoidance transaction at issue abuses that scheme.

As discussed in greater detail below, the minister has generally sought to apply GAAR and subsection 84(2) simultaneously in situations where it is alleged that the taxpayer has engaged in impermissible surplus-stripping transactions.³⁶ Given that the jurisprudence addressing the application of subsection 84(2) in the context of surplus-stripping transactions has often considered that provision together with section 84.1 and GAAR, the analysis below will also consider these provisions collectively.

Surplus Stripping, Part One (1997-2005)

In 1997, the Tax Court of Canada issued judgments in two cases that concerned surplus strips. The first case, *McNichol et al. v. The Queen*,³⁷ involved the application of GAAR (in the alternative) to a transaction designed to avoid section 84.1; the second, *RMM Canadian Enterprises Inc. et al. v. The Queen*,³⁸ involved the application of GAAR to a transaction designed to avoid section 212.1. In both cases, the minister also sought to apply subsection 84(2) to deem the funds received to be a dividend.

In *McNichol*, four individual taxpayers were partners of a law firm that rented space from a building owned by their jointly owned holding company ("Bec"). The relationship between the partners had deteriorated such that the taxpayers had no

35 *Copthorne*, supra note 11, at paragraphs 92-96.

36 In *RMM Canadian Enterprises Inc. et al. v. The Queen*, 97 DTC 302, at 311 (TCC), the court noted, "If I am right in believing that sections 84 and 212 or, alternatively, section 212.1, by themselves result in taxing this surplus strip, recourse to section 245 is not only unnecessary but inappropriate." Accordingly, if the minister wishes to apply both subsection 84(2) (or section 84.1 or 212.1) and GAAR to a transaction, the minister should proceed with the assessment under subsection 84(2) as the primary assessing position and the assessment under GAAR as an alternative assessing position.

37 97 DTC 111 (TCC).

38 *RMM*, supra note 36.

further use for the building. Bec sold the building, its primary asset, for \$600,000 and distributed half the gains to the appellants by way of a capital dividend. The remaining assets of Bec, valued at approximately \$315,000, consisted almost exclusively of cash. Rather than distributing these remaining assets by way of a dividend, the taxpayers sought out a third-party purchaser to acquire all of the outstanding shares of Bec. The purchaser, Mr. Forestell, incorporated a wholly owned corporation, Beformac Holdings Limited (“Beformac”), which borrowed money from the Canadian Imperial Bank of Commerce (CIBC) against Bec’s assets to purchase the shares of Bec from the appellants for \$300,000. The taxpayers each claimed their respective lifetime capital gains exemptions on the sale. The transactions had the effect of transforming what would have otherwise been a taxable dividend on the windup of Bec into a tax-free capital gain.

The Tax Court rejected the minister’s arguments that (1) subsection 84(2) applied to the transaction on the ground that the cash received by the taxpayers on the sale was originally from CIBC and not from Bec, and (2) section 84.1 applied to the transaction on the basis that the taxpayers and Mr. Forestell dealt, and negotiated the transaction, at arm’s length. Instead, the court held that the transaction violated GAAR and, in particular, the anti-surplus-stripping scheme in the Act, which it described as a “legislative scheme to tax as income all distributions by a corporation to a shareholder.”³⁹ In rendering its decision, the court further stated that the repeal of former subsection 247(1), a provision intended to prevent surplus stripping, could not be regarded as a basis for the conclusion that “the legislature intended to relax the strictures against surplus stripping.”⁴⁰

In *RMM*, a non-resident corporation (“EC”) and a subsidiary of a publicly traded corporation (“IC”) held all of the outstanding shares of a Canadian-resident corporation (“EL”). EL held all of the outstanding shares of another Canadian corporation (“ECL”), whose combined assets consisted of \$3 million in cash, a \$1.5 million entitlement to an income tax refund, and a portfolio of equipment leases. As an alternative to winding up EL and ECL, and thereby triggering a deemed dividend under subsection 84(2) that would be subject to part XIII non-resident withholding tax, the general counsel of IC approached a business associate about acquiring EL. This business associate along with two other individuals formed a Canadian corporation (“RMM”) for the purpose of acquiring the shares of EL. RMM acquired the shares of EL for a purchase price approximately equal to the amount of cash and the refund entitlement. After the sale, EL was wound up into RMM, and ECL was amalgamated with RMM. The effect of the transactions was that EC realized a capital gain on the sale of the shares of EL, which was not subject to Canadian tax pursuant to the Canada-US tax treaty,⁴¹ rather than a dividend subject to withholding tax on what would have been a windup of EL and ECL.

39 *McNichol*, supra note 37, at 121.

40 *Ibid.*

41 *Infra* note 64.

The Tax Court held that (1) subsection 84(2) applied to the transactions to deem the funds received to be a dividend, stating that “I do not think that the brief detour of the funds through RMM stamps them with a different character from that which they had as funds of EL distributed or appropriated to or for the benefit of EC”; and (2) section 212.1 applied to the transaction on the basis that RMM was under the de facto control of EC.⁴² In the alternative, the court stated that GAAR would apply to deem the appropriate portion of the sale proceeds to be a dividend, and cited *McNichol* for the proposition that the Act contains an anti-surplus-stripping scheme.⁴³

Surplus Stripping, Part Two (2005-2011)

Following the Supreme Court’s decision in *Canada Trustco*, the lower courts began to reconsider their position that the Act contained an anti-surplus-stripping scheme and generally held that sections 84.1 and 212.1 should be given a narrow interpretation.

The first case rejecting the existence of an anti-surplus-stripping scheme was the 2005 decision of the Tax Court in *Evans v. The Queen*.⁴⁴ In *Evans*, the taxpayer owned a corporation (“117679”), which issued a stock dividend of non-voting shares to the taxpayer that were redeemable and retractable for an aggregate amount equal to \$487,000. The taxpayer transferred these shares to a partnership of which his wife was the general partner, and in which his children held a 99 percent limited partnership interest, in consideration for a \$487,000 interest-bearing promissory note. The taxpayer used his lifetime capital gains exemption to shelter the gain he realized in respect of the sale. Dividends were paid on the shares, and the shares were redeemed over a period of three years. These dividends and redemption proceeds were included in the income of the partners, on which they paid a nominal amount of tax. The amounts received by the partners were subsequently paid to the taxpayer in respect of the principal and interest owing on the note. In effect, the taxpayer converted a dividend payment from 117679 into a capital gain. The minister applied GAAR and recharacterized the proceeds received by the taxpayer pursuant to the transfer as a dividend.

The Tax Court reversed the minister’s reassessment. In respect of the application of GAAR, the court stated that there is no “overarching principle of Canadian tax law that requires that corporate distributions to shareholders must be taxed as dividends.”⁴⁵ The court also noted that the transactions did not lack economic

42 *RMM*, supra note 36, at 307 and 311.

43 *Ibid.*, at 313.

44 2005 TCC 684.

45 *Ibid.*, at paragraph 30.

substance in that there was “a genuine change in legal and economic relations [that] took place as the result of the transactions.”⁴⁶

In the following year, the Tax Court heard another surplus-stripping case, *Desmarais v. The Queen*.⁴⁷ In *Desmarais*, the taxpayer held 14.28 percent of the shares of a Canadian corporation (“Comerscom”), with a nominal ACB. The taxpayer incorporated a new wholly owned corporation (“6311”) and transferred 9.76 percent of the shares of Comerscom to 6311 with an elected amount of \$123,000. The taxpayer claimed his lifetime capital gains exemption in respect of the gain realized on the transfer. Section 84.1 did not apply to the transfer because 6311 did not hold more than 10 percent of the shares of Comerscom following the transfer, and therefore the two corporations were not “connected” within the meaning of that term in subsection 186(4). The taxpayer subsequently transferred shares that he held in another Canadian corporation (“Gestion”) to 6311 on a tax-deferred rollover basis, and 6311 issued a separate class of shares to the taxpayer, thereby avoiding the averaging of the PUC of those shares with the PUC of the shares received on the earlier transfer. Gestion paid a dividend to 6311, which 6311 used to finance the redemption of its high PUC shares held by the taxpayer. As a result of these transactions, \$123,000 was distributed to the taxpayer tax-free.

The Tax Court applied GAAR to deny the tax benefit achieved by the taxpayer as a result of the series of transactions. The court noted that, notwithstanding that 6311 and Comerscom were not connected after the transfer, the taxpayer indirectly retained more than 10 percent control of Comerscom and was therefore still able to exercise “substantial influence” over it following the transfer.⁴⁸ The decision in *Desmarais* supports the proposition that GAAR will be applied to ensure that section 84.1 is not avoided by circumventing the connected status test in subsection 186(4), notwithstanding technical compliance with the provision. In this case, the court did not reject the existence of an anti-surplus-stripping scheme in the Act and noted that the intention of section 84.1 is “to prevent stripping of the surpluses of an operating company.”⁴⁹ However, in light of *Evans* and the subsequent jurisprudence discussed below, the applicability of the *Desmarais* decision can be restricted to its facts where a taxpayer has achieved technical compliance with section 84.1 by avoiding the “connected” rules in subsection 186(4).

The proposition put forth in *Evans* that the Act does not contain an anti-surplus-stripping scheme was reiterated by the Tax Court in two further cases, *McMullen v. The Queen*⁵⁰ and *Collins & Aikman Products Co. v. The Queen*.⁵¹

46 Ibid., at paragraph 35.

47 2006 TCC 44.

48 Ibid., at paragraph 34.

49 Ibid., at paragraph 32.

50 2007 TCC 16.

51 2009 TCC 299; aff'd 2010 FCA 251.

In *McMullen*, the Tax Court declined to apply GAAR in the context of an arm's-length surplus-stripping transaction. Mr. McMullen and his business partner, Mr. DeBruyn, were equal shareholders in a company ("DEL"), which operated a heating and air conditioning business at a loss. The partners decided to sever their business relationship by separating the corporation's two existing branches and each taking ownership of one branch. In order to effect the transaction, Mr. DeBruyn's wife incorporated 1149530 Ontario Inc. ("114") and Mr. McMullen incorporated Haven Home Comfort Inc. ("HHCI"). Mr. McMullen then sold his shares of DEL to 114 for \$150,000, and claimed his lifetime capital gains exemption in respect of the gain realized on the sale. DEL obtained a loan and declared a dividend of \$150,000 to the benefit of 114, which was not taxable because of the application of subsection 112(1). DEL issued a promissory note in satisfaction of the \$150,000 dividend, and 114 then assigned the note to Mr. McMullen in satisfaction of the purchase price. Mr. McMullen subsequently transferred the note to HHCI, which acquired the Kingston branch of the corporation for FMV. DEL then used the proceeds to repay its loan.

The Tax Court held that section 84.1 did not apply since Mr. McMullen acted at arm's length with his business partner at the time that he sold his shares of DEL. The court further held that GAAR did not apply to recharacterize the transactions. In this respect, the court found that none of the transactions in the series was an avoidance transaction, since each transaction had been undertaken primarily for the bona fide non-tax purpose of terminating Mr. McMullen's business association with Mr. DeBruyn. Although this was sufficient to find in favour of the taxpayer, the court went on to deny the existence of an anti-surplus-stripping scheme in the Act. In doing so, it affirmed the holding in *Evans* that there is no "overarching principle of Canadian tax law that requires that corporate distributions to shareholders must be taxed as dividends."⁵² The court therefore held that the transactions were not abusive.

In *Collins & Aikman*, the taxpayer, a corporation resident in the United States ("Products"), transferred shares of its non-Canadian subsidiary ("CAHL") to a newly incorporated Canadian-resident subsidiary ("Holdings") in exchange for a single common share of Holdings with PUC equal to the FMV of CAHL. CAHL subsequently amalgamated with two other Canadian corporations. The amalgamated entity ("Amalco") was a resident of Canada. Amalco paid dividends to Holdings, which distributed these amounts as a return of capital to Products. As a result of the PUC of Holdings, Products was able to receive these distributions from Holdings free of part XIII withholding tax.

The Tax Court described the reorganization as "a clear example of when it would be inappropriate to regard transactions as abusive tax avoidance."⁵³ It rejected the

52 *McMullen*, supra note 50, at paragraph 53, quoting *Evans*, supra note 44, at paragraph 30.

53 *Collins & Aikman*, supra note 51 (TCC), at paragraph 104.

existence of an anti-surplus-stripping scheme in the Act, stating that although the early cases, including *McNichol* and *RMM*, suggested the existence of such a scheme, subsequent cases have held to the contrary, including the Tax Court's decision in *Coptborne*, where the court held that "reliance on a general policy against surplus stripping is inappropriate to establish abusive tax avoidance."⁵⁴ In a brief judgment, the Federal Court of Appeal affirmed the Tax Court's decision in *Collins & Aikman*. It added that it found nothing about the transactions to be abusive, since the scheme of the Act should not be interpreted to bar a foreign corporation (Products) from dealing as it wished with the shares of a non-resident (CAHL).⁵⁵ In this vein, the Federal Court of Appeal stated, "We see no reason to conclude that the limited scope of [sections 84.1 and 212.1] was anything other than a deliberate policy choice by Parliament."⁵⁶

The position of the lower courts that the Act does not contain an anti-surplus-stripping scheme was affirmed by the Supreme Court of Canada in its 2011 decision in *Coptborne*.⁵⁷ In *Coptborne*, the taxpayer undertook a series of transactions in which it reorganized a parent and a subsidiary corporation to become two sister corporations. The taxpayer then caused the sister corporations to be amalgamated, such that the PUC of the former subsidiary corporation was not eliminated on the amalgamation in accordance with subsection 87(3).

Although *Coptborne* did not involve the application of section 84.1 or 212.1, the Supreme Court commented on the scheme of these provisions. In this regard, the court held that the Act does not contain an anti-surplus-stripping scheme.⁵⁸ Rather, the court stated that the Act contains a PUC scheme. The court then proceeded to describe this PUC scheme and how various provisions, including sections 84.1 and 212.1, fit into the scheme. The court stated that the existence of PUC is a "recognition of the fact that the initial investment is made with tax-paid funds."⁵⁹ The court noted that sections 84.1 and 212.1 are provisions that grind PUC and that the purpose of these PUC grinds is to preserve the PUC scheme in the Act, which is inextricably tied to a corporation's stated capital account.⁶⁰ The court further noted that the PUC grinds enumerated in subsection 89(1) are intended "to prevent the preservation of PUC in instances where bare reliance on stated capital

54 Ibid., at paragraph 77, quoting *Coptborne Holdings Ltd. v. The Queen*, 2007 TCC 481, at paragraph 73, and also citing *McMullen*, supra note 50, at paragraph 56, where the court affirmed this proposition.

55 *Collins & Aikman*, supra note 51 (FCA), at paragraph 4.

56 Ibid. The transactions at issue in *Collins & Aikman* would now be subject to the FAD rules.

57 *Coptborne*, supra note 11.

58 See *ibid.*, at paragraph 118, where the court stated that "[w]hat is not permissible is basing a finding of abuse on some broad statement of policy, such as anti-surplus stripping."

59 Ibid., at paragraph 93.

60 Ibid., at paragraph 95.

would not achieve *Parliament's intended tax purpose of allowing only for a return of tax-paid investment without inclusion in income.*"⁶¹ However, the court also stated that the existence of any scheme in the Act, including the PUC scheme, must address the "provisions at issue" and cannot be in relation to "a general policy unrelated to the scheme under consideration," such as "anti-surplus stripping."⁶²

In sum, the Supreme Court's decision in *Copthorne* confirmed the jurisprudence that had been developing in the lower courts—namely, that the Act does not contain an anti-surplus-stripping scheme. The court's holding that the Act contains a PUC scheme represents an important development in the surplus-stripping jurisprudence, since the existence of such a scheme in the Act had not previously been posited.

Surplus Stripping, Part Three (2011-2020)

In the cases decided since *Copthorne*, the Tax Court and the Federal Court of Appeal have been particularly careful to accommodate the Supreme Court's confirmation that there is no anti-surplus-stripping scheme in the Act, while recognizing that there exists a PUC scheme. In this regard, although taxpayers will certainly welcome the Supreme Court's finding regarding the lack of an anti-surplus-stripping scheme in the Act, its finding that the Act contains a PUC scheme has resulted in several lower-court decisions since *Copthorne* that have been unfavourable for taxpayers. Moreover, as discussed in greater detail below, an expansive interpretation of subsection 84(2) by the Federal Court of Appeal has created considerable uncertainty for taxpayers who have undertaken some types of surplus-stripping transactions.

Soon after *Copthorne*, the courts again addressed the issue of surplus stripping in *MacDonald v. The Queen*.⁶³ In *MacDonald*, the taxpayer had planned to emigrate to the United States but faced a deemed disposition of the shares of his wholly owned corporation ("PC") on emigration pursuant to subsection 128.1(4). Although the taxpayer had unused capital losses available to offset the gain, he would not have been able to achieve a corresponding step-up in tax basis for US tax purposes.⁶⁴ To address this issue, the taxpayer transferred his PC shares to his brother-in-law ("JS") in exchange for a promissory note equal to the FMV of the shares. JS subsequently

61 Ibid., at paragraph 96 (emphasis added).

62 Ibid., at paragraph 118, citing the Supreme Court's decision in *Canada Trustco*, supra note 29, at paragraph 41.

63 2012 TCC 123; rev'd 2013 FCA 110.

64 Although article XIII(7) of the Canada-US tax treaty provides that an individual taxpayer emigrating from Canada is entitled to a step-up in tax basis for US tax purposes, this provision was not applicable for the years at issue in *MacDonald*. See the Convention Between Canada and the United States of America with Respect to Taxes on Income and on Capital, signed at Washington, DC on September 26, 1980, as amended by the protocols signed on June 14, 1983, March 28, 1984, March 17, 1995, July 29, 1997, and September 21, 2007 (herein referred to as "the Canada-US tax treaty").

transferred the shares to a holding corporation (“601”) in exchange for a promissory note. PC declared a dividend, and 601 used the funds to repay the note to JS, who in turn used the funds to repay the note to the taxpayer. PC was subsequently wound up.

The Tax Court found that neither subsection 84(2) nor GAAR applied. In this regard, the court held that

triggering capital gains to utilize capital losses is not discouraged by the *Act* in any way. Transfers to a corporation without a section 85 election can be used to realize capital gains as can transfers between spouses. There is nothing abusive about realizing capital gains for no other purpose than to utilize available net capital losses.⁶⁵

The court further held that

it is doubtful whether in an integrated corporate/shareholder tax system, a surplus strip *per se* can be said to abuse the spirit and object of the *Act* read as a whole.⁶⁶

The Federal Court of Appeal reversed the Tax Court’s decision and held that subsection 84(2) applied on the basis that the distribution occurred in the course of a windup. Accordingly, the court found it unnecessary to comment on the application of GAAR to the taxpayer’s transactions. The court found support for its finding in respect of subsection 84(2) in the broad wording of the provision, which applies where funds of a corporation are distributed or otherwise appropriated in “any manner whatever” on the windup, discontinuance, or reorganization of the corporation’s business. In this regard, the court cited *RMM* for the proposition that the phrase “in any manner whatever” constitutes “words of the widest import, and cover[s] a large variety of ways in which corporate funds can end up in a shareholder’s hands.”⁶⁷ The court further noted that subsection 84(2) applied in *MacDonald* since “each transaction . . . was entered into and completed in contemplation of each other [transaction],”⁶⁸ and the series of transactions resulted in the windup of PC. The Federal Court of Appeal’s liberal interpretation of subsection 84(2) arguably creates significant uncertainty for taxpayers undertaking surplus-stripping transactions in the course of a windup, discontinuance, or reorganization of a corporation’s business, if proper consideration is not given to avoidance of its application.

65 *MacDonald*, supra note 63 (TCC), at paragraph 116.

66 *Ibid.*, at paragraph 101.

67 *MacDonald*, supra note 63 (FCA), at paragraph 27, quoting *RMM*, supra note 36, at 308.

68 *MacDonald*, supra note 63 (FCA), at paragraph 28, quoting the trial decision, supra note 63 (TCC), at paragraph 109.

The Tax Court in *Gwartz v. The Queen*⁶⁹ similarly followed the Supreme Court's guidance in *Copthorne* that there is no anti-surplus-stripping scheme in the Act. In *Gwartz*, the taxpayer undertook a series of transactions to convert a taxable dividend into a capital gain, thereby avoiding the "kiddie tax" under section 120.4. The appellants were minors and beneficiaries of a family trust ("the trust"), which held common shares and class C preferred shares of a management corporation ("FHDM") that provided services to Dr. Gwartz's dental practice. In 2003 and 2005, FHDM declared two stock dividends, consisting of an aggregate total of 300,000 class D preferred shares. The class D preferred shares were redeemable at \$1 per share, and the cumulative PUC of the class was \$2. During the same period, the trust sold 225,000 of the class D preferred shares to Dr. Gwartz in consideration for promissory notes with an aggregate value equal to the FMV of the shares. Dr. Gwartz then sold the shares to an Ontario corporation ("206") that was wholly owned by Dr. Gwartz's spouse, in consideration for promissory notes with an aggregate value equal to the FMV of the shares. FHDM subsequently redeemed the class D preferred shares held by 206. Both sets of notes were repaid out of the redemption proceeds, such that the trust received proceeds equal to \$225,000. The trust reported a total capital gain of \$224,998.50 on the sale of the class D preferred shares to Dr. Gwartz, and 206 included in its income the deemed dividend it received on the redemption of the class D preferred shares, claiming an offsetting intercorporate dividend deduction under section 112. In effect, a taxable dividend, on which section 120.4 kiddie tax would have been payable if the dividend had been received by the minor beneficiaries of the trust, was converted into a capital gain in respect of which the kiddie tax was (at that time) not applicable.⁷⁰

The Tax Court held that although section 120.4 was circumvented, there was no abuse because there is no policy in the Act against income splitting. The court went on to cite the holding of the Tax Court in *Collins & Aikman* and the Supreme Court in *Copthorne* that there is no anti-surplus-stripping scheme inherent in the Act. Interestingly, the Tax Court noted that the minister "declined to pursue" the position that the taxpayers "contravened a policy in the [Act] against surplus stripping."⁷¹

Shortly after the decision in *Gwartz*, the Tax Court was again asked to address a surplus-stripping transaction, in *Descarries v. The Queen*.⁷² In *Descarries*, the taxpayers held all of the class A shares of a Canadian-resident company ("Oka"). The class A shares had an approximate FMV of \$615,000, an approximate ACB of

69 2013 TCC 86.

70 It is noteworthy that the enactment of subsection 120.4(4) subsequently prevented this type of planning by (1) deeming the amount of the taxable capital gain not to be a taxable capital gain to the minor and (2) deeming twice the amount that would otherwise have been a taxable capital gain to be a non-eligible dividend received by the minor.

71 *Gwartz*, supra note 69, at paragraphs 50-51.

72 2014 TCC 75.

\$360,000, and PUC of \$25,100. The taxpayers exchanged the class A shares for class B and class C shares of Oka pursuant to subsection 85(1), triggering a \$255,000 capital gain on the exchange. They then transferred the class B and class C shares to a holding company ("9149") in exchange for class A and class B shares of 9149 on a tax-deferred rollover basis. The 347,848 class A shares of 9149 had an ACB and PUC equal to the FMV of the shares (each \$1 per share); the class B shares had a high FMV and ACB (\$269,618) and PUC of nil, owing to a PUC grind under section 84.1 in respect of the embedded V-day value of the class B shares (value that had accrued in the Oka shares prior to 1972). Subsequently, 9149 redeemed all of the class A shares and approximately three-quarters of the class B shares. The redemption of the class A shares did not trigger a capital gain or deemed dividend, while the redemption of the class B shares resulted in a deemed dividend and a capital loss of \$196,506. The capital loss was used to partially offset a significant portion of the \$255,000 capital gain incurred on the original disposition of the class A Oka shares. The subsequent redemption of the remaining class B shares again resulted in a deemed dividend and the realization of a capital loss.

The Tax Court held that the transactions in *Descarries* resulted in an abuse by using soft ACB that accrued prior to 1972 to fund a tax-free distribution on the redemption of the class C shares of 9149. In particular, the court indicated that the capital loss resulting from the redemption of the class B shares, which related to the soft ACB accruing prior to 1972, should not be available to create hard ACB in the class C shares that could be distributed through a deemed dividend.

It must be noted that *Descarries* is an informal procedure case and therefore is not a binding precedent.

In *Univar Holdco Canada ULC v. Canada*,⁷³ the Federal Court of Appeal held that the taxpayer had implemented a reorganization in connection with an arm's-length transfer of property that was not subject to the application of section 212.1 or GAAR.

Univar unfolded as a result of an arm's-length acquisition by CVC Capital Properties ("CVC") of Univar NV, a Netherlands company that operated a global business in the purchase and resale of chemicals. CVC was particularly interested in an indirect Canadian subsidiary of Univar NV ("Univar Canada"), which had accumulated a significant surplus. Although the shares of Univar Canada had a high FMV and significant accumulated surplus (approximately \$890 million), the shares had relatively low PUC (approximately \$1 million). Following CVC's acquisition of Univar NV, the corporate structure was reorganized so that the surplus in Univar Canada could be extracted without realizing a gain or triggering a deemed dividend to CVC pursuant to section 212.1. This was achieved by implementing a sandwich structure in which Univar NV held the shares of a US subsidiary ("UHI"), which in turn held the shares of a Canadian subsidiary ("Canada Holdco"). Canada Holdco was capitalized such that its PUC was approximately \$210 million and it owed approximately \$590 million to UHI (as well as approximately \$730 million to Univar NV).

Canada Holdco further held the shares of a second US corporation (“Univar Inc.”), which in turn held the shares of Univar Canada.⁷⁴ Univar Inc. transferred the shares of Univar Canada to Canada Holdco in satisfaction of the redemption of certain of its shares by Canada Holdco. The Canada-US tax treaty applied to exempt the minimal capital gain arising on such a transfer from Canadian taxation. In addition to avoiding Canadian capital gains tax, the series of transactions fit within the ambit of subsection 212.1(4), such that a section 212.1 deemed dividend was also avoided. As the provision then read, subsection 212.1(4) prevented a deemed dividend or a PUC grind from arising under subsection 212.1(1) where a non-resident corporation transferred the shares of a subsidiary Canadian corporation to its Canadian parent corporation. The implementation of the structure whereby Univar Inc. was sandwiched between Canada Holdco and Univar Canada allowed the taxpayer to access this exception. As a result of the transactions, the amount of capital that could be returned without attracting part XIII withholding tax increased from approximately \$1 million to \$890 million.

The Tax Court held that the incorporation of a Canadian corporation (that is, Canada Holdco) for the sole purpose of satisfying subsection 212.1(4), and thus avoiding the application of subsection 212.1(1.1), was an avoidance transaction that constituted an abuse of the Act.⁷⁵ The Federal Court of Appeal overturned the Tax Court’s decision on the ground that the series of transactions flowed from an arm’s-length purchase of shares. In reaching its conclusion in this regard, the Federal Court of Appeal held that “the purpose of section 212.1 of the [Act] was not to prevent the removal from Canada, by an arm’s length purchaser of a Canadian corporation, of any surplus that such Canadian corporation had accumulated prior to the acquisition of control.”⁷⁶

As a result of the decision of the Federal Court of Appeal in *Univar*, subsection 212.1(4) has since been amended such that it does not apply if any shares of a Canadian parent corporation that is acquiring the shares of a Canadian subsidiary are held by a non-resident that does not deal at arm’s length with the Canadian parent (that is, where the Canadian parent is itself a subsidiary of a non-resident).

In 2016, the Tax Court applied section 84.1 to a series of transactions in *Poulin v. The Queen*.⁷⁷ In *Poulin*, two individuals, Mr. Poulin and Mr. Turgeon, were equal shareholders of a company (“Amiante”). A reorganization was undertaken for the purpose of implementing Mr. Poulin’s gradual departure from Amiante. Mr. Turgeon

74 The structure was implemented by the transfer of most of Univar NV’s shares in Univar Inc. to UHI in exchange for shares of UHI, followed by the transfer by UHI of the Univar Inc. shares to Canada Holdco in exchange for common shares and a promissory note. Canada Holdco concurrently acquired the remaining shares of Univar Inc. directly from Univar NV for a promissory note.

75 2016 TCC 159.

76 *Univar*, supra note 73, at paragraph 21.

77 2016 TCC 154; aff’d 2017 FCA 103 (sub nom. *Turgeon v. Canada*).

incorporated a wholly owned subsidiary (“Gestion Turgeon”). In 2007, Mr. Poulin sold 450,004 class F shares of Amiante to Gestion Turgeon for \$1 per share, satisfied by \$45,000 payable to Mr. Poulin and a promissory note in the amount of \$405,004, bearing interest at 5 percent per annum and payable in five consecutive annual payments of the greater of \$81,000.80 and 90 percent of the sums received by Gestion Turgeon from Amiante. There was an agreement by Amiante to pay its shareholders at least 80 percent of its annual net profits, in the form of dividends or in some other form. The repayment of the note was funded by the redemption by Amiante of the class F shares held by Gestion Turgeon. In 2012, Mr. Poulin sold his remaining interest in Amiante to Gestion Turgeon for \$1,370,000. Also in 2007, Mr. Hélie, who had been working as the controller of Amiante since 2004, incorporated a wholly owned subsidiary (“Gestion Hélie”). Mr. Turgeon sold 388,861 class D shares of Amiante to Gestion Hélie for \$1 per share, satisfied by the issuance of a promissory note in the amount of \$388,861, bearing interest at 4 percent and payable on the basis of the cash flows generated by Amiante (which, as noted, had agreed to pay its shareholders at least 80 percent of its annual net profits in the form of dividends or otherwise). Gestion Hélie committed to paying 90 percent of the sums received from Amiante to Mr. Turgeon. Amiante redeemed most of the class D shares held by Gestion Hélie over a five-year period, and those funds were used to repay the amount owing to Mr. Turgeon. The remaining class D shares held by Gestion Hélie and not redeemed by Amiante were transferred to the parent company of Amiante (“GPI”); it is unclear whether these class D shares were transferred for consideration. Mr. Poulin and Mr. Turgeon each claimed the capital gains deduction under subsection 110.6(2.1) on the sale of their class F shares and class D shares, respectively. The minister reassessed Mr. Poulin and Mr. Turgeon under section 84.1 in respect of the sale of shares in Amiante by Mr. Poulin to Gestion Turgeon and by Mr. Turgeon to Gestion Hélie.

The Tax Court held that section 84.1 did not apply to the sale by Mr. Poulin to Gestion Turgeon on the basis that Mr. Poulin dealt at arm’s length with Gestion Turgeon. In its reasoning, the court noted that Mr. Poulin and Mr. Turgeon came to a sale agreement that was intended to facilitate the departure of Mr. Poulin from Amiante, and was arrived at following “arduous negotiations.”⁷⁸ The court further noted that each of Mr. Poulin and Mr. Turgeon “called upon several independent professionals to better represent their respective interests.”⁷⁹ However, the court found that Mr. Turgeon and Gestion Hélie were acting in concert and *de facto* dealing not at arm’s length on the basis that (1) “[t]he purpose of that sale was to help Mr. Turgeon claim his capital gains deduction”; (2) “no period was stipulated to repay the promissory note that Gestion Hélie issued to Mr. Turgeon”; (3) as of the hearing date, nine years after the transaction, a balance still remained payable on the promissory note from Gestion Hélie to Mr. Turgeon; and (4) for Mr. Hélie,

78 *Poulin*, supra note 77 (TCC), at paragraph 69.

79 *Ibid.*

there were no risks involved in participating in the transaction, since Gestion Hlie could force Amiante to redeem the class D shares held by it.⁸⁰

In *Perry Wild v. The Queen*,⁸¹ the taxpayer, Mr. Wild, made use of the PUC averaging mechanism in the Act to offset a PUC grind that had occurred pursuant to section 84.1. The PUC averaging rules provide, in general terms, that PUC is calculated on a class-by-class, rather than a share-by-share, basis. To access the use of this mechanism, Mr. Wild stepped up the ACB of his common shares in a wholly owned small business corporation (“PWR”) by transferring a portion of his PWR common shares to two new Holdcos, which were wholly owned by him and his wife, respectively, in exchange for preferred shares of each of the Holdcos. To effect the transfer, Mr. Wild elected under subsection 85(1) at an amount resulting in the realization of a capital gain, which he eliminated through the use of his lifetime capital gains exemption. Consequently, section 84.1 applied to grind the PUC of the preferred shares of the two Holdcos down to a nominal amount. PWR then transferred assets with a high cost base to each of the Holdcos for additional preferred shares of the same class as those that were issued to Mr. Wild. As a result of the PUC averaging rule in subsection 89(1), the PUC of Mr. Wild’s preferred shares was increased and the PUC of PWR’s shares was effectively decreased. The cross-shareholdings between PWR and the Holdcos were subsequently eliminated.

The Tax Court held that the transactions violated GAAR and abused both section 84.1 and subsection 89(1). In particular, the court found that the transactions abused section 84.1 by allowing Mr. Wild to withdraw PWR’s earnings tax-free in excess of the capital he had invested in the company, thereby violating the PUC scheme in the Act. The court stated that the “object, spirit and purpose” of section 84.1

is to prevent the removal of taxable corporate surplus as a tax-free return of capital through the use of the capital gains exemption (or tax-exempt margin), where there is a non-arm’s length transfer of shares by an individual resident in Canada from one corporation to another and PUC in excess of the amount invested cannot be withdrawn tax free.⁸²

The Federal Court of Appeal reversed the Tax Court’s decision. While the Federal Court of Appeal agreed with the lower court that Mr. Wild had increased the PUC of his Holdco shares, it noted that the surpluses of the Holdcos and PWR had not in fact been extracted by Mr. Wild tax-free, since PWR had not distributed its

80 Ibid., at paragraphs 86 and 96. The analysis in *Poulin* primarily involved the determination of factual non-arm’s-length relationships, and did not involve GAAR, nor did the Tax Court undertake a detailed discussion of the object, spirit, and purpose of section 84.1. For a discussion of factual non-arm’s-length relationships, see Sandra Mah and Mark Meredith, “Factual Non-Arm’s-Length Relationships,” in *Report of Proceedings of the Sixty-Sixth Tax Conference*, 2014 Conference Report (Toronto: Canadian Tax Foundation, 2015), 16:1-24.

81 Sub nom. 1245989 *Alberta Ltd. v. The Queen*, 2017 TCC 51; rev’d 2018 FCA 114.

82 1245989 *Alberta*, supra note 81 (TCC), at paragraph 68.

retained earnings to either of the Holdcos. In this regard, the court noted the decision of Rothstein J in *OSFC Holdings Ltd. v. Canada*⁸³ that the pre-packaging of assets with beneficial tax attributes does not result in a tax benefit until such attributes are ultimately realized by the taxpayer. Therefore, the court held that the transactions had not resulted in a tax benefit. However, this may ultimately be a hollow victory for Mr. Wild, since the CRA will surely be lying in wait and will be prepared to apply GAAR if he attempts to use his increased PUC in the Holdco shares to realize the tax benefit that the transactions sought to achieve.

In *Pomerleau v. The Queen*,⁸⁴ the taxpayer sought to extract funds from a family-held corporation in order to build a chalet, in the context of an intergenerational transfer of the business. The taxpayer held, among other investments, class A shares and class G shares of his holding company (“P Pom”). The class A shares had hard ACB of approximately \$1 million (representing an amount on which tax was paid), a high FMV (approximately \$22 million), and nominal PUC. The class G shares had an FMV of approximately \$1 million, soft ACB of approximately \$1 million (in respect of which the lifetime capital gains exemption was claimed), and nominal PUC. P Pom redeemed all of the class G shares, triggering a deemed dividend of approximately \$1 million pursuant to subsection 84(3) and a capital loss in the same amount. The capital loss was denied under subsection 40(3.6) and added to the ACB of the class A shares pursuant to paragraph 53(1)(f.2). This transformed the previously soft ACB in the class G shares into hard ACB in the class A shares for the purposes of section 84.1, since the ACB was created under paragraph 53(1)(f.2) as a result of the capital loss on the share redemption, rather than as a result of a capital gain in respect of which the lifetime capital gains exemption had been claimed. The taxpayer then transferred the class A shares of P Pom to another Holdco (“Gestion”) in consideration for class A and class C shares of Gestion. The PUC of the class C shares was set at approximately \$2 million, representing the hard ACB of the class A shares of P Pom. The class C shares of Gestion were then redeemed without any adverse tax consequences, because the PUC and the ACB of the shares were equal to the proceeds received on redemption. In effect, the taxpayer was able to extract \$2 million of corporate surpluses while paying dividend tax rates on \$1 million and not paying tax on the other \$1 million.

The Tax Court applied GAAR to the series of transactions, and this decision was upheld by the Federal Court of Appeal. The Tax Court held that the transformation of “what was once a ‘soft’ adjusted cost base into a ‘hard’ adjusted cost base” violated the object, spirit, and purpose of section 84.1.⁸⁵ The Federal Court of Appeal defined the object, spirit, and purpose of section 84.1 even more broadly, stating that “[t]he purpose of section 84.1 is to prevent amounts which have not been subject to

83 2001 FCA 260.

84 2016 TCC 228; aff’d 2018 FCA 129.

85 *Pomerleau*, supra note 84 (TCC), at paragraph 81 (emphasis in original).

tax from being used in order to allow shareholders to withdraw corporate surpluses on a tax-free basis.”⁸⁶ Although the Federal Court of Appeal’s conception of the object, spirit, and purpose of section 84.1 was quite broad, the decision in *Pomerleau* is best understood as preventing a taxpayer from circumventing the application of section 84.1 by converting soft ACB directly or indirectly into hard ACB.

Subsection 84(2): Windups, Discontinuances, and Reorganizations

In addition to decisions on the application of GAAR, jurisprudence relating to subsection 84(2) has created uncertainty for taxpayers. In particular, as a result of the liberal interpretation of the phrase “in any manner whatever” adopted by the Tax Court in *RMM* and subsequently by the Federal Court of Appeal in *MacDonald*, the minister may seek to apply this provision to any extraction of funds from a corporation, whether received directly or indirectly, on the “winding-up, discontinuance or reorganization” of its business.⁸⁷ According to the Supreme Court of Canada in *Smythe et al. v. Minister of National Revenue*, a formal liquidation or windup of a corporation is not necessary in order for the corporation to be considered to have wound up or discontinued its business.⁸⁸ Regarding whether there is a “reorganization”

86 *Pomerleau*, supra note 84 (FCA), at paragraph 64.

87 In a much earlier case involving the application of a prior version of subsection 84(2), the Federal Court Trial Division similarly adopted a broad interpretation of the provision. In *David v. The Queen*, 75 DTC 5136 (FCTD), the taxpayers were shareholders of a corporation that had disposed of its principal business assets. The corporation did not distribute the proceeds directly to the shareholders; instead, the shareholders sold their shares to the corporation’s pension plan several months later. As a result, the shareholders incurred a capital gain on the sale, rather than the deemed dividend that would have been triggered if the proceeds from the disposition had been distributed. The court held that the transaction fell within the ambit of former subsection 84(2), stating that “if any meaning is to be given to the word ‘on’ it must at the very least mean at the ‘same time as’ or possibly ‘as a result of’ or ‘consequential to’” (ibid., at 5418). The court then went on to find that even though it was “not at the time of or ‘on’ the discontinuance of the commercial operations of the company in August that the funds were appropriated for the benefit of the David group but only five months later,” it nonetheless was “evident that the Dunn group planned to wind-up not only the commercial but all business of the company immediately after they took over,” such that “the winding-up appears to have been part of the plan” (ibid.).

88 [1969] SCR 64. The Supreme Court of Canada stated, ibid., at 70, “There was a winding-up and a discontinuance of the business of the old company, although it is apparent that there was no formal liquidation under the *Winding-Up Act* or the winding-up provisions of the *Ontario Companies Act*.” See also *Gilmour v. The Queen*, 81 DTC 5322 (FCTD), in which a holding corporation (“Trident”) sold the shares of one of its subsidiaries and distributed the proceeds to its shareholder, in anticipation of the liquidation and winding up of Trident. The Federal Court held, ibid., at 5324, that there was “a winding up, discontinuance or reorganization” of the business, notwithstanding the taxpayers’ contention that Trident made certain warranties on the sale of its subsidiary that may have required the shareholders to return the money to Trident and that the amounts paid were therefore only an “advance” to the shareholders.

of a business, in *Kennedy v. MNR*,⁸⁹ the Federal Court Trial Division stated that a reorganization involving the transfer of corporate assets will not necessarily constitute a “reorganization” for the purposes of subsection 84(2), so long as the corporation continues to carry on the same business. The court went on to state that “the word ‘reorganization’ presupposes the conclusion of the conduct of the business in one form and its continuance in a different form.”⁹⁰ Similarly, in *Geransky v. The Queen*,⁹¹ the Tax Court held that a series of steps undertaken by the taxpayer resulting in the transfer of the assets of one part of the business operated by a corporation to a second corporation did not constitute a “reorganization” for the purposes of subsection 84(2).⁹² Bowman J observed that, although “[s]ubsection 84(2) is a reasonably broad section . . . I do not think one can contort it beyond all recognition.”⁹³

Notwithstanding recent decisions adopting a broad interpretation of subsection 84(2), it should be possible in certain circumstances to avoid its application. The Federal Court of Appeal differentiated its decision in *MacDonald* from the decision of the Tax Court in *McNichol*, stating that in *McNichol* “the financing of the share purchase came from the bank, and Bec’s assets remained deposited in its bank account for some time after the amalgamation,”⁹⁴ whereas in *MacDonald* the corporation’s funds were used to repay the shareholder. Consequently, subsection 84(2)

89 72 DTC 6357 (FCTD); aff’d 73 DTC 5359 (FCA). In this case, the taxpayer was the sole shareholder of a corporation that purchased a property for use in its car dealer business. The corporation subsequently sold the property to the taxpayer, who subsequently leased it back to the corporation for use in its business. The Tax Court held that there was no reorganization, because the same corporation continued the same business in the same manner and form, and a sale of the capital asset was not sufficient to constitute a “reorganization” under subsection 84(2): supra (TCC), at paragraphs 47-49.

90 *Kennedy*, supra note 89 (FCTD), at 6362.

91 2001 DTC 243 (TCC).

92 Ibid., at paragraphs 20-21. In *Geransky*, the taxpayers (two shareholders) held shares in a holding company (“GH”) that held shares of an operating company (“GBC”), which carried on a concrete construction business. The taxpayers agreed to sell the cement manufacturing division to an arm’s-length party. Prior to the sale, the taxpayers undertook a series of steps to realize their respective capital gains exemptions. Both taxpayers crystallized their capital gains exemptions by transferring a portion of their GH shares to a newly incorporated company (“Newco”) in consideration for shares of Newco having a value of \$500,000. GBC paid a dividend in kind to GH, which was satisfied by the transfer of the cement plant assets (with an FMV of \$1 million). GH redeemed the GH shares held by Newco and satisfied the redemption by transferring the cement plant assets to Newco. Newco was subsequently sold to the third-party purchaser. The Tax Court held, *ibid.*, at paragraph 21, that “[t]here was no discontinuance, wind-up or reorganization of any company’s business [as] [b]oth GH and GBC continue to this day to do what they have always done,” and that in any case the taxpayer was a shareholder of GH, whose “business . . . is the holding of shares of GBC,” and was not a shareholder of GBC itself.

93 Ibid., at paragraph 20.

94 *MacDonald*, supra note 63 (FCA), at paragraph 25.

may not apply where third-party funds, rather than corporate-generated surplus, are used to fund the distribution by the corporation and the corporate surplus remains in the corporation for some time.⁹⁵

As well, subsection 84(2) should not apply where the surplus-stripping transaction involves a company that is carrying on business as a going concern and is not performed in contemplation of a “winding-up, discontinuance or reorganization” of the corporation’s business. In this regard, the Federal Court of Appeal in *Perrault v. The Queen* held that a dividend was not paid on the “winding-up, discontinuance or reorganization” of a company’s business because, following the payment, the company “continued to carry on business at [one of its plants], albeit on a reduced scale” for over a year.⁹⁶ In contrast, in *David v. The Queen*, the Federal Court Trial Division held that a distribution occurred on the discontinuance of the company’s commercial operations, even though the funds were appropriated four months after the sale of the company’s principal business assets, since “the winding-up appears to have been part of the plan.”⁹⁷ Similarly, in *Descarries*, the Tax Court held that subsection 84(2) did not apply on the basis that the business continued to operate for a significant period of time (one year and nine months) after the first share redemption occurred.⁹⁸

The Current Position of the CRA

Despite the jurisprudence to the contrary, including the Supreme Court’s judgment in *Coptborne*, the CRA maintains the position, and its desire to demonstrate, that there is an anti-surplus-stripping scheme in the Act. Specifically, the CRA is hoping to have the opportunity to argue its position that there is a specific scheme in the Act to tax any distribution or allocation of surplus (after-tax income) of a Canadian corporation as dividends in the hands of its shareholders who are individuals.⁹⁹ The CRA has similarly stated that the purpose of section 84.1, along with a number of other provisions in the Act, “is to prevent individual shareholders from indirectly accessing the surplus of a corporation otherwise than as a dividend.”¹⁰⁰ The CRA has further noted that, notwithstanding the decisions in *Gwartz*, *Collins & Aikman*, and

95 In *RMM*, supra note 36, at 308, notwithstanding that RMM used a bank loan to fund the purchase of the shares of EL, the Tax Court held that subsection 84(2) applied on the basis that RMM was “an instrumentality used to effect the distribution of property to the shareholder.” In analyzing the decision in *RMM*, the Federal Court of Appeal in *MacDonald* specifically noted that while in *RMM* the corporate surplus was used to repay the bank loan within three days of the acquisition, in *McNichol* it was used to repay the bank loan two weeks later: *MacDonald*, supra note 63 (FCA), at paragraphs 25-26.

96 *Perrault v. The Queen*, 78 DTC 6272, at 6277 (FCA).

97 *David*, supra note 87, at 5148.

98 *Descarries*, supra note 72, at paragraphs 29-34.

99 See CRA document no. 2012-0433261E5, June 18, 2013.

100 CRA document no. 2014-0538091C6, October 10, 2014.

Coptborne, it “does not believe that it has had the opportunity to fully state its case regarding surplus stripping.”¹⁰¹

In our view, there are important differences between the PUC scheme delineated in *Coptborne* and the anti-surplus-stripping scheme described above by the CRA. While the Supreme Court in *Coptborne* stated that the PUC scheme in the Act was intended to prevent “a return of tax-paid investment without inclusion in income,”¹⁰² the court did not specify the required character of the income inclusion; that is, it did not state that the income should be characterized as a dividend in certain circumstances and as a capital gain in others. Rather, it could be inferred that, in stating that there is no anti-surplus-stripping scheme in the Act, the court believed that the characterization of the income inclusion does not matter so long as the transactions do not result in the creation or preservation of PUC where the provisions of the Act clearly did not intend such a result. In contrast, the necessity to characterize the extraction of all corporate surplus as dividend income, regardless of the legal substance of the transaction that gives rise to such extraction, is central to the CRA’s characterization of its anti-surplus-stripping scheme. Furthermore, the insistence by the CRA that it has not “had the opportunity to fully state its case regarding surplus stripping” is perhaps a recognition on the part of the CRA that the PUC scheme delineated by the Supreme Court in *Coptborne* differs to some degree from the anti-surplus-stripping scheme for which it advocates.

Unsurprisingly, the CRA has also adopted a broad interpretation of the cases in which the courts have found in its favour. Of particular note is the Federal Court of Appeal’s decision in *MacDonald*. The CRA has stated that it will “maintain its position of applying the GAAR and/or subsection 84(2) to cases like *The Queen v. Macdonald* where a taxpayer uses losses or other tax shelter to reduce a capital gain realized as part of a surplus stripping scheme.”¹⁰³ It is not surprising that the CRA has given this overly broad interpretation to *MacDonald*. However, its position is particularly odd since the Federal Court of Appeal did not opine on GAAR in the *MacDonald* decision, and it concluded that subsection 84(2) applied because the business of the operating company was wound up.

It is worth noting that the CRA has been willing not to apply subsection 84(2) to post mortem pipeline transactions.¹⁰⁴ Generally, such transactions involve the transfer of shares of an Opco (the cost of which is stepped up on the death of the deceased

101 “26 November 2013 Annual CTF Roundtable,” at question 13, under the heading “Notes from Presentation,” *Tax Interpretations* (<https://taxinterpretations.com>).

102 *Coptborne*, supra note 11, at paragraph 96.

103 CRA document no. 2015-0610701C6, November 24, 2015.

104 Numerous articles have considered the treatment of such transactions. Some of the more recent articles include S. Dane ZoBell and Stephen A. Miazga, “Succession and Post-Mortem Planning,” in *2018 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2018), 5:1-24; Erin Podio and David Stevens, “Update on Post-Mortem Planning,” in *2018 Ontario*

under subsection 70(5)) to a Holdco in exchange for a promissory note or “high/high” shares, followed by the amalgamation or windup of Opco into Holdco. An election may be made separately to bump the basis of Opco’s capital property to the extent permissible under paragraph 88(1)(d). The CRA has stated that it is its administrative position that such a transaction will be considered permissible so long as (1) the corporation remains a separate and distinct entity for at least one year; (2) during that period, the corporation continues to carry on its business in the same manner as before; and (3) thereafter, the note is repaid, or the PUC of the shares is reduced, on a progressive basis.¹⁰⁵ Although the Tax Court in *MacDonald* indicated that this timeline was “arbitrary,”¹⁰⁶ it appears to be consistent with the decision of the Federal Court of Appeal in *Perrault*. Nonetheless, if the CRA takes the position that there is no windup, discontinuance, or reorganization so long as the taxpayer waits at least one year between the transfer and the liquidation, on principled grounds it would be inconsistent to permit post mortem pipeline transactions while prohibiting transactions similar to the one undertaken in *MacDonald*, provided that the taxpayer waited one year before winding up the business.

KEY TAKEAWAYS FROM THE SURPLUS-STRIPPING JURISPRUDENCE

There are several themes that emerge from the foregoing jurisprudence to determine whether a transaction or a series of transactions violates the PUC scheme identified by the Supreme Court of Canada in *Copthorne*.

First, in accordance with the decisions of the Tax Court and the Federal Court of Appeal in *Wild*, non-arm’s-length transactions that use the PUC averaging rules in subsection 89(1) to shift PUC within a particular class of shares to shares held by an individual taxpayer from shares held by other shareholders that are indifferent to reductions in their share of the PUC of the class (such as a corporation that is wholly owned by the taxpayer) may be considered an abuse of the Act.

Second, in accordance with the decision in *Pomerleau*, transactions that convert soft ACB into hard ACB to increase the PUC of a class of shares may contravene the PUC scheme.

Tax Conference (Toronto: Canadian Tax Foundation, 2018), 7:1-38; David Stevens, “Passage of Shares of a Private Corporation on Death,” in *Taxation of Private Corporations and Their Shareholders*, 5th ed. (Toronto: Canadian Tax Foundation, 2020), 19:1-68; and Gwen Benjamin and Robert Martini, “Post Mortem Planning: Selected Issues and Planning Tips,” in *2011 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2011), 5:1-28.

105 See, for example, CRA document no. 2011-0401861C6, June 2, 2011.

106 *MacDonald*, supra note 63 (TCC), at paragraph 80. The court pointed out, *ibid.*, at paragraph 79, that the CRA’s position regarding the “post-mortem plan clearly parallels the Appellant’s tax plan in the case at bar,” and that “[t]he conditions imposed on the post-mortem transactions, if imposed in the case at bar, would show that the CRA’s assessing practice was consistent in trying to apply subsection 84(2).”

Third, a court will likely apply GAAR to transactions undertaken to sidestep the “connected” rules in subsection 186(4) with the aim of circumventing section 84.1, as was attempted by the taxpayer in *Desmarais*.

Fourth, it is noteworthy that the courts have generally refrained from applying GAAR to surplus-stripping transactions where those transactions involved arm’s-length transfers.¹⁰⁷ In *McMullen*, the taxpayer and his business associate were severing their business relationship and therefore had differing interests that caused them to be acting at arm’s length. In refusing to apply GAAR, the court found that none of the transactions in the series was an avoidance transaction because each transaction was undertaken for the bona fide non-tax purpose of separating the business. Furthermore, in *Univar*, the Federal Court of Appeal held that the series of transactions resulting in the avoidance of section 212.1 did not violate GAAR since the series of transactions flowed from an arm’s-length purchase of shares, a context in which section 212.1 did not apply. In contrast, the courts have been less sympathetic where the context of the transactions involved a transfer to a non-arm’s-length person. For example, in *Pomerleau*, the taxpayer argued that the overall purpose of the transactions was to effect an intergenerational transfer of the business. Although this case was decided on different grounds—namely, that the taxpayer attempted to convert soft ACB into hard ACB—the Federal Court of Appeal noted in obiter that section 84.1 does not reveal an intent that its application may be bypassed in the case of intergenerational transfers of family businesses, which fall within the category of non-arm’s-length transfers.¹⁰⁸ It is noted that *McNichol*

107 See, for example, *Brouillette v. The Queen*, 2005 TCC 203, at paragraph 55. In *Brouillette*, Mr. Brouillette and Mr. Ferland each owned 50 percent of the issued and outstanding shares of a Canadian-resident corporation (“Brouillette Automobiles”). Mr. Ferland and Mr. Brouillette sought to sever their business relationship and agreed that Mr. Brouillette would acquire Mr. Ferland’s shares. The bank refused to lend the cash to Brouillette Automobiles to fund the acquisition. In light of the bank’s refusal, Mr. Brouillette sought to bring two new shareholders into the business (Mr. Chagnon and Mr. Brunet) to replace Mr. Ferland. Mr. Brouillette incorporated a Canadian-resident corporation (“9016”) and subscribed for class A and class C shares, which represented 51 percent of the voting shares of 9016. Mr. Chagnon and Mr. Brunet were equal shareholders in another Canadian-resident corporation (“9017”), which held class A and class G shares of 9016. The National Bank of Canada loaned \$490,000 to Brouillette Automobiles, of which \$75,000 was paid to Mr. Ferland as a retiring allowance and \$400,000 was loaned to 9016 to partially fund the purchase of the shares of Brouillette Automobiles held by Mr. Ferland. On the same day, Mr. Brouillette transferred his shares in Brouillette Automobiles to 9016 in consideration for 500,000 non-voting class E shares, on a tax-deferred basis, after which 9016 became the sole shareholder of Brouillette Automobiles. Following disagreements related to the operation of the business with Mr. Brouillette, Mr. Chagnon and Mr. Brunet agreed to cause 9017 to acquire Mr. Brouillette’s class E shares in 9016 in exchange for a non-interest-bearing promissory note that was to be paid off over a period of five years (although the note was actually paid off in two years). The Tax Court held that neither section 84.1 nor GAAR should apply to the sale to 9017 of the class E shares of 9016 held by Mr. Brouillette, on the basis that the parties dealt at arm’s length.

108 *Pomerleau*, supra note 84 (FCA), at paragraph 80.

involved an arm's-length transfer, the terms of which were subject to significant negotiation, yet the Tax Court applied GAAR to deny the benefit received by the appellants. In light of the evolution of the jurisprudence, and the subsequent GAAR test set out by the Supreme Court, *McNichol* is arguably no longer an accurate representation of the law in this respect.¹⁰⁹

CONCLUSION: THE PERMISSIBILITY OF SURPLUS STRIPPING

For a short time, when amendments to section 84.1 and the addition of section 246.1 were proposed, there was the possibility that permissible surplus stripping was going to be legislatively curtailed, resulting in some collateral damage to other commercial transactions. However, with the subsequent withdrawal of those proposals, the jurisprudence over the past 20 years, summarized above, continues to be highly relevant in determining the framework for permitted surplus-stripping transactions.

Although the courts have sought to apply the PUC scheme to transactions involving surplus stripping, there are clear boundaries to its application. Where tax is paid at capital gains rates and the transactions fall outside the bright-line tests delineated in section 84.1, section 212.1, and subsection 84(2), the courts should not find that the transaction or series of transactions violates the PUC scheme and therefore GAAR. For instance, the three examples described below should continue to fit within these guidelines.

Example 1

An individual, Mr. A, exchanges some of the common shares he holds in his operating company, A Co, for preferred shares and triggers a gain on the transfer by electing under subsection 85(1). Mr. A pays capital gains tax in respect of the gain on the transfer. He subsequently transfers the preferred shares to a holding company, B Co, in exchange for a promissory note. A Co redeems the preferred shares and B Co repays the principal of the note. At all times, A Co continues to carry on its business.

Example 2

An individual, Mr. X, transfers some of the common shares he holds in his operating company, X Co, to his uncle, Mr. Y, in exchange for a promissory note equal to the FMV of the transferred shares. Mr. X pays capital gains tax in respect of the gain on the transfer. Mr. Y subsequently transfers the common shares of X Co to his holding company, Y Co, in exchange for a promissory note. X Co then redeems the common shares held by Y Co; Y Co uses the funds received from X Co to repay the promissory note owing to Mr. Y; and Mr. Y repays the promissory note owing to Mr. X. At all times, X Co continues to carry on its business.

¹⁰⁹ See, for example, *Collins & Aikman*, supra note 51 (TCC), at paragraphs 74-78, where the court noted that *McNichol* was no longer an accurate description of the law.

Example 3

An individual, Ms. R, owns all of the issued and outstanding common shares of R Co, which holds capital assets with unrealized gains. R Co forms a new corporation, S Co, and transfers the capital assets with unrealized gains to S Co in exchange for common shares of S Co. A capital gain is realized on the transfer of the assets. The assets are subsequently leased back to R Co. R Co pays a dividend to Ms. R equal to the capital dividend account (CDA) balance in R Co.

In example 1, Mr. A pays tax in respect of each share on the exchange of his common shares for preferred shares of A Co, albeit at a capital gains rate rather than a dividend rate. As a result, hard ACB is legitimately created on the preferred shares for the purposes of section 84.1. Therefore, when Mr. A transfers the preferred shares to B Co in consideration for the note, no deemed dividend should result under section 84.1. In a 2006 ruling, the CRA opined on a substantively identical transaction, stating that it would seek to apply GAAR because the transaction constituted “a mechanism for the stripping of surplus of [the] corporation.”¹¹⁰ However, the proposition that a transaction such as the one described above would violate GAAR would disregard the Supreme Court’s pronouncement in *Cophthorne* that there is no anti-surplus-stripping scheme in the Act.

The facts in example 2 are almost identical to the facts in *MacDonald*. Similar to example 1, in example 2 Mr. X pays tax in respect of each share that subsequently contributes to the PUC bump on the transfer by Mr. Y to his holding company, again at a capital gains rate rather than a dividend rate. Moreover, notwithstanding the courts’ willingness to apply GAAR in certain non-arm’s-length situations,¹¹¹ because the same result could be achieved by other means (namely, the transactions set out in example 1), there is a strong argument that GAAR should not apply in the circumstances described in example 2.

In example 3, as a result of the transfer and capital gain consequently realized, R Co will be required to pay capital gains tax on the sale of the assets. The disposition should cause an increase in R Co’s CDA balance, and R Co should be able to distribute funds to Ms. R to the extent of such balance. In this scenario, there is no concern regarding the application of section 84.1 since the transferor is a corporation, not an individual, and the objective is to create additional CDA balance, not PUC. GAAR should also not apply since the CDA balance is increased as a result of a disposition in respect of which tax has been paid. It is noteworthy that the CRA has stated that it will not seek to apply GAAR to transactions where there is a deliberate triggering of a capital gain in order to distribute a capital dividend to shareholders.¹¹²

110 CRA document no. 2004-0099201R3, April 26, 2006.

111 Although uncles and nephews are not “related” persons as that term is defined in section 251, in this situation it is presumed that they are considered to be dealing not at arm’s length as a question of fact, pursuant to paragraph 251(1)(c).

112 See Suzanne Saydeh’s remarks in “How the Government Has Dealt with the GAAR,” presentation at The General Anti-Avoidance Rule: Past and Future, conference held by the

The CRA could seek to apply subsection 84(2) to transactions similar to those in examples 1 and 2, but if the businesses are carried on as a going concern, subsection 84(2) should not apply.¹¹³ In this regard and in accordance with *Perrault*, subsection 84(2) should not apply provided that the company continues to carry on its business for at least one year, even if it does so at reduced activity levels. As well, given the decision of the Federal Court of Appeal in *MacDonald* and consistent with the Tax Court's decision in *McNichol*, in examples 1 and 2 it may be possible to avoid the application of subsection 84(2) provided that the company funds the distribution with third-party money.¹¹⁴ In example 3, there is a risk that the series of transactions would constitute a "reorganization" under subsection 84(2). However, on the basis of the decisions in *Geransky* and *Kennedy*, the sale of the capital assets in and of itself should not constitute a reorganization for the purposes of subsection 84(2) provided that R Co continues to carry on the same business.

In sum, although the Tax Court and the Federal Court of Appeal have held that various types of transactions result in an abuse of the PUC scheme and therefore violate GAAR, in light of the Supreme Court's position that there is no anti-surplus-stripping scheme in the Act, there are limits on the type of transactions that violate the PUC scheme. Therefore, subject to any new pronouncements by the Supreme Court regarding an anti-surplus-stripping scheme, or new legislative amendments, and provided that the transactions do not run afoul of subsection 84(2), the transactions described in the three examples above should continue to be permissible.

Canadian Tax Foundation, March 7, 2019, citing the CRA's response in CRA document no. 2015-0610701C6, November 24, 2015. This technical interpretation involved a series of transactions whereby an individual transferred the shares of its Opco to a Holdco in consideration for shares of Holdco. A portion of the FMV of the shares of Opco was attributable to something other than safe income on hand. Opco subsequently redeemed the Opco shares held by Holdco, and no designation was made under former paragraph 55(5)(f), such that the entire amount of the dividend was recharacterized as a capital gain. The CRA stated, "The GAAR Committee was of the view that it would be unlikely that the GAAR could be successfully applied to the Transactions given the current state of the jurisprudence." As a result of certain amendments in 2016 that introduced the "bifurcation rules" in paragraph 55(5)(f), and subsection 55(2.3) (which prevents a shareholder's CDA from being increased through the payment of an intercorporate dividend attributable to safe income that contributes to an unrealized capital gain on the shares), it seems that this type of planning is no longer available. However, this should not prevent corporations from triggering a capital gain to increase their CDA account in other ways.

113 Subsection 84(2) should have no adverse application for example 3 since distributions in that scenario are paid to the shareholder as taxable and capital dividends.

114 As noted above, the decision in *RMM* would need to be carefully considered to determine the application of subsection 84(2) in this context.

Vertical Sharing and Horizontal Distribution of Federal-Provincial Transfers in Canada, 1983-2018

Deepak Sethia*

PRÉCIS

Le Transfert canadien en matière de santé (TCS), le Transfert canadien en matière de programmes sociaux (TCPS) et le programme de péréquation sont les principaux piliers des transferts intergouvernementaux au Canada. Ces transferts visent à corriger les déséquilibres fiscaux verticaux et horizontaux qui se produisent au sein de la fédération canadienne. Cet article fournit un cadre pour la décomposition des transferts fédéraux en leurs composantes verticales et horizontales. L'analyse empirique porte sur la période de 1983 à 2018, qui est divisée en sept sous-périodes à des fins d'analyse. Les résultats pour la sous-période la plus récente, de 2015 à 2018, montrent que 1) les transferts verticaux, horizontaux et excédentaires comptent respectivement pour 74,85, 24,27 et 0,88 pour cent du total des transferts fédéraux; 2) les transferts fédéraux ont permis de corriger près de 77 pour cent des inégalités fiscales horizontales initiales; 3) le programme de péréquation est le principal canal de réduction des inégalités fiscales horizontales, comptant pour 85 pour cent du total des transferts horizontaux; et 4) le TCS et le TCPS sont effectivement devenus un canal pour les transferts verticaux, contribuant peu à la péréquation horizontale. Dans ce contexte, il existe un potentiel de réforme du système fédéral de transferts. L'auteur propose de réduire les déséquilibres fiscaux verticaux en transférant des points d'impôt aux provinces plutôt que de leur fournir des transferts à des fins particulières. Il soutient également qu'il faut réformer immédiatement le programme de stabilisation fiscale pour répondre aux préoccupations des provinces productrices de pétrole qui se retrouvent avec un manque à gagner en raison de la baisse des prix du pétrole.

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ABSTRACT

The Canada health transfer (CHT), the Canada social transfer (CST), and the equalization program are the main pillars of intergovernmental transfers in Canada. These transfers aim to address the vertical and horizontal fiscal imbalances that arise within the Canadian federation. This article provides a framework for the decomposition of federal transfers into their vertical and horizontal components. The empirical analysis is carried out for the period 1983-2018, which is divided into seven subperiods for analytical purposes. The results for the most recent subperiod, 2015-2018, show that (1) vertical, horizontal, and surplus transfers account for 74.85, 24.27, and 0.88 percent, respectively, of the total federal transfers; (2) the federal transfers addressed nearly 77 percent of the initial horizontal fiscal inequalities; (3) the equalization program is the primary channel for reducing horizontal fiscal inequalities, accounting for 85 percent of the total horizontal transfers; and (4) the CHT and CST have effectively become a channel for vertical transfers, contributing little toward horizontal equalization. In this context, there is potential for reform in the federal transfer system. The author suggests that vertical fiscal imbalances could be reduced by transferring tax points to provinces instead of providing specific-purpose transfers. The author also argues that immediate reforms are required in the fiscal stabilization program to address the concerns of oil-producing provinces that face a revenue shortfall because of the decline in oil prices.

KEYWORDS: FEDERALISM ■ FEDERAL-PROVINCIAL ■ INTERGOVERNMENTAL ■ REGIONAL ■ REDISTRIBUTION ■ PUBLIC FINANCE

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INTRODUCTION

Intergovernmental transfers from the federal to provincial governments have been a keystone of the Canadian federation. The federal government collects, on average, about 40 percent of the combined revenue receipts of the federal and provincial (including local)¹ governments but incurs about 30 percent of the combined expenditures. Correspondingly, the provincial governments collect only 60 percent of the combined revenue receipts but incur around 70 percent of the combined expenditures.² This mismatch in the revenue resources and expenditure burden between the two tiers of government is usually referred to as the vertical fiscal imbalance (VFI). The horizontal fiscal imbalance (HFI), on the other hand, refers to differences in the revenue capacity of various subnational governments, which usually originate from regional income inequalities. Lower-income provinces lack the capacity to generate per capita tax revenues comparable to those collected by richer provinces, owing to differences in their income levels and tax base. Unequal distribution of natural resources is another source of horizontal fiscal inequalities in Canada, since royalties from natural resource extraction and processing also form a part of provincial revenues.

To address these fiscal imbalances, the federal government provides financial support to the provinces through various channels. The Canada health transfer (CHT), the Canada social transfer (CST), and the equalization program are the main pillars of intergovernmental transfers in Canada, accounting for nearly 80 percent of the federal government's total transfers to provincial and territorial governments. Through the equalization program, the federal government provides transfers to provinces with a fiscal capacity below a standard/benchmark minimum, to augment their fiscal resources. The transfer mechanism for the CHT/CST is different from that for the equalization program; these transfers are allocated among all provinces on an equal per capita basis.

Although the concepts of VFI and HFI have been in use for several decades, to justify intergovernmental transfers, it is difficult to measure these imbalances in an unambiguous way. Several approaches to the definition of these concepts have been developed in the literature. One stream of thought builds on welfare economics and public-choice processes to provide a theoretical conceptualization of VFI and HFI.³ Another stream focuses on the observed fiscal imbalances between federal

1 Throughout this article, provincial finances are inclusive of local governments' finances.

2 Author's calculations based on data from Canada, Department of Finance, *Fiscal Reference Tables 2019* (Ottawa: Department of Finance, 2019). Intergovernmental transfers are netted out in the calculation of the respective shares of the two tiers of government. Federal expenditure is calculated net of the transfers to provinces, while on the revenue side, only own-revenue receipts of provinces (not accounting for federal transfers) are used.

3 See Walter Hettich and Stanley Winer, "Vertical Imbalance in the Fiscal Systems of Federal States" (1986) 19:4 *Canadian Journal of Economics* 745-65; and Bev Dahlby, *The Optimal Taxation Approach to Intergovernmental Grants*, Working Paper no. 2009-16 (Edmonton: University of Alberta, Department of Economics, 2019).

and subnational governments to develop measures of VFI that can be empirically quantified.⁴ Some policy makers opine that, in principle, there cannot be a VFI in Canada, since the provinces have access to essentially the same range of revenue sources as is available to the federal government.⁵ Also, it has been noted that while there are advantages in distinguishing between the amount of the vertical transfer and the amount of horizontal transfers, empirically it is often difficult to separate them.⁶ Grants provided to address vertical imbalances may be distributed in a way that assists some subnational governments more than others (depending on the distributional criteria employed).

This article contributes to the literature by developing a framework to separate the vertical and horizontal components of intergovernmental transfers. The framework presumes a hypothetical world in which federating units/provinces form a federation. The interprovincial mobility of tax bases can be a source of distortion in resource allocation and create challenges for income redistribution policies.⁷ To avoid such inefficiencies and realize economies of scale in taxation, provinces surrender certain fiscal space (measured as a tax point transfer) to the federal government in exchange for transfers of funds to fill the arising vertical fiscal gap. To address interprovincial fiscal disparities, the federating provinces also surrender additional fiscal space (again measured as a tax point transfer) that can be used by the federal government to undertake horizontal fiscal equalization. By comparing federal transfers to the richest/benchmark province with transfers to other provinces, it is possible to separate the vertical and horizontal components of the tax points that are used to fund those transfers.

This framework permits a comparison of the amount of horizontal transfers against the level of initial fiscal disparities among the federating units that might have prevailed in the absence of federation. The comparison can be used as an indicator of the quantum of horizontal disparities addressed through federal transfers. To be sure, the quantum of horizontal fiscal disparities to be addressed and the level of tax points transferred to the federal government for vertical/horizontal equalization need not be fixed forever. They are an outcome of the political, economic, and institutional characteristics of the federation in question that evolves over time.

4 G.C. Ruggeri, D. Van Wart, G.K. Robertson, and R. Howard, "Vertical Fiscal Imbalance and the Reallocation of Tax Fields in Canada" (1993) 19:2 *Canadian Public Policy* 194-215; Chris Matier, Lisa Wu, and Harriet Jackson, *Analysing Vertical Fiscal Imbalance in a Framework of Fiscal Sustainability*, Working Paper no. 01/23 (Ottawa: Department of Finance, 2001); and Jonathan Rodden and Erik Wibbels, "Beyond the Fiction of Federalism: Macroeconomic Management in Multi-Tiered Systems" (2002) 54:4 *World Politics* 494-531.

5 Advisory Panel on Fiscal Balances, *Reconciling the Irreconcilable: Addressing Canada's Fiscal Imbalance* (Ottawa: Council of the Federation, 2006), at 107-8.

6 J.S.H. Hunter, *Federalism and Fiscal Balance: A Comparative Study* (Canberra: Australian National University, Centre for Research on Federal Financial Relations, 1977), at 37.

7 Wallace E. Oates, "The Theory of Public Finance in a Federal System" (1968) 1:1 *Canadian Journal of Economics* 37-54, at 45.

The main advantage of the framework described in this article is that it compares the existing system of federal transfers with a counterfactual world, in which there is no federal government and taxing powers reside entirely with the provinces. The counterfactual can be considered as the “original position,” and can serve as an appropriate benchmark to measure the level of horizontal fiscal equalization achieved among provinces through federal transfers. However, given the rich literature in this domain, and the wide variations in the conceptual/measurement approaches taken by researchers to define fiscal imbalances, it is necessary to review those approaches in order to understand the advantages and disadvantages of the proposed framework.

The rest of the article is organized as follows. The next section provides a review of the existing approaches, followed by a discussion of the theoretical context for the proposed framework. The “Analytical Framework” section provides a method for decomposing the federal transfers into their vertical and horizontal components. The “Results” section applies this new framework to Canada’s federal-provincial transfers. The empirical analysis is carried out for the 1983–2018 fiscal years.⁸ The results show that the composition of the federal transfers has increasingly shifted toward the vertical component: from 53.4 percent during the 1983–1990 subperiod to 74.85 percent during 2015–2018. The quantum of horizontal deficiency has also declined substantially during the study period: from 0.5 percent to 0.23 percent of the aggregate provincial gross domestic product (GDP). The CHT and CST have become essentially a channel of vertical transfers, contributing little toward horizontal equalization. In the “Policy Discussion” section, I explore (1) the need for reforming the fiscal stabilization program to support provinces that rely on fossil-fuel extraction and face a revenue shortfall, and (2) the possibility of reducing the vertical fiscal gap by transferring tax points to provinces instead of providing specific-purpose transfers (the CHT and CST). The article ends with a brief concluding section. An appendix is included that provides a concise account of the historical evolution of federal-provincial fiscal transfers in Canada.

EXISTING CONCEPTS AND MEASUREMENTS

Ruggeri et al. note that VFI is conventionally defined as a mismatch between actual revenues and expenditures at different levels of government.⁹ There are some interesting theoretical works explaining the existence of VFI. Hettich and Winer develop a public-choice-based model where VFI arises because the impact of mobility costs on political choices differs across levels of government in a federation.¹⁰ They argue that a simple majority-based electoral system permits some voters to coerce others

8 The fiscal year for Canada’s federal and provincial governments runs from April 1 to March 31. Accordingly, the study period, 1983–2018, covers the fiscal years 1982–83 through 2017–18.

9 Ruggeri et al., *supra* note 4, at 198.

10 Hettich and Winer, *supra* note 3.

into paying a tax price greater than their marginal evaluation of the public goods. This argument is more applicable at the federal level than at the provincial level, where competition among provincial governments and greater mobility of the tax base serve as a check on tax rates.¹¹ These differences lead to a vertical imbalance, where the federal budget is too large relative to the Lindahl equilibrium.¹² Such vertical imbalances can be addressed by grants from the federal to the provincial level.

Another interesting approach is grounded in welfare economics. Dahlby uses optimal tax theory to define fiscal imbalances.¹³ Under this approach, fiscal imbalances occur when the marginal costs of public funds (MCPF) are not equalized between levels of government or across subnational governments. Fiscal capacity is defined as the ability of a government to raise revenues at a low MCPF. It depends not only on the size but also on the tax sensitivity of the government's tax base. The greater the tax sensitivity of the tax base, the lower will be a government's fiscal capacity, because its MCPF will be higher. As in Hettich and Winer's model, given that the tax bases of subnational governments are usually more mobile/tax-sensitive than those of the federal government, the optimal fiscal system will involve relatively high taxes at the federal level, requiring transfers to subnational governments to correct the vertical imbalances.

While these two approaches to VFI have an explicit theoretical foundation, they are not amenable to the empirical measurement of VFI.¹⁴ Empirical studies have focused on the mismatch between actual revenues and expenditures at the federal and subnational levels to quantify VFI. Rodden and Wibbels define VFI as the degree to which subnational spending is financed by revenue transfers from the federal government.¹⁵ On the same lines, a report on intergovernmental transfers published

11 Ruggeri et al., *supra* note 4, at 199, cite Wagner's argument that "[t]he national government is a fiscal monopolist, while state and local governments are fiscal competitors. As a result, majority coalitions will be better able to extract redistributive gains through budgetary expenditures at the national level than at the state-local level." (Richard Edward Wagner, *The Public Economy* [Chicago: Markham Publishing, 1973].)

12 The Lindahl equilibrium is considered as an ideal where unanimity is achieved among the voters on the tax-spending proposal. In this context, all possible expenditure proposals regarding federal and provincial goods are combined with all possible tax-sharing formulas and put up for a country-wide decision. Under the assumption of constant costs, the Lindahl equilibrium is the Pareto-efficient combination of public services and tax prices that receives unanimous consent. Hettich and Winer, *supra* note 3, at 749.

13 Dahlby, *supra* note 3.

14 After outlining their theoretical model, Hettich and Winer admit that VFI is "difficult to measure." Hettich and Winer, *supra* note 3, at 763. Similarly, on the elasticity of tax bases, which are crucial for applying the MCPF-based model, Dahlby mentions that "measuring fiscal capacity in a way that adjusts for the tax sensitivities of tax bases is difficult given our lack of knowledge about such sensitivities." Dahlby, *supra* note 3, at 24.

15 Rodden and Wibbels, *supra* note 4, at 505.

by the Organisation for Economic Co-operation and Development (OECD) defines VFI as “the difference between own tax revenue and own expenditure of a jurisdiction.”¹⁶ This measure has the virtue of being easy to calculate, and provides a useful indication of the actual level of VFI prevailing in a particular year in terms of inter-governmental fiscal flows.

Ruggeri et al. follow the conventional “mismatching” definition of VFI.¹⁷ However, rather than measuring VFI for a particular year—which they call a static approach—they focus on the structural imbalances arising from differential growth rates in the taxation powers and expenditure responsibilities of the two levels of government. To measure the dynamic VFI, Ruggeri et al. apply a three-stage process. First, they measure the income elasticity of tax revenues (E_T^F) and expenditures (E_X^F), where superscript F refers to the federal level. Similar elasticities are measured for the provincial level as well. Second, the federal structural imbalance is defined as $F = E_T^F - E_X^F$. A positive value of F indicates that federal revenues would grow at a faster rate than program spending. Similarly, the provincial structural imbalance is defined as $P = E_T^P - E_X^P$. Finally, the algebraic difference between the F and P is defined as an index of dynamic VFI such that $I = F - P$. Ruggeri et al. calculate that the built-in elasticity of the federal revenues exceeds the elasticity of the federal expenditures by 0.51 percentage points. On the other hand, E_T^P is 0.06 percentage points lower than E_X^P , resulting in a dynamic VFI of 0.57. Ruggeri et al. argue that the dynamic VFI would result in a divergent path for the deficit and debt-to-GDP ratios for the two levels of government, such that the federal indicators would turn into surpluses while the provinces would continue to face the pressures of rising deficits and debt.

Matier et al. follow a different route for measuring dynamic VFI, based on a fiscal sustainability framework.¹⁸ They calculate the primary fiscal balances (defined as revenue minus program spending) for the two levels of government from 2001 to 2041 by projecting expenditures and revenues at each level under various demographic and economic assumptions. For fiscal sustainability, the intertemporal budget constraint must be satisfied; this requires the present value of future primary balances to be equal to or more than the base-year level of net debt. If the base-year net debt is less than the present value of future primary balances for a particular level of government, that level of government has room to reduce taxes or increase program spending. Under this approach, VFI exists only if a government at one level has such fiscal room available while a government at the other level must increase taxes or reduce spending to attain fiscal sustainability. Matier et al. project primary balances for the two levels of government and show that in all but one of eight scenarios, both levels of government have fiscal room available to undertake additional

16 Hansjörg Blöchliger, Olaf Merk, Claire Charbit, and Lee Mizell, *Fiscal Equalisation in OECD Countries*, Working Paper no. 4 (Paris: OECD, 2007), at 8.

17 Ruggeri et al., *supra* note 4.

18 Matier et al., *supra* note 4.

program spending or tax cuts. On this basis, they conclude that no VFI could be detected (in seven out of eight scenarios).¹⁹

While these dynamic approaches are more formal than the static approach and provide a long-term structural perspective on fiscal imbalances, their results seem very sensitive to both model specifications and empirical assumptions. Further, the authors of both studies, while using the concept of dynamic VFI, include the existing federal transfers (at certain assumed growth rates) to reach their conclusion about the presence or magnitude of a VFI.²⁰ Hence, both studies admit the importance of the existing mechanism for federal-provincial transfers in addressing the VFI.

There is an interesting argument that led some policy makers to deny the existence of a VFI in Canada. For example, in 2005, an advisory panel reporting to the federal government contended that

[t]he Government does not believe in the existence of a fiscal imbalance between the federal and provincial governments in Canada. Both orders of government have access to all the major sources of tax revenues and have complete autonomy in setting their tax policies to address spending pressures related to their respective responsibilities.²¹

Essentially, proponents of this view argue that the provinces can simply raise their own tax rates if they feel that a VFI exists. However, Courchene disagrees with this view, arguing that there are international competitive limits to tax rates.²² Thus, provinces cannot meaningfully raise tax rates further unless the federal government reduces its rates. Further, if the provinces raise tax rates and the federal government does not simultaneously vacate the fiscal space, such measures to address the VFI will burden taxpayers. All these issues create practical constraints in using this route to address the VFI.

PROPOSED APPROACH

Discussing the issue of intergovernmental transfers, Bird observed:

Although all transfers from higher level to lower level governments help close the fiscal gap, it is useful to consider vertical fiscal balance in an accounting sense as achieved

19 In the eighth scenario, where VFI could be detected under the definition used by Matier et al., the health-spending growth rate is raised from the benchmark assumption of 1.5 percent to 2 percent (real per capita, per age group). It should also be noted that in six of the seven scenarios where, according to the authors, no VFI could be detected, the fiscal room available to the federal government is higher than that available at the provincial level—a result that may be considered to be a sign of fiscal imbalance in favour of the federal government under the approach of Ruggeri et al. However, under the definition followed by Matier et al., where both levels of government have fiscal room available, a difference in the amount of room does not qualify as a case of vertical fiscal imbalance.

20 Ruggeri et al., *supra* note 4; and Matier et al., *supra* note 4.

21 Advisory Panel on Fiscal Balances, *supra* note 5, at 107-8.

22 Thomas J. Courchene, “Variations on the Federalism Theme” (2006) 27:7 *Policy Options* 46-54.

when expenditures and revenues (including transfers) are balanced for the richest local government, measured in terms of *its capacity to raise resources on its own*. Fiscal gaps will still remain for all poorer local governments, but such gaps are better considered in relation to the problem of achieving horizontal fiscal balance within the local government sector.²³

While Bird provided an interesting way to conceptualize fiscal imbalances, he did not suggest a framework for empirically separating the vertical and horizontal components of the intergovernmental transfers. The framework proposed in this article builds on his argument by adding certain assumptions.²⁴ Federal transfers to the richest provincial government form the basis for measuring the vertical gap. The total of the province's own revenues and transfers by the federal government is considered as the norm of expenditure that the richest provincial government strives to achieve. It is assumed that, in the absence of fiscal interventions by the federal government through taxation and spending measures, the richest provincial government could have collected an amount equivalent to the prevailing federal transfers from its own tax base. For this, it would have to make additional tax effort over and above the effort applied to collect its existing own-revenues. Hypothetically, this is equivalent to the richest province surrendering fiscal space (tax points) to the federal government and the federal government returning it provided that the richest provincial government agrees on zero transfers. Obviously, the federal government collects more in tax revenues from the richest province than it transfers back. However, these additional taxes are transferred to other provinces to address their HFI and special needs.

Assume that the federal government collects taxes from the entire country at a roughly uniform tax effort. All provinces have surrendered some fiscal space to

23 Richard M. Bird, "Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization" (1993) 46:2 *National Tax Journal* 207-27, at 218 (emphasis added).

24 Two similar frameworks have been applied previously in the Indian context. See C. Rangarajan and D.K. Srivastava, "Reforming India's Fiscal Transfer System: Resolving Vertical and Horizontal Imbalances" (2008) 43:23 *Economic & Political Weekly* 47-60; and Deepak Sethia, "Re-Examining Vertical Sharing and Horizontal Distribution of Fiscal Resources in India" (2018) 53:50 *Economic & Political Weekly* 41-49. Rangarajan and Srivastava consider per capita federal transfers to the richest Indian state (the equivalent of a province in Canada) as aimed at addressing the vertical imbalance, and presume a uniform vertical transfer for all states at a fixed absolute amount. However, Sethia argues that instead of presuming a uniform absolute amount for vertical transfers to all states, the hypothetical tax rate at which the richest state can collect transfers made to it should be uniformly applied to the tax base of other states to measure the vertical component for them. This vertical rate applied to the tax base of other states would provide lower revenues for those states than for the richest state. The gap attributable to regional variations in the tax base should ideally form part of the horizontal fiscal imbalance. The present article uses the same assumption. Further, while the two previous articles in the Indian context focus on the decomposition of federal transfers at the aggregate level, the present article extends the framework to decomposition at the individual transfer level as well and applies it in the Canadian context.

the federal government and, in return, receive vertical transfers. As part of the federal contract, provinces have surrendered additional fiscal space to enable the federal government to undertake transfers for horizontal fiscal equalization.²⁵ Transfers made to the richest province would allow identification of the vertical component of the overall fiscal space surrendered by the provinces. In the absence of vertical transfers by the federal government coupled with the return of vertical fiscal space to the provinces, other provincial governments could also use this vertical fiscal space. However, the additional taxes collected by them would be lower than the amount collected by the richest province, because the tax base of the latter is larger. The total of the additional taxes collected by all provincial governments from the hypothetically surrendered vertical fiscal space can be considered as the vertical component of the federal transfers. The remaining federal transfers can be considered to be meant for horizontal fiscal equalization or for addressing special needs.

This approach to measuring VFI leaves us with two sources of HFI. The first source arises from the existing differences in the own-revenue capacity of provincial governments at a representative tax rate,²⁶ which can be measured against the revenue capacity of the richest province. The second source arises from disparities in potential tax collection by provinces using the hypothetically surrendered vertical fiscal space. The gap in tax collection between the richest province and other provinces using the same vertical tax rate is due to the differences in their tax bases. Accordingly, it should be treated as part of the HFI.

For empirical analysis, I explicitly assume that the federal transfers aim first to address the vertical imbalance arising from the uneven assignment of fiscal powers and responsibilities between the federal and provincial governments. After addressing the vertical gap, the remaining transfers are meant to address the horizontal imbalances. The federal government may also provide certain provinces with transfers over and above the requirements for VFI and HFI, to meet special-need considerations. Thus, federal transfers are utilized to address VFI, HFI, and special-need considerations in that order.

The system of equalized tax point transfers that has been used in Canada provides interesting parallels to the proposed approach for separating tax points used for vertical and horizontal transfers. The equalization program that began in 1957 was created by separating tax rental payments (the vertical component) from the fiscal aid (the horizontal component) to provinces below a certain benchmark fiscal capacity. In 1941, to enable the federal government to finance the war effort, the provinces agreed to vacate the income tax and estate tax domains in return for cash

25 The tax points surrendered in exchange for vertical and horizontal transfers are over and above the fiscal space required for the federal government to meet its own expenditures on federally provided public goods (national defence, foreign affairs, etc.).

26 The idea of a representative tax rate in this context is similar to the one used in the equalization program, where own-revenues of a province for a particular tax base are measured at the average tax rate on that tax base across provinces. This method of calculating a province's entitlement to an equalization transfer is referred to as "the representative tax system" (RTS).

transfers from the federal government. Tombe argues that these cash grants had an implicit equalization component, since per capita transfers for provinces that accepted the deal were similar irrespective of the amount of the taxes collected from them under these tax heads.²⁷ Thus, the cash grants, although designed to compensate the provinces for their surrender of taxing powers, also contained an implicit redistribution element, correcting for both VFI and HFI.

In 1957, the horizontal component was made explicit by separating the vertical tax rental and horizontal equalization components. Each province participating in the tax rental agreement was provided with a portion of the three federally collected taxes—personal income tax (10 percent), corporate income tax (9 percent), and succession duties (50 percent)—that were generated in that province. Since the value of these vertical transfers was relatively lower for the less wealthy provinces, their transfers were topped up by a horizontal equalization amount to match a certain benchmark (the average of transfers given to the two richest provinces, Ontario and British Columbia). Any province that set up its own tax system would receive only the equalization payment, but it would be entitled to collect the vertical component on its own using the equivalent tax points vacated (returned) by the federal government.

Although this approach to equalization ended in 1967, tax point transfers were a central component of many federal transfer programs until 2015. Established programs financing (EPF), the Canada health and social transfer (CHST), and its two successors (the CST until 2008 and the CST until 2015) provided equal per capita support to provinces with a mix of equalized tax point transfers and cash transfers. Under tax point transfers, the federal government vacated 13.5 percent of the personal income tax and 1 percent of the corporate income tax that could be levied by the provinces to raise tax revenues, causing no net increase in burden for taxpayers. Since the revenues raised by the richest province using the same tax points would be higher than those collected by other provinces, the other provinces were provided with an additional cash payment—known as “associated equalization”—to equalize the tax point transfer.

In the proposed framework, when the richest province is considered as the benchmark, (returning) federal tax point transfers to provinces would be considered as a case of addressing the VFI, where provinces are being compensated on the derivation or source-of-revenue basis.²⁸ The cash transfers made to equalize the tax

27 Trevor Tombe, “‘Final and Unalterable’—But Up for Negotiation: Federal-Provincial Transfers in Canada,” *Finances of the Nation* feature (2018) 66:4 *Canadian Tax Journal* 871-917, at 882.

28 It may be the case that some provinces receive vertical cash transfers under a tax rental agreement on a derivation basis. In contrast, others use tax points or the federal abatement to collect the vertical component on their own. To maintain comparability across the provinces, the proposed framework considers the revenues raised by provinces using the tax points transferred as a part of the vertical component. Thus, the amount ceded by the federal government under the Quebec abatement would be considered as a part of the federal transfer to Quebec. (See the source notes to table 1 for details on the Quebec abatement.)

point transfers would be considered as horizontal transfers. By providing equalized tax point transfers, the federal government has separated out the vertical and horizontal components of what otherwise could have been an equal per capita transfer. The proposed approach clearly recognizes that the federal government does not engage in redistribution between regions via vertical transfers. That purpose is served by the horizontal component of the federal transfers.

There are some disadvantages of the proposed approach compared to the approaches described in the existing literature and reviewed in the previous section. The proposed measures of VFI and HFI are defined on the basis of the existing transfers and fiscal disparities among the provinces, rather than being derived from fundamental concerns such as elasticity of the tax-base or public-choice processes.

On the empirical side, the proposed approach does not focus on the long-term structural fiscal imbalances grounded in intertemporal budget constraints or a mismatch in the growth rates of expenditures and tax revenues of the federal and provincial governments. Thus, the proposed approach is not suitable for commenting on the controversial issue of whether the existing level of federal transfers fully reflects the transfers required to address the mismatch between the respective taxing powers and fiscal responsibilities assigned to the two tiers of government. (This issue gave rise to a heated debate that began in the late 1990s and continued until the global financial crisis in 2008, when the federal government was running large budget surpluses while provinces were facing deficits.) The proposed approach has the modest goal of decomposing the existing transfers into their vertical and horizontal components.

An interesting property of the proposed approach is that it keeps the relative measures of inequality in fiscal capacity unchanged, with or without including the tax point transfers (all measures that satisfy the scale invariance property, such as Gini, Theil, or the Schutz index). Tax point transfers to provinces to address the vertical imbalance will result in a uniform ratio for provincial revenues inclusive of a vertical component compared to provincial own-revenues without a vertical component. Following the notations used in the analytical framework in the present article (described in the next section), this ratio will be equal to $\left(\frac{a_v + a_r}{a_r}\right)$.²⁹ Uniform scaling up of the variable will keep the relative measures of inequality levels in fiscal capacity unchanged, with or without the vertical component.³⁰

29 Here a_v is the tax point transferred, and a_r is the representative tax rate on existing own-revenues.

30 To be sure, absolute measures of inequality—that is, measures satisfying translation invariance, such as variance or standard deviation—will increase after the vertical tax point transfer. Variance or standard deviation will remain unchanged only when per capita equal transfers are made, but such transfers would reduce horizontal imbalances in accordance with the relative measures of inequality. However, there is a reason to prefer relative measures of inequality compared to absolute measures of inequality. The proposed framework compares the federal transfers against the counterfactual of the “original position,” where there is no federal

In sum, the proposed approach considers the prevailing levels of federal transfers as an outcome of an evolving federal contract among the provinces and the federal government. Under that contract, provinces have surrendered part of their fiscal space to the federal government in order to address the twin issues of inefficiencies arising from the interprovincial mobility of tax bases and interprovincial fiscal disparities. Thus, the levels of vertical and horizontal transfers measured using this approach are implicitly being compared against the counterfactual world, in which there is no federal government and taxing powers reside entirely with the provinces. The latter can be considered as the “original position,”³¹ an appropriate benchmark to measure the level of horizontal fiscal equalization achieved among provinces through federal transfers.³² The original position is a purely hypothetical situation rather than one based on the actual historical state of affairs. The idea of the original position in the present context acts as an expository device that permits the separation of vertical and horizontal fiscal transfers. The theoretical approach discussed above is incorporated in the analytical framework presented below, both at an aggregate level and at the individual transfer level.

ANALYTICAL FRAMEWORK

Aggregate

In the framework discussed below, lower-case letters denote variables on a per capita basis, while the upper-case letters are used to denote variables at the provincial level by multiplying per capita values with the provincial population. Let the per capita provincial tax/revenue base be defined as y and provinces be denoted by subscript $i = 1 \dots n$, arranged in the ascending order of per capita revenue base. The provincial population can be denoted by $N_1, N_2, \dots, N_n$, where N_n denotes the population of the province with the richest per capita revenue base. The poorer provinces are able to collect less own-revenues compared to the richest province when both apply a representative tax rate. This horizontal fiscal inequality in per capita own-revenues for province i can be measured as

$$b_i^{or} = a_r(y_n - y_i), \quad (1)$$

government and taxing powers reside entirely with the provinces. In this scenario, the benchmark horizontal inequality would be the one measured by including the vertical tax point transfers. The relative measures of inequality are more suitable in this context, since they keep the observed fiscal inequalities in own-revenues comparable to the original position. (The term “original position” is borrowed from John Rawls, who used it in the context of social contract theory. See John Rawls, *A Theory of Justice* [Cambridge, MA: Belknap Press, 1971].)

31 See supra note 30.

32 It may be the case that legally, the size and interprovincial distribution of federal transfers are determined by the federal government. However, the framework presumes that they are a long-run outcome of the forces of conflict, cooperation, and intergovernmental negotiations.

where

b^{or} = horizontal fiscal inequalities in own-revenues on a per capita basis, and
 a_r = the representative own tax rate measured as the average tax rate across provinces.

The entire amount of federal transfers given to the richest province is meant to address the vertical imbalance, since the richest provincial government cannot have any horizontal fiscal gap. The richest provincial government could have collected this transferred amount from its own-revenue base at tax rate a_v . Thus,

$$t_n = v_n = a_v \cdot y_n, \quad (2)$$

where

t = per capita transfers received by a province;
 v = the per capita vertical fiscal gap that exactly equals the federal transfers received in the case of the richest province; and
 a_v = the vertical fiscal space that can be returned by the federal government to the richest provincial government in lieu of transfers.

The vertical fiscal gap for any other province i can be calculated as

$$v_i = a_v \cdot y_i. \quad (3)$$

Thus, a_v —the vertical rate component of fiscal transfers measured on the basis of transfers received by the richest province—forms the basis for calculating the vertical fiscal gap for all provinces. However, the vertical transfers received by any other province are obviously lower than the amount $a_v \cdot y_n$. The difference represents the horizontal fiscal disparity arising from the inability of a poorer province to raise the same amount of tax as the richest province when the federal government returns this vertical fiscal space to both the richest and other provinces in lieu of the vertical component of fiscal transfers. The horizontal fiscal gap induced as a result of the return of this fiscal space to provinces can be shown as

$$b_i^{ft} = a_v(y_n - y_i), \quad (4)$$

where

b_i^{ft} = the horizontal fiscal disparity attributable to differences in tax collection by provinces at the rate a_v ; and

superscript ft indicates that rather than being horizontal fiscal inequality attributable to differences in existing own-revenues of provinces, this component of horizontal fiscal inequality is caused by the return of vertical fiscal space in lieu of the vertical component of fiscal transfers (ft).

Thus, the overall horizontal fiscal gap (b) attributable to own revenues and the hypothetically returned vertical fiscal space from the federal government to provinces can be measured by adding equations 1 and 4; thus,

$$b_i = (a_r + a_v)(y_n - y_i). \quad (5)$$

For any province, i , the per capita transfer (t_i) can be decomposed into three components: a vertical component equal to the per capita revenue raised using fiscal space a_v ; horizontal equalization transfers to address the deficiency in fiscal capacity with respect to the revenue capacity of the richest province inclusive of the vertical fiscal space $[(a_r + a_v)y_n]$; and the surplus component, which reflects cost disabilities and other special-need considerations. Thus,

$$t_i = a_v y_i + (a_v + a_r)(y_n - y_i) + sur_i, \quad (6)$$

where

$a_v y_i$ reflects vertical transfers;

$(a_v + a_r)(y_n - y_i)$ represents horizontal equalization transfers; and

$sur_i > 0$ for provinces receiving additional transfers for cost/special-need considerations.

The provinces may be divided into two groups. For one group, the per capita recommended transfer consists of three components—vertical, horizontal, and special needs, as given above. For other provinces, after vertical transfers are taken out, the balance may fall short of horizontal equalization entitlement, and there is nothing left for special needs. Let the shortfall in such cases be def_i . Per capita transfers may then be expressed as

$$t_i = a_v y_i + (a_v + a_r)(y_n - y_i) - def_i. \quad (7)$$

In both cases, we can multiply the provincial-level per capita transfers by respective populations to get total transfers ($T_i = N_i t_i$) for every province. By adding the two sets of provinces (equations 6 and 7), we get the total transfers ($\sum_{i=1}^n T_i$) to all provinces as

$$\sum_{i=1}^n T_i = \sum N_i t_i = a_v \sum N_i y_i + [\sum N_i (a_v + a_r)(y_n - y_i) - \sum N_i def_i] + \sum N_i sur_i. \quad (8)$$

Here, $def_i > 0$ for provinces that get less than their horizontal equalization entitlement and $sur_i > 0$ for provinces that get more than their horizontal equalization entitlement. The total transfers can thus be divided into three components:

Vertical transfers (VT), expressed as

$$\sum VT_i = a_v \sum N_i y_i; \quad (9)$$

Horizontal equalization transfers (HT), expressed as

$$\sum HT_i = \sum N_i (a_v + a_r)(y_n - y_i) - \sum N_i def_i; \quad (10)$$

Surplus transfers for special-need/cost considerations (ST), expressed as

$$\sum ST_i = \sum N_i sur_i. \quad (11)$$

Individual shares of the three components in the total transfers can be obtained simply by dividing each component by T_i . HT_i is meant to address the horizontal fiscal gap of $H_i = N_i(a_v + a_r)(y_n - y_i)$, but for some provinces receiving less than this amount, there remains a shortfall of $N_i def_i$. The extent of initial horizontal fiscal inequalities addressed by the federal transfers can be calculated as HT_i/H_i .

Individual Transfers

In most federal countries, there exist multiple channels of intergovernmental transfers. In Canada, the CHT, CST, and equalization program are the main pillars of federal-provincial transfers. In addition to analyzing the overall impact of the federal transfers on the horizontal fiscal gap, it may be of interest to understand the contribution of individual fiscal transfer channels in addressing the horizontal fiscal disparities. The framework presented below can be used for this purpose.

Let the individual fiscal transfer channels be defined as $j = 1 \dots m$. The transfer provided to the richest province continues to form the basis for measuring the vertical component of any transfer channel. The richest province receives the amount $a_{vj}y_n$ on a per capita basis under transfer channel j . Thus, any province with income lower than that of the richest province should receive a per capita vertical transfer of $v_{ij} = a_{vj}y_i$ under the same channel, which obviously is lower than the amount $a_{vj}y_n$. Returning the fiscal space of a_{vj} from the federal to provincial governments, in lieu of the vertical component of this transfer channel, would result in an additional horizontal fiscal disparity of $a_{vj}(y_n - y_i)$ over and above the horizontal fiscal inequality of $a_r(y_n - y_i)$ in the existing per capita own-revenues as measured in equation 1. As shown in equation 12, after meeting the vertical requirement of $a_{vj}y_i$, the remaining transfer under channel j can be considered for addressing horizontal fiscal disparities or special needs.³³

$$bst_{ij} = t_{ij} - a_{vj}y_i, \quad (12)$$

where bst is equal to the horizontal equalization and surplus grant components.

The vertical requirement of all fiscal transfers $j = 1 \dots m$ for province i can be represented as

$$v_i = (a_{v1} + a_{v2} + a_{v3} \dots a_{vm})y_i = \sum_{j=1}^m v_{ij} = a_v y_i. \quad (13)$$

This is comparable to equation 2. Thus, the overall vertical fiscal space (a_v) surrendered by provinces equals the sum of the individual vertical space surrendered for each fiscal transfer channel. The size of the vertical transfer for any channel j across provinces can be measured as

33 In some cases, the amount received by a province under a particular channel (say channel 1) can be less than $a_{vj}y_i$. In such a case, following the sequence of priorities, bst from other channels is proportionately used first to meet the vertical gap left in transfer channel 1. Only the remaining bst is used for horizontal or surplus transfers.

$$\sum_{i=1}^n VT_{ij} = a_{vj} \sum_{i=1}^n N_i y_i. \quad (14)$$

The contribution of any channel in addressing the aggregate vertical imbalance across provinces can be measured as $\sum_{i=1}^n VT_{ij} / \sum_{i=1}^n VT_i$. The same approach can be followed for horizontal fiscal inequalities, where the sum of horizontal fiscal inequalities arising from all fiscal transfers is exactly the same as shown in equation 4:

$$b_i^{ft} = (a_{v1} + a_{v2} + a_{v3} \dots a_{vm})(y_n - y_i) = a_v(y_n - y_i). \quad (15)$$

As before, there will be two groups of provinces. For the provinces in one group, the transfers through all channels will exceed V_i and H_i —that is, $[\sum_{j=1}^m HST_{ij} > (H_i^{OR} + H_i^{FT})]$ —leaving the province with a surplus of $N_i sur_i$ for special needs. For other provinces, the balance after vertical transfers are taken out falls short of the equalization entitlement $[\sum_{j=1}^m HST_{ij} < (H_i^{OR} + H_i^{FT})]$, leaving an overall deficiency of $N_i def_i$.

To understand the contribution of each transfer channel in addressing the overall horizontal fiscal disparities and surplus for special needs, one needs to compare the equalizing and surplus grant components for each transfer channel (HST_{ij}) against the overall horizontal fiscal disparities (H_i). In the case of provinces with a shortfall, $HST_{ij} = HT_{ij}$ since there is no surplus element in the transfer. The contribution of each channel in addressing the horizontal fiscal disparities can be simply measured as

$$H_{ij}^B = \left(\frac{HST_{ij}}{H_i} \right) \times 100, \quad (16)$$

where H_{ij}^B equals the contribution of channel j in addressing horizontal fiscal disparities/improving the horizontal fiscal balance (H^B) for province i .

Further, the shortfall in meeting horizontal fiscal inequalities can be represented as

$$H_i^D = 100 - \sum_{j=1}^m H_{ij}^B = \left(\frac{N_i def_i}{H_i} \right) \times 100, \quad (17)$$

where H_i^D equals the deficiency/unmet horizontal fiscal inequalities as a percentage of H_i .

In the case of provinces with a surplus, $\sum_{j=1}^m HST_{ij} = H_i + N_i sur_i$. Thus, it is necessary to measure each channel's contribution toward eliminating horizontal fiscal disparities and augmenting the resources for special-need considerations. However, unlike the previous case for provinces with a deficiency of $N_i def_i$, it may not be desirable to calculate the HST_{ij} as a percentage of $H_i + N_i res_i$. This is because, while at the aggregate level all transfer channels taken together are able to eliminate the H_i , for some channels transfers received by the poorer provinces on a per capita basis might be lower than the transfers received by the richest province. In such a case, the transfer channel is not progressive enough to eliminate, by itself, the resulting b_{ij}^{ft} , since $t_{ij} < a_{vj} y_i + a_{vj} (y_n - y_i)$. Ideally, such channels should not be considered to be contributing to special needs.

On the other hand, if the amount of the per capita transfer under transfer channel j is exactly equal for all provinces, including the richest one (as it is, for example, currently under the CHT and CST), then such a transfer channel itself addresses the horizontal fiscal disparity arising from this particular channel. This is because here $t_{ij} = a_{vj}y_i + a_{vj}(y_n - y_i)$. Thus, only the transfer channels where $t_{ij} > a_{vj}y_i + a_{vj}(y_n - y_i)$ can be considered to be contributing toward sur_i .

The above discussion requires following a two-stage process for provinces receiving surplus ($N_i sur_i$) transfers. In the first stage, the contribution of all those channels where $t_{ij} \leq a_{vj}y_i + a_{vj}(y_n - y_i)$ is measured in relation to the reduction of H_i . For these channels, $HST_{ij} = HT_{ij}$. In the second stage, the contributions of channels where $t_{ij} > a_{vj}y_i + a_{vj}(y_n - y_i)$ are measured in relation to full elimination of the remaining H_i and the building of sur_i . For these channels, $HST_{ij} = HT_{ij} + ST_{ij}$.

The first stage can be represented as follows:

$$H_{ij}^{BNS} = \left(\frac{HST_{ij}^{NS}}{H_i} \right) \times 100 \text{ if } t_{ij} \leq a_{vj}y_i + a_{vj}(y_n - y_i);$$

that is, $bst_{ij} \leq a_{vj}(y_n - y_i)$, (18)

where H_{ij}^{BNS} equals the contribution of channel j in addressing horizontal fiscal disparities/improving the horizontal fiscal balance (H^B) for province i . Superscript NS indicates that channel j does not contribute to the surplus ($N_i sur_i$) for province i .

The second stage can be represented as follows:

$$H_{ij}^{BS} = \left(\frac{HST_{ij}^S}{H_i + N_i sur_i - \sum_{j=1}^m HT_{ij}^{NS}} \right) \times (100 - \sum_{j=1}^m H_{ij}^{BNS}) \text{ if } t_{ij} > a_{vj}y_i + a_{vj}(y_n - y_i). \quad (19)$$

Equation 19 differs from equation 18 in the following manner:

1. superscript NS is replaced with S , signifying that these channels contribute toward surplus;
2. in the denominator, $N_i sur_i$ is added while $\sum_{j=1}^m HT_{ij}^{NS}$ is deducted, because these channels (HST_{ij}^S) contribute toward eliminating the remaining H_i (after accounting for the contribution of $\sum_{j=1}^m HT_{ij}^{NS}$ and building $N_i sur_i$;³⁴ and
3. the multiplication is made by $(100 - \sum_{j=1}^m H_{ij}^{BNS})$ instead of 100.

Since both stages taken together eliminate entirely horizontal fiscal equalities and achieve full horizontal fiscal balance for the province,

$$\sum_{j=1}^m H_{ij}^{BNS} + \sum_{j=1}^m H_{ij}^{BS} = 100. \quad (20)$$

34 This implicitly assumes that for all the channels contributing toward $N_i sur_i$ for the given province, uniform fractions of HST_{ij}^S are devoted to eliminating H_i and building $N_i res_i$.

The contribution of the various channels in surplus building can be measured as

$$S_{ij} = \left(\frac{HST_{ij}^S}{H_i + N_i \text{sur}_i - \sum_{j=1}^m HT_{ij}^{NS}} \right) \times 100, \quad (21)$$

where $\sum S_{ij}$ equals 100.

Equation 21 is similar to equation 19 except for the multiplicative factor used. No deduction for $\sum_{j=1}^m H_{ij}^{BNS}$ is required since these channels (HST_{ij}^{NS}) do not contribute toward surplus. The federal government collects taxes from the richest province and transfers part of those revenues to the poorer regions. However, as Buchanan rightly argued, inter-area transfers do not represent outright subsidization of the poorer areas.³⁵ In a national economy, the citizens of low-income regions—who may be rich or poor at the individual level—have the “right” to be treated on an equal standing with their counterparts in the richer regions by the fiscal policy of the federal and subnational governments taken together. This is the argument underlying the horizontal equity enshrined in the Canadian constitution.³⁶ The decomposition of intergovernmental transfers considered in the framework presented above is concerned solely with the measuring vertical and horizontal components, and the extent of horizontal imbalances addressed. In the next section, I operationalize this framework by applying it to actual federal-provincial transfers in Canada between 1983 and 2018.

RESULTS

Operationalizing the framework described above begins with two basic steps: (1) measurement of provincial fiscal capacity and (2) identification of the benchmark province. Once these steps have been completed, transfers received by the benchmark province will be used to identify the vertical fiscal space surrendered by provinces to the federal government. Then, the fiscal capacity of the benchmark province (inclusive of the vertical component) will be compared with the fiscal capacity of other provinces to measure the horizontal fiscal inequalities.

Currently, there is one channel of federal transfers for which provincial fiscal capacities are explicitly measured, namely, equalization. The mechanism used to measure the fiscal capacity of a province involves the calculation of the amount of revenue that the province could raise by levying national average tax rates on a number of revenue sources covered under the program. The number of provincial revenue bases covered under the equalization program has varied over time. An alternative for measuring provincial fiscal capacity could be a macro approach (that is, a macroeconomic indicator-based approach) in which a broad indicator such as provincial GDP is used as a revenue base. This approach implicitly assumes that a

35 James M. Buchanan, “Federalism and Fiscal Equity” (1950) 40:4 *American Economic Review* 583-99, at 596.

36 Section 36(2) of the Constitution Act, 1982, being schedule B to the Canada Act 1982 (UK), 1982, c. 11.

uniform tax rate is applied to all types of income. However, in the real world, each dollar of income is not taxed at the same rate; for example, in a progressive taxation system, individuals at a higher income level can be taxed at a higher rate than lower income earners, and certain commodities/sectors may attract higher/lower tax rates. These considerations have led Canadian policy makers to use a tax-by-tax approach for measuring provincial fiscal capacity under the equalization program. However, the advantages of the macro approach lie in its simplicity and comparability over time. The macro approach also avoids the strong incentives for manipulating tax bases that are created under the existing tax-by-tax equalization program.³⁷ For these reasons, I use provincial GDP as an indicator of the revenue base.

This brings us to the next step, identifying the benchmark province. Alberta is the richest province in Canada in terms of income and fiscal capacity, largely owing to its abundant natural resource revenues. Alberta's per capita income in 2018 was \$78,600, and Alberta accounted for 11.6 percent of the aggregate provincial population. Ontario—the most industriously advanced province, with a per capita income of \$60,000—is the largest province in terms of population, accounting for 38.7 percent of the aggregate provincial total. Clearly, using Alberta, or the other, smaller oil-producing provinces of Saskatchewan and Newfoundland and Labrador, as the benchmark would significantly raise the comparison measure of fiscal capacity and, consequently, the horizontal fiscal inequalities for other provinces. In the past, the federal government has been concerned about limiting the impact of Alberta's huge oil revenues on the benchmark fiscal capacity under the equalization program. It has experimented with a 2-province, 5-province, and 10-province standard, with varying rates of inclusion of natural resource revenues. Choosing an appropriate benchmark is evidently not an easy task.

There has been an implicit “Ontario clause” operating in Canadian federalism. Because Ontario is the most populous province, and one of the richest, the notion that it could receive equalization transfers was considered politically and financially unacceptable. The equalization program was even adapted to prevent such an outcome under the 1977 equalization formula, when Ontario would otherwise have qualified as a “have not” province. It was only after the economic slowdown of 2008 that Ontario received equalization grants, for the years 2010 through 2019.

Another instance of the Ontario clause could be observed during the negotiations for the 2005 offshore accords with Newfoundland and Labrador and Nova Scotia, when the federal government wished to explicitly introduce an “Ontario ceiling.” Under this proposal, the two Atlantic provinces would be eligible for “revenue protection” under the accords provided “that no such additional payments result[ed] in the fiscal capacity of the province exceeding that of the province of Ontario.”³⁸

37 Tombe, *supra* note 27, at 916.

38 Canada, Department of Finance, A Letter from Ralph Goodale to the Premier, Government of Newfoundland and Labrador, October 24, 2004 (www.releases.gov.nl.ca/releases/2004/exec/oct24.pdf).

Taking these considerations into account, I have chosen Ontario as the benchmark province for measuring the vertical fiscal space surrendered by provinces and the horizontal fiscal inequalities for other provinces.

For the subsequent discussion, the time frame of 1983 to 2018 has been divided into seven subperiods of varying duration. From 1983 to 2004, except for some technical adjustments, the equalization program remained largely the same in its basic approach, using a 5-province standard. This time frame is divided into three subperiods of roughly equal duration in order to capture intertemporal trends. The “new framework” for the equalization program during the years 2005–2007 saw a significant departure from the representative tax system (RTS) approach; hence, those years are treated as a separate subperiod. Next is a two-year-long subperiod (2008–2009), when the equalization program returned to the RTS-based approach at the recommendation of the O’Brien expert panel.³⁹ During those years, Ontario remained a non-recipient province. While the RTS-based approach continued in the subsequent years, Ontario became a recipient of the equalization grants for the first time in 2010. The years 2010–2014 and 2015–2018 are treated as two separate subperiods. The practice of awarding an “associated equalization” grant was abolished during the second of those subperiods.

A more detailed account of the changes to the equalization program summarized above, and the evolution of federal-provincial transfers in Canada, is provided in the appendix to this article.

Decomposition at an Aggregate Level

Table 1 provides results at an aggregate level. Total transfers and other aggregates are shown as percentages of the provincial GDP. (Annual percentages are calculated first and then averaged over the subperiod.) The percentage composition of the total transfers for each of the vertical, horizontal, and surplus components (which together total 100 percent) is also shown. Finally, an important variable of interest—the extent of initial horizontal fiscal disparities/the horizontal requirement addressed by the horizontal transfer component—is shown in the last column.

The vertical requirement is calculated on the basis of transfers received by Ontario as a share of its GDP. The transfers received by any other province are first used to meet the vertical requirement. In certain cases, federal transfers received by the province as a share of its GDP are less than the transfers received by Ontario as a share of its GDP, leaving a vertical gap for the former. This has been the case for Alberta over most of the study period, and recently for Saskatchewan (since 2009), British Columbia (since 2012), and Newfoundland and Labrador (since 2013). The reason for Alberta having a vertical gap is obvious. It is the richest province, entitled to CHT/CST only, which are comparable across the provinces on a per capita basis.

39 Canada, Expert Panel on Equalization and Territorial Formula Financing, *Achieving a National Purpose: Putting Equalization Back on Track*, chaired by Al O’Brien (Ottawa: Department of Finance, May 2006) (herein referred to as “the O’Brien report”).

TABLE 1 Decomposition of Federal Transfers and Extent of Horizontal Equalization Achieved, 1983-2018

Fiscal years ^a	Percentage of GDP				Composition of transfers			Extent of equalization achieved ^c
	Total transfers ^b	Vertical requirement	Vertical transfers	Vertical gap	Horizontal requirement	Horizontal transfers	Horizontal transfers	
1983-1990	3.71	2.02	1.98	0.04	2.14	1.64	0.50	76.7
1991-1997	3.41	1.93	1.91	0.02	2.07	1.49	0.58	71.9
1998-2004	2.40	1.22	1.18	0.04	1.87	1.21	0.66	64.7
2005-2007	2.77	1.91	1.75	0.15	1.19	0.88	0.31	74.1
2008-2009	2.92	2.14	1.94	0.19	0.88	0.82	0.06	93.6
2010-2014	3.12	2.62	2.30	0.31	0.88	0.71	0.17	80.7
2015-2018	3.21	2.61	2.40	0.21	1.01	0.78	0.23	77.1

(Table 1 is concluded on the next page.)

TABLE 1 Concluded

GDP = gross domestic product.

- a The subperiods listed refer to fiscal year-ends; for example, 1983-1990 covers fiscal years 1982-83 through 1989-90.
- b Vertical transfers + horizontal transfers + surplus.
- c Horizontal transfers as a percentage of the horizontal requirement.

Sources: Author's calculations based on the following data sets. Transfers: Government of Canada, "Historical Transfer Tables: 1980 to Present." GDP: Statistics Canada table 36-10-0222-01 (formerly CANSIM 384-0038), "Gross Domestic Product, Expenditure-Based, Provincial and Territorial, Annual (x 1,000,000)," for 1980 to 2018. These are calendar-year data, whereas budget data are measured on a fiscal-year (April 1-March 31) basis. GDP data were converted to the fiscal-year basis by a weighted average (three-quarters of which covered April 1-December 31 of the calendar year and one-quarter January 1-March 31). The newly calculated fiscal-year basis GDP data were used to calculate the ratios. Population: Statistics Canada table 17-10-0009-01 (formerly CANSIM table 051-0005), "Population Estimates, Quarterly," for 1941 to 2019, by province (estimated population on October 1, annually). Own-revenues of provinces: Statistics Canada table 36-10-0477-01 (formerly CANSIM table 380-0080), "Revenue, Expenditure and Budgetary Balance—General Governments." The provincial revenues reported in these tables are inclusive of the amount collected by Quebec using tax points (in lieu of cash transfers) received from the federal government under alternative payments for standing programs (13.5 percentage points of federal income tax) and the youth allowances program (3 percentage points of federal income tax). Correspondingly, Quebecers receive an "abatement" of equivalent tax points when paying their federal taxes. To maintain comparability of own-revenues across provinces, amounts ceded (or vertical fiscal space returned) by the federal government under the Quebec abatements are deducted from Quebec's revenues. Those amounts are also considered to be part of the federal transfer to Quebec, to maintain comparability of federal transfers across provinces. For all provinces, royalty revenues are included in own-revenues at a 50 percent rate, in line with the recommendations of the O'Brien panel's report: Canada, Expert Panel on Equalization and Territorial Formula Financing, *Achieving a National Purpose: Putting Equalization Back on Track* (Ottawa: Department of Finance, May 2006). Local governments' revenues are considered to be part of provincial revenues. These revenues are taken into account under the equalization program as well.

Thus, the transfers received by Alberta will be less than the transfers received by Ontario, when measured as a share of GDP, leaving the former with a vertical gap.

As noted earlier, Ontario has been receiving equalization grants in recent years (from 2010 through 2019). During those years, Saskatchewan, British Columbia, and Newfoundland and Labrador received only CHT/CST.⁴⁰ Thus, the total grants received by these three provinces on a per capita basis have been lower than Ontario's levels. Further, the per capita GDP of these provinces either exceeded Ontario's level (in the case of Saskatchewan and Newfoundland and Labrador) or was close to it (in the case of British Columbia). A combination of these factors led to a vertical gap for these provinces. This is the reason why the vertical gap has been at its highest levels in recent years. Clearly, the vertical gap, shown here, is mainly a result of taking Ontario rather than Alberta as the benchmark province.

40 Newfoundland and Labrador also received grants under the offshore accord until 2012.

Total federal transfers to provinces were 3.71 percent of the aggregate provincial GDP in 1983-1990 and declined to 2.40 percent in 1998-2004. The decline in the transfers had both vertical and horizontal sources. At 1.22 percent of the provincial GDP, the vertical requirement was at its lowest level during 1998-2004. Since the vertical requirement is measured on the basis of the transfers received by Ontario, there must have been a decline in the CHST transfers—the only channel that provided transfers to Ontario in this period. The CHST transfers (or the sum of the Canada assistance program [CAP], EPF, and CHST) were indeed lowest in this time period, at 1.17 percent of the GDP of all provinces compared to an average of 2.14 percent of the provincial GDP during 1983-2018. On the horizontal front, at 0.66 percent of GDP, the deficiency was at its highest level, and the extent of horizontal fiscal equalization achieved fell to the lowest level in the entire study period (64.7 percent).

The rise in the vertical requirement since 2004 can be linked to developments in the funding of CHT/CST transfers following the bifurcation of the CHST. In 2004, the funding for the CHT was increased under the federal government's 10-year plan to strengthen health care, which included a base adjustment and an annual 6 percent escalator applicable until 2017. A similar annual escalator was introduced for the CST in 2008, set at 3 percent per year. These developments raised the amount of transfers received by Ontario. The slowdown in Ontario's economy compared to other provinces after 2004 and a reduction in tax rates by most provinces led to a fall in the benchmark fiscal capacity for equalization. This, coupled with faster economic growth in some equalization recipient provinces (Saskatchewan, Manitoba, and Newfoundland and Labrador) since 2004, further reduced the horizontal requirement. On the transfer side, the new framework and subsequent adoption of the O'Brien panel's recommendations increased the equalization transfers, compared to the amount that would have been transferred by following the earlier five-province standard. The rise in transfers under equalization and the CHT/CST combined with a falling level of horizontal fiscal requirement explains the improvement in the extent of horizontal fiscal equalization achieved during 2005-2009.

A further rise in the vertical component took place from 2010 onward, when Ontario became a recipient of equalization grants. The slowdown in Ontario's economy following the 2008 financial crisis also meant a further fall in the benchmark fiscal capacity. Thus, a larger share of the overall transfers to all provinces went toward addressing the vertical imbalance, reducing somewhat the horizontal component of the transfers. Surplus transfers increased substantially between 2005 and 2014 owing to a combination of larger equalization grants, rising transfers under the CHT/CST, and offshore agreements. I will explore this issue further in the next section, where I analyze province-level decomposition.

Decomposition by Province

Table 2 expands the results shown in table 1 using a broadly similar scheme of column headings. Since the vertical requirement is exactly the same for all the provinces (as a percentage of GDP), it is shown only once for each time period. A

separate column titled “Relative GDP” is added, showing provincial per capita GDP as a percentage of the per capita GDP for Ontario. The row containing numbers for “All provinces” essentially reproduces the numbers shown in table 1 for each subperiod.

The poorer provinces are expected to receive more transfers per capita, which, given their lower income levels, would translate into a higher transfer-GDP ratio. Transfers received by Prince Edward Island, Nova Scotia, and Newfoundland and Labrador (which had a lower per capita income than Ontario until 2005) corroborate that expectation. Given that the vertical requirement is the same across all provinces (as a percentage of GDP), higher transfers to the poorer provinces are largely used for horizontal requirements and surpluses, if any.

In 1983-1990, Saskatchewan was the province with the highest level of horizontal fiscal disparities even after accounting for the transfers. The deficiency, at 2.37 percent of provincial GDP, meant that the federal transfers addressed only 46.5 percent of the initial horizontal fiscal disparity. The province continued to face a horizontal deficiency until 2004, though the level of the deficiency declined to 1.58 percent of GDP during 1998-2004. Since 2006, Saskatchewan's per capita income has exceeded Ontario's, eliminating the need for horizontal transfers.

Newfoundland and Labrador received grants under offshore agreements from 2002 through 2012, the period in which the province received large surplus transfers from the federal government. Interestingly, the province's per capita income exceeded Ontario's from 2005 onward, yet its surplus transfers continued until 2012. Nova Scotia, the other beneficiary under offshore agreements, received surplus transfers only during 2007-2009. In fact, between 2005 and 2014, many provinces received large surplus transfers, a phenomenon caused by a combination of larger equalization transfers (initially under the new framework and subsequently the implementation of the O'Brien panel's recommendations), higher transfers under the CHT/CST, and offshore agreements. During 2015-2018, Manitoba, New Brunswick, and Prince Edward Island received surplus transfers. On the other hand, Nova Scotia, Quebec, and British Columbia suffered from a horizontal fiscal deficiency in this period.

A surplus transfer essentially means that the recipient province has a higher fiscal capacity in per capita terms than Ontario after including the federal transfers. If a fiscal cap had been applied, as recommended by the O'Brien panel, Ontario's fiscal capacity should have determined that cap in my framework. Some of the surpluses and deficiencies in the above results can be explained by the choice of provincial GDP instead of the revenue bases covered under the equalization program to determine the provincial tax base. For example, British Columbia's per capita GDP has been consistently lower than Ontario's, necessitating horizontal transfers to the province in the framework used here. However, British Columbia has substantial property tax revenues, which make it mostly ineligible for equalization grants. A shift from the existing RTS-based equalization program to a macro-indicator-based equalization program would eliminate the horizontal deficiencies and surpluses observed in my framework (the per capita equal amount under the CHT/CST would

TABLE 2 Decomposition of Federal Transfers by Province, 1983-2018

Province	Relative GDP	Percentage of GDP					Composition of transfers			Extent of equal- ization achieved		
		Total transfers	Vertical transfers	Vertical gap	Horizontal		Vertical	Horizontal	Surplus			
					require- ment	transfers					Deficiency	Surplus
1983-1990 (Vertical requirement: 2.02) <i>percent</i>												
Newfoundland and Labrador	58	13.19	2.02	0.00	13.14	11.16	1.97	0.00	15.34	84.66	0.00	85.0
Prince Edward Island	58	13.27	2.02	0.00	13.29	11.25	2.05	0.00	15.25	84.75	0.00	84.6
Nova Scotia	69	8.34	2.02	0.00	7.97	6.32	1.65	0.00	24.25	75.75	0.00	79.3
New Brunswick	66	9.87	2.02	0.00	9.10	7.85	1.25	0.00	20.50	79.50	0.00	86.2
Quebec	80	5.97	2.02	0.00	4.43	3.95	0.49	0.00	33.88	66.12	0.00	89.0
Ontario	100	2.02	2.02	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	81	5.88	2.02	0.00	4.29	3.85	0.43	0.00	34.42	65.58	0.00	89.9
Saskatchewan	82	4.08	2.02	0.00	4.42	2.06	2.37	0.00	49.60	50.40	0.00	46.5
Alberta	123	1.90	1.90	0.13	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	91	2.82	2.02	0.00	1.90	0.79	1.10	0.00	71.86	28.14	0.00	41.8
All provinces	91	3.71	1.98	0.04	2.14	1.64	0.50	0.09	53.40	44.29	2.31	76.7

(Table 2 is continued on the next page.)

TABLE 2 Continued

Province	Relative GDP	Percentage of GDP					Composition of transfers			Extent of equal- ization achieved		
		Total transfers	Vertical transfers	Vertical gap	Horizontal		Vertical	Horizontal	Surplus			
					require- ment	transfers					Deficiency	Surplus
1991-1997 (Vertical requirement: 1.93) <i>percent</i>												
Newfoundland and Labrador	60.52	13.05	1.93	0.00	12.90	11.12	1.78	0.00	14.77	85.23	0.00	86.2
Prince Edward Island	64.17	11.09	1.93	0.00	11.06	9.16	1.90	0.00	17.39	82.61	0.00	82.8
Nova Scotia	70.85	8.38	1.93	0.00	8.15	6.46	1.69	0.00	23.00	77.00	0.00	79.2
New Brunswick	70.65	9.11	1.93	0.00	8.24	7.18	1.06	0.00	21.18	78.82	0.00	87.1
Quebec	81.32	5.33	1.93	0.00	4.54	3.40	1.14	0.00	36.20	63.80	0.00	74.8
Ontario	100.00	1.93	1.93	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	80.52	6.42	1.93	0.00	4.79	4.49	0.29	0.00	30.03	69.97	0.00	93.9
Saskatchewan	82.39	4.22	1.93	0.00	4.29	2.29	2.00	0.00	45.71	54.29	0.00	53.4
Alberta	109.71	1.84	1.84	0.09	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	93.09	2.15	1.93	0.00	1.47	0.22	1.25	0.00	89.81	10.19	0.00	14.8
All provinces	91.34	3.41	1.91	0.02	2.07	1.49	0.58	0.01	55.94	43.74	0.32	71.9

(Table 2 is continued on the next page.)

TABLE 2 Continued

Province	Relative GDP	Percentage of GDP					Composition of transfers			Extent of equal- ization achieved		
		Total transfers	Vertical transfers	Vertical gap	Horizontal		Vertical	Horizontal	Surplus			
					require- ment	transfers						
1998-2004 (Vertical requirement: 1.22) <i>percent</i>												
Newfoundland and Labrador	70.73	10.05	1.22	0.00	8.08	8.08	0.00	0.75	12.13	80.40	7.47	100.0
Prince Edward Island	64.84	9.63	1.22	0.00	9.96	8.42	1.55	0.00	12.65	87.35	0.00	84.5
Nova Scotia	71.84	7.05	1.22	0.00	7.24	5.84	1.41	0.00	17.27	82.73	0.00	80.6
New Brunswick	72.30	7.72	1.22	0.00	7.04	6.50	0.54	0.00	15.79	84.21	0.00	92.3
Quebec	81.69	3.95	1.22	0.00	4.12	2.73	1.39	0.00	30.85	69.15	0.00	66.3
Ontario	100.00	1.22	1.22	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	79.87	5.39	1.22	0.00	4.62	4.17	0.45	0.00	22.61	77.39	0.00	90.3
Saskatchewan	87.12	2.37	1.22	0.00	2.73	1.15	1.58	0.00	51.49	48.51	0.00	42.0
Alberta	121.45	0.94	0.94	0.28	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	87.53	1.81	1.22	0.00	2.61	0.59	2.02	0.00	67.42	32.58	0.00	22.5
All provinces	92.70	2.40	1.18	0.04	1.87	1.21	0.66	0.02	49.12	50.26	0.62	64.7

(Table 2 is continued on the next page.)

TABLE 2 Continued

Province	Relative GDP	Percentage of GDP				Composition of transfers			Extent of equalization achieved			
		Total transfers	Vertical transfers	Horizontal		Vertical	Horizontal	Surplus				
				Vertical gap	requirement					transfers	Surplus	
Newfoundland and Labrador	100	6.57	1.91	0.00	0.65	0.65	0.00	4.02	28.98	9.92	61.10	100.0
Prince Edward Island	70	9.55	1.91	0.00	8.02	7.65	0.37	0.00	19.95	80.05	0.00	95.4
Nova Scotia	77	7.03	1.91	0.00	5.55	5.13	0.43	0.00	27.08	72.92	0.00	92.3
New Brunswick	78	7.99	1.91	0.00	5.30	5.30	0.00	0.79	23.83	66.26	9.91	100.0
Quebec	84	4.18	1.91	0.00	3.58	2.28	1.31	0.00	45.55	54.45	0.00	63.6
Ontario	100	1.91	1.91	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	84	6.18	1.91	0.00	3.51	3.51	0.00	0.77	30.81	56.74	12.45	100.0
Saskatchewan	101	2.84	1.91	0.00	0.12	0.12	0.00	0.81	67.05	4.37	28.58	100.0
Alberta	151	0.96	0.96	0.95	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	96	2.51	1.91	0.00	0.85	0.60	0.24	0.00	75.98	24.02	0.00	71.2
All provinces	99	2.77	1.75	0.15	1.19	0.88	0.31	0.13	63.35	31.80	4.86	74.1

(Table 2 is continued on the next page.)

TABLE 2 Continued

Province	Relative GDP	Percentage of GDP					Composition of transfers			Extent of equal- ization achieved		
		Total transfers	Vertical transfers	Vertical gap	Horizontal		Vertical	Horizontal	Surplus			
					require- ment	transfers					Deficiency	Surplus
2008-2009 (Vertical requirement: 2.14) <i>percent</i>												
Newfoundland and Labrador	124	4.38	2.14	0.00	0.00	0.00	0.00	2.24	48.76	0.00	51.24	na
Prince Edward Island	73	9.51	2.14	0.00	7.01	7.01	0.00	0.37	22.46	73.70	3.84	100.0
Nova Scotia	79	7.20	2.14	0.00	4.88	4.88	0.00	0.19	29.67	67.72	2.60	100.0
New Brunswick	82	8.01	2.14	0.00	4.19	4.19	0.00	1.69	26.66	52.24	21.10	100.0
Quebec	86	4.96	2.14	0.00	3.11	2.83	0.28	0.00	43.05	56.95	0.00	90.9
Ontario	100	2.14	2.14	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	91	6.20	2.14	0.00	1.86	1.86	0.00	2.21	34.45	29.97	35.58	100.0
Saskatchewan	128	2.05	2.05	0.09	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Alberta	164	1.07	1.07	1.07	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	99	2.25	2.14	0.00	0.10	0.10	0.00	0.02	94.75	4.37	0.88	100.0
All provinces	103	2.92	1.94	0.19	0.88	0.82	0.06	0.16	66.52	28.10	5.38	93.6

(Table 2 is continued on the next page.)

TABLE 2 Continued

Province	Relative GDP	Percentage of GDP				Composition of transfers			Extent of equalization achieved			
		Total transfers	Vertical transfers	Horizontal		Vertical	Horizontal	Surplus				
				Vertical gap	requirement					transfers	Deficiency	
2010-2014 (Vertical requirement: 2.14) <i>percent</i>												
Newfoundland and Labrador	120.13	3.15	2.62	0.00	0.00	0.00	0.00	0.54	82.95	0.00	17.05	na
Prince Edward Island	76.52	9.23	2.62	0.00	5.86	5.86	0.00	0.76	28.32	63.44	8.24	100.0
Nova Scotia	80.30	7.31	2.62	0.00	4.69	4.69	0.00	0.00	35.80	64.19	0.01	100.0
New Brunswick	82.94	8.05	2.62	0.00	3.93	3.93	0.00	1.50	32.48	48.84	18.68	100.0
Quebec	86.94	5.03	2.62	0.00	2.87	2.42	0.45	0.00	51.97	48.03	0.00	84.3
Ontario	100.00	2.62	2.62	0.00	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Manitoba	92.99	5.91	2.62	0.00	1.44	1.44	0.00	1.85	44.25	24.43	31.32	100.0
Saskatchewan	136.97	1.72	1.72	0.90	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
Alberta	157.68	1.18	1.18	1.43	0.00	0.00	0.00	0.00	100.00	0.00	0.00	na
British Columbia . . .	96.84	2.44	2.44	0.18	0.62	0.00	0.62	0.00	100.00	0.00	0.00	0.0
All provinces	103.18	3.12	2.30	0.31	0.88	0.71	0.17	0.11	73.83	22.63	3.55	80.7

(Table 2 is concluded on the next page.)

TABLE 2 Concluded

Province	Relative GDP	Percentage of GDP				Composition of transfers			Extent of equalization achieved	
		Total transfers	Vertical transfers	Vertical gap	Horizontal		Vertical	Horizontal		
					requirement	transfers		Surplus		Surplus
2015-2018 (Vertical requirement: 2.61) percent										
Newfoundland and Labrador	108	2.22	2.22	0.40	0.00	0.00	0.00	100.00	0.00	na
Prince Edward Island	76	9.01	2.61	0.00	6.19	0.00	0.21	29.01	68.66	2.33
Nova Scotia	78	7.37	2.61	0.00	5.59	0.83	0.00	35.46	64.54	0.00
New Brunswick	80	7.91	2.61	0.00	5.06	0.00	0.23	33.07	63.98	2.95
Quebec	86	5.26	2.61	0.00	3.23	2.64	0.59	49.74	50.26	0.00
Ontario	100	2.61	2.61	0.00	0.00	0.00	0.00	100.00	0.00	0.00
Manitoba	91	5.17	2.61	0.00	1.85	1.85	0.71	50.55	35.73	13.72
Saskatchewan	124	1.91	1.91	0.70	0.00	0.00	0.00	100.00	0.00	0.00
Alberta	141	1.71	1.71	0.91	0.00	0.00	0.00	100.00	0.00	0.00
British Columbia	96	2.40	2.40	0.21	0.77	0.00	0.77	100.00	0.00	0.00
All provinces	101	3.21	2.40	0.21	1.01	0.78	0.23	74.85	24.27	0.88

GDP = gross domestic product.

Note: When averaging the annual figures over a subperiod, it is possible that for a particular province, there were surpluses in some years, while other provinces had a horizontal deficiency. To avoid reporting a coexistence of surplus and deficit for the same province over a subperiod, in averaging surpluses are first used to cover the province's deficit (as a percentage of GDP). Since fiscal inequalities are a relatively longer-term issue, such an averaging of data helps in avoiding short-term fluctuations and focusing on the long-term trends for each province. However, this adjustment is not made for the row containing figures for all provinces, in order to retain details of the aggregate-level surpluses and deficiency. Thus, it is possible to have a scenario (as for the period 1983-1990 and 1991-1997) where no province is showing a surplus at the individual level, but at the aggregate level, a surplus is shown.

Source: Author's calculations using data sources cited for table 1. Relative GDP refers to the per capita GDP of a province as a percentage of the per capita GDP of Ontario.

have no impact on a province's horizontal deficiency/surplus), and may have its own set of winners and losers.

Decomposition by Transfers

Table 3 provides decomposition by different channels of federal transfers. As expected, the CHT and CST are the main channels for vertical transfers, while equalization plays a major role in horizontal transfers.⁴¹ Moreover, the role of equalization in addressing horizontal fiscal disparities has increased over the years. In 1983-1990, equalization grants accounting for 30.8 percent of the total transfers contributed to 67.1 percent of the horizontal transfers. In 2015-2018, equalization grants accounted for 26.8 percent of the total transfers but contributed to 85 percent of the horizontal transfers. With the entry of Ontario into the equalization recipient club in 2010, the role of equalization increased in the vertical transfers as well, where equalization contributed to 7 percent of the overall vertical grants during 2015-2018.

The overall assessment from table 3 suggests that the CHT and CST have essentially become channels for vertical transfers over the years. While the federal government has historically played an important role in equalizing the provincial resources to provide health-care and social services, today the presence of the CHT/CST is not contributing much in equalizing the resources across provinces for these national priorities. The role played by the federal government through the continuance of the CHT/CST is merely that of an agent to ensure that the provinces follow nationally accepted criteria/principles in providing these services. The provinces retain discretion with regard to other aspects of these expenditures.

POLICY DISCUSSION

In 2018, the federal government renewed the equalization program for the next five-year period. Non-recipient provinces, particularly resource-rich Alberta and Saskatchewan, were highly critical of the program. Both of those provinces were facing budgetary deficits as a result of the downturn in global oil prices, while some of the equalization recipient provinces (notably Quebec) were running budgetary surpluses. Provinces facing budgetary deficits are aggrieved that they do not have access to equalization funds when their economy is facing a slowdown. Seeking a change in the existing fiscal transfer arrangements, the Alberta government struck a "fair deal panel," which recommended that a referendum be held on abolishing equalization.⁴²

41 Until 2010, Ontario received grants under the CHT/CST only. However, for some of the provinces, the CHT/CST grants fell short of their vertical requirements. The framework explicitly assumes that any federal transfer is used to meet the vertical, horizontal, and surplus transfer requirements in this order. This explains why a portion of equalization, along with other grants, is shown under the vertical transfers category.

42 Alberta, Fair Deal Panel, *Report to Government*, submitted May 2020, at 18 (<https://open.alberta.ca/dataset/d8933f27-5f81-4cbb-97c1-f56b45b09a74/resource/d5836820-d81f-4042-b24e-b04e012f4cde/download/fair-deal-panel-report-to-government-may-2020.pdf>).

TABLE 3 Decomposition of Federal Transfers by Type of Transfer, 1983-2018

Fiscal years ^a	Percentage of GDP				Contribution of various channels			
	Total	Vertical	Hori- zontal	Surplus	Total	Vertical	Hori- zontal	Surplus
<i>percent</i>								
1983-1990								
Equalization	1.14	0.00	1.10	0.04	30.8	nil	67.1	48.3
EPF + CAP	2.56	1.98	0.54	0.04	69.0	100.0	32.6	49.8
Others	0.01	0.00	0.00	0.00	0.2	nil	0.3	1.9
All	<u>3.71</u>	<u>1.98</u>	<u>1.64</u>	<u>0.09</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
1991-1997								
Equalization	1.08	0.01	1.07	0.00	31.7	0.5	71.7	5.2
EPF + CAP/ CHST	2.30	1.87	0.42	0.00	67.4	98.3	28.1	31.2
Others	0.03	0.02	0.00	0.01	0.9	1.2	0.2	63.7
All	<u>3.41</u>	<u>1.91</u>	<u>1.49</u>	<u>0.01</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
1998-2004								
Equalization	0.92	0.00	0.91	0.01	38.3	nil	75.2	77.6
CHST	1.47	1.17	0.30	0.00	61.0	99.1	24.5	8.5
Others	0.02	0.01	0.00	0.00	0.7	0.9	0.4	13.9
All	<u>2.40</u>	<u>1.18</u>	<u>1.21</u>	<u>0.02</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
2005-2007								
Equalization	0.78	0.00	0.68	0.10	28.1	nil	76.8	75.5
CHT	1.29	1.15	0.13	0.01	46.6	65.7	14.4	8.2
CST	0.59	0.51	0.07	0.01	21.2	29.3	7.4	4.8
Others	0.11	0.09	0.01	0.02	4.1	5.0	1.3	11.5
All	<u>2.77</u>	<u>1.75</u>	<u>0.88</u>	<u>0.13</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
2008-2009								
Equalization	0.82	0.00	0.70	0.12	28.1	0.2	85.3	75.2
CHT	1.38	1.29	0.08	0.01	47.3	66.4	10.1	4.9
CST	0.62	0.59	0.03	0.00	21.4	30.5	3.6	1.5
Others	0.09	0.06	0.01	0.03	3.2	3.0	0.9	18.4
All	<u>2.92</u>	<u>1.94</u>	<u>0.82</u>	<u>0.16</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
2010-2014								
Equalization	0.85	0.19	0.58	0.09	27.3	8.2	81.7	77.6
CHT	1.54	1.47	0.07	0.00	49.4	63.8	9.4	2.8
CST	0.65	0.63	0.03	0.00	21.0	27.2	3.8	0.7
Others	0.07	0.02	0.04	0.02	2.4	0.8	5.1	18.9
All	<u>3.12</u>	<u>2.30</u>	<u>0.71</u>	<u>0.11</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

(Table 3 is concluded on the next page.)

TABLE 3 Concluded

Fiscal years ^a	Percentage of GDP				Contribution of various channels			
	Total	Vertical	Hori- zontal	Surplus	Total	Vertical	Hori- zontal	Surplus
<i>percent</i>								
2015-2018								
Equalization	0.86	0.17	0.66	0.03	26.8	7.0	85.0	97.7
CHT	1.70	1.62	0.08	0.00	52.9	67.4	10.3	1.7
CST	0.64	0.61	0.03	0.00	20.0	25.5	3.9	0.6
Others	<u>0.01</u>	<u>0.00</u>	<u>0.01</u>	<u>0.00</u>	<u>0.3</u>	<u>0.1</u>	<u>0.8</u>	<u>nil</u>
All	<u>3.21</u>	<u>2.40</u>	<u>0.78</u>	<u>0.03</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

CAP = Canada assistance program; CHST = Canada health and social transfer; CHT = Canada health transfer; CST = Canada social transfer; EPF = established programs financing; GDP = gross domestic product.

Note: "Others" includes grants under offshore agreements, total transfer protection, health-reform grants, wait-time reduction, and stabilization. Columns may not add because of rounding.

- a The subperiods listed refer to fiscal year-ends; for example, 1983-1990 covers fiscal years 1982-83 through 1989-90.

Source: Author's calculations using data sources cited for table 1.

While the concerns regarding the exclusion of some provinces from federal support at a time of economic slowdown are valid, criticism of the equalization program by non-recipient provinces in this context is misplaced. As discussed earlier, fiscal capacity instead of budgetary deficit should be the basis for providing transfers for horizontal fiscal equalization. Given its mandate, equalization cannot be the channel to support the two richest provinces. Complaints about the lack of adequate federal support when provincial revenues are falling because of temporary shocks should be directed at the federal stabilization program, which is supposed to protect provinces from substantial year-over-year declines in their revenues.

The current design of the fiscal stabilization program is not suitable for addressing the needs of resource-rich provinces. For example, when Alberta's revenues dropped by \$9.2 billion over two years, in 2015-2016, the province received \$500 million in support under the stabilization program. The current program structure provides support to a province only if the year-over-year decline exceeds 5 percent in the case of non-resource revenues and 50 percent in the case of resource revenues, and the total support is capped at \$60 per capita (see the appendix to this article for details). It seems clear that this formula will result in inadequate support to the resource-rich provinces. However, given the inherent volatility of resource revenues, the long-to medium-term average of such revenues can be very different from the annual figures. Thus, compensating a province for a shortfall from the peak observed in the previous year might actually result in an overpayment of stabilization support.

Dahlby proposes that in addition to the deductible, a co-insurance component can also be included in the program, whereby the federal government will cover a certain portion of revenue loss over and above the deductible.⁴³ The payment should be made for a shortfall against the province's fiscal capacity over a five-year moving average rather than on the basis of a year-over-year decline. With these adjustments, Dahlby argues that the distinction between resource and non-resource revenues should be removed. Tombe argues that, in the short term, the 50 percent deductible for resource revenues should be maintained.⁴⁴ This is because covering reasonably expected volatility-induced losses through the stabilization program would dampen the incentive to save more revenues and to introduce more stable revenue sources such as, in Alberta's case, a sales tax. Tombe argues that the stabilization program, like equalization, should be linked to fiscal capacity or a macro-indicator in the long term. Both authors emphatically make a case for removal of the \$60 per capita limit. Clearly, reform in the stabilization program needs to be urgently pursued to address the pain felt by resource-rich provinces.

As shown in the previous section, the equalization program is the main channel through which interprovincial horizontal fiscal inequalities are addressed in Canada. The CHT and CST, for their part, have become a channel for vertical transfers and contribute little toward horizontal equalization. Provinces could raise the same amount through taxes if the fiscal space were returned to them. This creates a possibility of simplification in the federal transfer system, namely, reducing the vertical fiscal imbalance by transferring tax points to provinces instead of providing specific-purpose transfers.

Experience has shown that when faced with fiscal constraints owing to lower federal transfers, as occurred in the mid-1990s, the provinces have "compromised every provincial program except medicare, since gutting medicare would spell certain electoral defeat."⁴⁵ This negates the necessity that the federal government must label a particular domain while transferring funds under the CHT to ensure that provinces use that money for expenditure on health care. Transferring the tax points would provide an elastic revenue source to provinces that are shouldering rising health-care expenditures. Given that the provinces have a constitutional responsibility to provide social services, and the electoral importance of social-sector spending, a similar argument can be made for the CST. The revenue raised from the

43 Bev Dahlby, "Reforming the Federal Fiscal Stabilization Program" (2019) 12:18 *SPP Briefing Papers* [University of Calgary School of Public Policy] 1-20 (<https://doi.org/10.11575/spp.v12i0.68076>).

44 Trevor Tombe, "An (Overdue) Review of Canada's Fiscal Stabilization Program" (2020) 31 *IRPP Insight* [Montreal, Institute for Research on Public Policy] 1-25.

45 Thomas J. Courchene, "Hourglass Federalism—How the Feds Got the Provinces To Run Out of Money in a Decade of Liberal Budgets," *Policy Options*, April 1, 2004, at 15 (<http://irpp.org/wp-content/uploads/assets/po/budget-2004/courchene.pdf>).

proposed tax point transfers would be covered under the equalization program, addressing concerns of interprovincial inequity in fiscal resources.⁴⁶

In this context, the current ceiling on the growth of the aggregate equalization amount to be distributed among provinces, which is capped at the rate of growth in GDP, can create challenges. The purpose of a tax point transfer in lieu of the CHT and CST grants is to provide provinces with an elastic source of revenue, growing at a faster rate than GDP. Even without these considerations, the ceiling should be removed since it uncouples overall equalization support from the quantum of interprovincial fiscal disparities. Another challenge in shifting toward equalized tax point transfers in lieu of per capita equal social transfers could be a “transfer illusion.” A major source of dissatisfaction with the equalization program among the “have” provinces is that they do not receive anything, a complaint that cannot be made about the CHT and CST. For example, Saskatchewan’s premier argued in 2018 for a 50-50 formula for equalization: half of the collected money would be distributed in the same manner as it is now, while the other half would be distributed on a per capita basis. The premier admitted that “[t]his would not result in any huge windfalls to our province of Saskatchewan. Our province would receive about \$300 million, about 1.6 per cent of the total equalization pool—but we would receive something.”⁴⁷ Thus, to simplify the federal transfer system on the proposed lines, provinces would need to be convinced regarding the broad fiscal equivalence of an equalized tax point transfer and the existing per capita equal grants.

LIMITATIONS AND FUTURE DIRECTIONS

This article explores the vertical and horizontal composition of the federal transfers and their impact on addressing initial horizontal fiscal disparities between provinces. However, the federal government also incurs expenditures in making transfers to persons and other transfer payments, and other direct expenses. Except for spending on national public goods, such as national defence and foreign affairs, other direct expenditures by the federal government have implications for the provision of public services and welfare at the regional level. Thus, these programs can be brought within the ambit of analysis for addressing horizontal fiscal disparities. The framework outlined in this article can be applied to this broader coverage of federal transfers and spending, where the direct federal expenditure can be an additional channel to augment the existing federal-provincial transfers.

In this article, it is assumed that the burden of federal taxation as a percentage of GDP is uniform across the provinces. In practice, while the federal tax code (rates, brackets, exemptions, etc.) may be uniform across the nation, it may not

46 To be sure, when the tax point transfer is equalized on the basis of the 10-province standard fiscal capacity, provinces above the standard fiscal capacity will be able to collect more revenues than the equalized value of the tax point transfer for other provinces.

47 David Baxter, “Saskatchewan Premier Scott Moe Pitches New 50-50 Equalization Formula,” *Global News*, June 20, 2018.

translate into a uniform tax burden. Built-in progressivity in taxation, differential tax rates (and tax breaks) across sectors/regions/types of income/consumption, and differential compliance rates can translate into a differential tax burden across provinces. To incorporate these variations, one may possibly consider any provincial contribution lower than the average federal tax rate to be an additional channel of horizontal fiscal equalization, while a higher contribution than the average tax rate can be considered a negative horizontal transfer. Interestingly, this treatment of a geographically differential tax burden can be traced back to Buchanan's founding contribution on horizontal fiscal equalization, where, instead of federal transfers to provinces, the author preferred to use a differential federal tax code across provinces to address horizontal fiscal disparities.⁴⁸

In Canada, researchers have calculated federal fiscal balances at the provincial level by deducting federal transfers and direct expenditures from the federal taxes collected at the regional level.⁴⁹ Although such exercises involve certain assumptions regarding the regional incidence of federal taxes and spending, these studies improve our understanding of the role played by federal fiscal policy in provincial economies. As a first-cut attempt, the present article focuses only on federal-provincial transfers. The proposed framework can be expanded to incorporate other regionally relevant dimensions of federal fiscal policy.

48 Under this scheme, the federal tax rate would be lower in the poorer regions. The subnational governments in poorer regions, compared to those in richer regions, are able to provide a lower level of public services to their citizens, even when citizens in both regions may be facing similar tax rates/regimes. A lower federal tax rate in a poorer region would compensate its citizens for the lower level of public services provided by their subnational government and thus help in addressing horizontal fiscal inequity. The federal tax rate in the poorer regions should be lowered such that citizens at a similar income level in the rich and poorer regions face an identical combined federal-provincial fiscal residuum; that is, the benefits (expenditure) minus the burden (taxes) are identical for those citizens. This ensures horizontal fiscal equity. In Buchanan's view, the use of "geographically discriminatory taxation" for horizontal equalization is better than the federal transfers, since the former method abides by the principles of financial responsibility and state fiscal independence. Another major advantage of geographically discriminatory taxation is that "it allows the necessary inter-area transfer of funds to take place without any necessary increase in the total amount of federal revenue," an important consideration in the "era of big central government." However, Buchanan recognized that geographically discriminatory taxation will face challenges of constitutional legality and the phenomenon of "tax illusion," where individuals might be more elastic in their response to the differential tax burden compared to the differential benefits received from the government expenditure. Thus, federal transfers can be considered as the second-best alternative to achieve horizontal fiscal equity. See Buchanan, *supra* note 35, at 595-96.

49 See François Vaillancourt and Richard M. Bird, "The Interregional Incidence of Central Budgets in Federations: Some Evidence from Canada" (2007) 27:1 *Public Budgeting & Finance* 1-19; G.C. Ruggeri and Weiqiu Yu, "The Measurement of Interregional Redistribution" (2003) 31:4 *Public Finance Review* 392-412; Robert Mansell and Ronald Schlenker, "The Provincial Distribution of Federal Balances" (1995) 3 *Canadian Business Economics* 3-19; and Robert Mansell, Mukesh Khanal, and Trevor Tombe, "The Regional Distribution of Federal Fiscal Balances: Who Pays, Who Gets and Why It Matters" (2020) 13:14 *SPP Research Papers* [University of Calgary School of Public Policy] 1-38.

I have taken Ontario as the benchmark province for measuring the vertical fiscal space surrendered by provinces and the horizontal fiscal inequalities for other provinces—even though Alberta is the richest province owing to its natural resource endowment. The choice of tax base and the benchmark province can create more possible combinations for analysis. This article contributes to both the theory and the empirical analysis of the decomposition of federal transfers into their vertical and horizontal components. Researchers may use different benchmarks and tax base measures to explore the issue further.

CONCLUSION

The intergovernmental transfers provided by the federal government comprise both vertical and horizontal components, and sometimes surplus transfers as well. The framework presented in this article makes it possible to separate these components. Empirical analysis has been carried out using Ontario as the benchmark province throughout, and GDP as the revenue base for applying a representative tax rate. Over the study period, the composition of the federal transfers has increasingly shifted toward the vertical component, from 53.4 percent during 1983-1990 to 74.85 percent during 2015-2018. The quantum of horizontal deficiency has also declined substantially during this period, from 0.5 to 0.23 percent of the provincial GDP. These results are driven by a combination of factors, including an increase in the per capita income of some former equalization recipient provinces (Saskatchewan and Newfoundland and Labrador); a slowdown in Ontario's economy, bringing down the benchmark fiscal capacity; and a continuous rise in total federal transfers (as a percentage of GDP) since 2005.

The federal transfers should be seen as a system addressing fiscal imbalances and providing stability to provincial finances. The former purpose is served by the CHT, the CST, and the equalization program, while the latter purpose—particularly for the richer provinces—needs to be served by a reformed fiscal stabilization program. Since all three major federal transfers (the CHT, CST, and equalization) flow together into the general revenue funds of provincial governments, these programs should not be treated as separate silos. It is possible to reduce the vertical fiscal imbalance by transferring tax points to provinces instead of providing specific-purpose transfers. Simplification of the federal transfers on the proposed lines would improve the fiscal accountability of the provinces and save them from federal discretion and threats of possible cutbacks in health-care and social-sector funding. The proposed reform would also shift the focus of the fiscal transfer system to equalization—a constitutional responsibility of the federal government “to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.”⁵⁰

50 Section 36(2) of the Constitution Act, *supra* note 36.

APPENDIX HISTORICAL EVOLUTION OF CANADIAN INTERGOVERNMENTAL FISCAL TRANSFERS SINCE THE SECOND WORLD WAR

The federal-provincial transfer system plays a vital role in addressing the impact of regional inequalities and regional business cycles on provincial finances. The Canada health transfer (CHT), the Canada social transfer (CST), and the equalization program are the main pillars of the redistribution/equalization policy. A fourth channel for transfers to the provinces, the federal stabilization program, is meant to address issues related to regional business cycles by protecting provinces from substantial year-over-year declines in their revenues. This appendix provides a brief overview of the history and design of these transfers.⁵¹

Equalization

Origin of the Representative Tax System Framework

Equalization emerged as a stand-alone program in 1957, though its origin can be traced back to the Second World War.⁵² In 1941, the provinces vacated income tax and estate tax domains in return for cash transfers from the federal government. These “tax rental” arrangements were created to enable the federal government to finance the war effort, but the arrangement continued in the post-war period. These cash grants had an implicit equalization component, since per capita transfers to the provinces that accepted the tax rental agreements were similar irrespective of the amount of taxes collected from them. However, Quebec, and later Ontario, considered the continuation of tax rental arrangements after the war as a

51 This overview heavily draws on the following publications: Daniel Béland, André Lecours, Gregory P. Marchildon, Hizhen Mou, and M. Rose Olfert, *Fiscal Federalism and Equalization Policy in Canada: Political and Economic Dimensions* (Toronto: University of Toronto Press, 2017); Tombe, *supra* note 27; Jim Feehan, “Canada’s Equalization Formula: Peering Inside the Black Box . . . and Beyond” (2014) 7:24 *SPP Research Papers* [University of Calgary School of Public Policy] 1-27; Richard M. Bird, “Policy Forum: Equalization and Canada’s Fiscal Constitution—The Tie That Binds?” (2018) 66:4 *Canadian Tax Journal* 847-69; the O’Brien report, *supra* note 39; Tombe, *supra* note 44; and Canada, Department of Finance, “History of Health and Social Transfers” (www.canada.ca/en/departement-finance/programmes/federal-transfers/history-health-social-transfers.html).

52 Even earlier, the report of the Rowell-Sirois commission, published in 1940, had recommended the introduction of equalization grants. See Canada, *Report of the Royal Commission on Dominion-Provincial Relations* (Ottawa: King’s Printer, 1940). The equalization program adopted in 1957 differed from the Rowell-Sirois proposal in two important aspects: (1) the commission had recommended the creation of an independent body, similar to the Common-Wealth Grant Commission in Australia, to determine the amount and distribution of transfers; and (2) the commission had recommended that the expenditure needs of the provinces, as well as their revenues, should be considered. However, the equalization formula adopted is determined by the federal government, and only the revenue side of the provinces is considered in determining the transfers. See Béland et al., *supra* note 51, at 17, for details on these differences.

sign of fiscal centralism. Quebec instituted its own corporate income tax system in 1947 and introduced a personal income tax in 1954. Quebec made it clear that “any trade-off of equalization for the federal occupation of the central tax sources . . . was impossible.”⁵³ Ontario agreed to join the 1952 tax rental arrangements for income tax; however, in 1955, it announced plans to set up its own corporate income tax.⁵⁴

The need to end the fiscal isolation of Quebec, to accommodate provinces’ insistence on their right to self-determination, and to provide a mechanism for fiscal redistribution outside the tax rental arrangements together triggered the creation of a formula-driven equalization program.⁵⁵ In 1957, the federal government separated its tax rental payment from the equalization component. Each province participating in the tax rental agreement was allocated a portion of the three federally collected taxes—personal income tax (10 percent), corporate income tax (9 percent), and succession duties (50 percent)—that were generated in that province. Since the value of these transfers was lower for the less wealthy provinces, their transfers were topped up by an “equalization amount” to match the average of transfers given to the two richest provinces (Ontario and British Columbia).⁵⁶ This equalization grant was made independent of the tax rental agreement. Thus, any province running its own tax system would not receive the tax rental payment, but it would be entitled to equalization grants for the deficiency measured against the two-province standard.

Since 1957, the equalization program has evolved in terms of the number of tax/revenue bases for which provincial fiscal capacities are equalized and the standard/benchmark fiscal capacity against which shortfalls are to be measured. Once these two choices have been made, the formula for determining the equalization amount is relatively straightforward. The fiscal capacity of a province for a given revenue base is measured not on the basis of actual revenue collected, but rather by calculating how much the province could collect if it applied a representative tax rate, which is usually the average tax rate applied by all provinces on the particular revenue base. The representative tax revenues collected from all tax bases covered under the equalization program are added together to calculate the province’s overall fiscal capacity. This overall fiscal capacity of a province is compared against the benchmark fiscal capacity to determine whether that province is eligible for equalization payments to meet the shortfall. This method for the calculation of equalization entitlement is known as the representative tax system (RTS).

In 1962, 50 percent of a province’s natural resource revenues were included as the fourth revenue base to be equalized. This share has varied in subsequent years, between 50 and 100 percent inclusion. In 1962, the benchmark was also shifted from the 2-province standard to a 10-province average. The number of tax/revenue

53 See Bélard et al., *supra* note 51, at 18.

54 Tombe, *supra* note 27, at 881.

55 Bélard et al., *supra* note 51, at 19.

56 Tombe, *supra* note 27, at 882.

bases to be equalized expanded to 27 by the late 1970s and 33 in the 1980s. However, it is the treatment of natural resource revenues that has been the most troublesome issue. In the words of Thomas Courchene, a leading expert on Canada's equalization program, treatment of resource revenues is "a theoretical and empirical minefield," and an issue that "one copes with rather than solves."⁵⁷ The "reforms" made to the equalization program were driven by the need to contain the impact of Alberta's huge oil revenues on the benchmark fiscal capacity, particularly after the two oil crises in the 1970s increased the revenues of oil-producing provinces.

An interesting situation arose in the late 1970s when the inclusion of the growing resource revenues in the equalization formula meant that Ontario would become eligible for equalization payments. To avoid labelling the most populous and one of the richest provinces as a "have not" province, a new federal law was introduced to ensure that a province would not be eligible for equalization if its per capita personal income was higher than the national average.⁵⁸ This intervention eliminated Ontario as a candidate for equalization payments. It was only after the economic slowdown of 2008 that Ontario received equalization grants, for the years 2010 through 2019.

From Constitutional Incorporation to the New Framework

The year 1982 was an important landmark in the history of equalization. Now equalization was embedded in section 36(2) the Canadian constitution, in the following words: "Parliament and the government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."⁵⁹ Among other major changes, the federal government replaced the 10-province standard with a 5-province standard (mainly to exclude Alberta), which reduced the cost of the program. This allowed the federal government to include 100 percent of resource revenues in the equalization formula. Further, for the first time, the growth rate of aggregate entitlements was capped to the growth rate in Canada's gross domestic product (GDP).⁶⁰

From 1982 to 2004, except for some technical adjustments, the program remained mostly the same in its basic approach. The principle of raising the provinces with weaker fiscal capacity to the benchmark fiscal capacity through equalization transfers may create certain undesirable incentives for recipient provinces. Any expansion of a province's own tax base will raise its fiscal capacity, leading to a decrease in its equalization entitlement (termed a "clawback"). To address these concerns, the federal

57 Thomas Courchene, quoted by James Feehan in Harvey Lazar, *Canadian Fiscal Arrangements: What Works, What Might Work Better* (Montreal and Kingston, ON: McGill-Queen's University Press, 2005), at 185.

58 Bélard et al., *supra* note 51, at 23.

59 *Supra* note 36.

60 Tombe, *supra* note 27, at 899.

government entered into specific agreements with Nova Scotia (in 1982) and Newfoundland and Labrador (in 1985). These arrangements provided the two provinces with time-limited partial compensation for any reduction in equalization payments as a result of increasing revenues from offshore development.

The most significant departure from the RTS-based equalization mechanism occurred during 2005-2007. The aggregate equalization payments had started to decline under the formula-based system, from a peak of \$10.9 billion in 2001 to an expected level of \$8.9 billion in 2005. This was due to the combined impact of a slowdown in Ontario's economy and tax-rate reductions in several provinces, which reduced the benchmark against which shortfalls were to be determined.⁶¹

A "new framework" was announced in October 2004, which set a fixed pool of \$10 billion as the aggregate equalization payment for 2005, with a guaranteed growth rate of 3.5 percent per year. Equalization payments were distributed among provinces partly as a function of their past shares and partly on a per capita basis. In 2005, new offshore accords were signed with Newfoundland and Labrador and Nova Scotia, extending, until 2012, the protection against any reductions in equalization payments as a result of increased revenues from offshore development.

These changes broke the link between equalization payments and fluctuations in a province's relative fiscal capacity, to the extent that Newfoundland and Labrador had a higher fiscal capacity after equalization than Ontario (even without taking the offshore accord in account). Further, Quebec was left with a lower fiscal capacity (inclusive of an equalization payment) than would have occurred under the former system.⁶²

The O'Brien Report and the Current Framework

The federal government established an expert panel, chaired by Al O'Brien, to examine the overall system of equalization and territorial formula financing. The panel submitted two separate reports in 2006, one for equalization and the other for territorial financing. The panel's main recommendations on equalization still form (for the most part) the basis for equalization payments in effect today. The panel recommended a return to the RTS system with the 10-province standard for calculating equalization payments. All of the 33 revenue sources used in the previous formula were aggregated into five categories: personal income tax, business income tax, sales tax, property tax, and natural resource revenues.

Regarding natural resources, the panel agreed that the provinces should receive a net fiscal benefit from the development of these resources, but it also justified a reduction in equalization entitlement resulting from an increase in natural resource revenues. In the panel's words, "that's precisely how equalization is intended to work."⁶³ However, the panel recognized that there are public costs involved in

61 See the O'Brien report, *supra* note 39, at 23.

62 *Ibid.*, at 24-25.

63 *Ibid.*, at 55.

providing the infrastructure necessary to develop natural resources. Full inclusion may create disincentives for maximizing the potential of those resources. Thus, the panel coped with the difficult question of the treatment of natural resource revenues by including only 50 percent of such revenues in the calculation of a province's entitlement to equalization.

However, the panel recognized that the exclusion of half of a province's resource revenues could result in a situation where a recipient province (for example, British Columbia, Newfoundland and Labrador, or Saskatchewan) might have a higher fiscal capacity after equalization than a non-receiving province (such as Ontario). The panel recommended that a fiscal cap for equalization payments be implemented to ensure that no receiving province would have a fiscal capacity higher than that of the lowest non-receiving province. For the purpose of the fiscal cap, 100 percent of a province's resource revenues, along with any payment under an offshore accord, would be included in calculating a province's fiscal capacity.⁶⁴ Finally, the panel recommended using a three-year weighted moving average for revenue bases to smooth out year-over-year changes in the equalization grants.

The federal government implemented the recommendations of the expert panel in 2008, with certain modifications. The inclusion of resource revenues, along with the provision of the fiscal cap, meant a clawback for some provinces. To address this concern, the federal government announced in its 2007 budget that "all provinces will receive the greater of the equalization entitlements under the formula based on a 50-per-cent exclusion rate, and the amounts they would receive under the same formula based on full exclusion of all natural resource revenues,"⁶⁵ though the fiscal cap recommended by the panel was retained.⁶⁶ To avoid the impact of the fiscal cap on offshore agreements, Nova Scotia and Newfoundland and Labrador were given the option of remaining under the previous framework until the existing agreements expired.

The global financial market crisis in 2008 led to a decline in Ontario's manufacturing sector (particularly the automobile industry). In 2010, for the first time in the history of Canada's equalization program, the province received equalization transfers. This had two consequences. First, the sheer size of Ontario's population translated into a large increase in funding for the aggregate equalization transfers, with a greater share going to Ontario. The equalization transfers to Ontario increased from \$0.35 billion (out of \$14.2 billion for all provinces) in 2010 to peak at \$3.3 billion in 2013 (out of \$15.4 billion for all provinces). Second, with the transition of Ontario from a "have" to a "have not" province, British Columbia became the non-recipient province with the lowest fiscal capacity, which was to act as a fiscal cap. However, this cap was substantially higher than the level that prevailed in the earlier years, based on Ontario's fiscal capacity, resulting in a relatively lower clawback of

64 Ibid., at 62.

65 Canada, Department of Finance, 2007 Budget, Budget Plan, March 19, 2007, at 114.

66 Bélard et al., *supra* note 51, at 38.

equalization entitlement from the recipient provinces and a higher burden for the federal government.

The federal government took two steps to limit its burden for financing the equalization program. First, given Ontario's entry into the "have not" group, it modified the fiscal cap, setting it at the average fiscal capacity of the equalization-receiving provinces. Second, the total size of the equalization program was capped to increase at the growth rate of nominal GDP. Any excess of the formula-based aggregate equalization over the capped amount linked to GDP growth was to be eliminated by a reduction in the former by an equal per capita amount to keep the overall transfers within the ceiling of the latter. These two measures reduced the equalization bill by \$1.9 billion for 2010, compared to the calculation of equalization payments based on the approach followed in the 2007 budget.⁶⁷

An interesting twist came in 2019, when a decline in oil prices led to a decline in the benchmark fiscal capacity. This led to a situation where the formula-based aggregate payments were less than the aggregate equalization amount based on nominal GDP growth. The federal government chose to stick with the higher aggregate amount and raised the formula-based provincial entitlement upward. Thus, under the new scheme, the role of the formula for calculating the provincial fiscal gap has been limited to an allocator of a predetermined amount, not a determinant of that amount.

This brief review of the equalization program suggests that while the federal government has shown a sense of its commitment to alleviate interprovincial fiscal disparities, it has also been concerned about the cost of the program. Natural resource revenues are a very significant source of interprovincial fiscal disparities. While an increase in oil prices does not create a revenue gain for the federal government, the resulting interprovincial fiscal disparities increase the demand for equalization grants. This concern has motivated the federal government to "reform" the equalization program multiple times, either by excluding Alberta's revenues from the equalization benchmark or by reducing the inclusion rate.

Provinces are affected to varying degrees by these changes. In general, receiving provinces with substantial natural resource revenues but lower than average non-resource revenues (for example, Saskatchewan and British Columbia)⁶⁸ benefit if resource revenues are excluded from the program. The inclusion of resource revenues leads to a clawback of equalization dollars for such provinces. On the other hand, receiving provinces lacking resource revenues (for example, New Brunswick and Prince Edward Island) benefit by the inclusion of natural resource revenues because it enlarges the revenues to be equalized. The non-receiving provinces (for example, Alberta and typically Ontario and British Columbia) usually suffer from

67 Tömbe, *supra* note 27, at 899.

68 During the study period of 1983-2018, Saskatchewan was a recipient of equalization transfers from 1987 to 2008 (excluding 2004), while British Columbia was a recipient from 2000 to 2007 (excluding 2001).

the inclusion of natural resources revenues because they have to pay taxes to the federal government without receiving equalization transfers. Clearly, as in the words of the O'Brien panel, the treatment of natural resource revenues under the equalization program is a "Canadian conundrum."⁶⁹

The CHT and CST

The evolution of the welfare state after the Great Depression and the Second World War increased expenditures on health, social assistance, and education programs. This led to fiscal imbalances, because the provinces' revenue capacity was inadequate to fund their rising expenditure responsibilities in the social sector. The federal assistance to meet these challenges has evolved over the years, from cost-sharing programs to block funding transfers. In the 1950s and 1960s, the federal government started to provide cost-sharing grants to provinces for social services programs. In 1966, the Canada assistance program (CAP) replaced four existing shared-cost programs in the social sector (old-age assistance, unemployment assistance, and assistance for blind persons and disabled persons). In 1977, the cost-sharing grants for health and post-secondary education were replaced by a block transfer called established programs financing (EPF).

Unlike the cost-sharing nature of CAP, under EPF the provinces received equal per capita support through a mix of cash and equalized tax points. The federal government vacated 13.5 percent of the personal income tax and 1 percent of the corporate income tax, which could now be levied by the provinces. Since wealthier provinces could collect more tax by levying the same tax rate, the federal government equalized the tax points on an ongoing basis, by providing higher cash transfers to less wealthy provinces through what was known as "associated equalization."⁷⁰ In 1984, funding under EPF was made conditional on respecting the five criteria of the newly enacted Canada Health Act (universality, accessibility, portability, comprehensiveness, and public administration).

In 1994, CAP and EPF were merged into a single block fund, the Canada health and social transfer (CHST). The provision of equal per capita support with a mix of an equalized tax point transfer and a cash transfer was continued on the lines of EPF. There was a drastic reduction in the outlay on the CHST program from \$18.5 billion in 1996 to \$12.5 billion in 1998, creating tensions between the federal and provincial governments. In 2004, the CHST was bifurcated into two new transfers, the CHT and the CST. Also, in the same year, the federal and provincial governments committed to a 10-year plan to strengthen health care, with the federal government agreeing to provide \$41.3 billion in support of this plan.⁷¹ This was operationalized by increases in funding for the CHT through a base adjustment and

69 O'Brien report, *supra* note 39, at 55.

70 *Ibid.*, at 47.

71 Canada, Department of Finance, 2005 Budget, Budget Plan, February 23, 2005, at 13.

an annual 6 percent escalator, which continued until 2017.⁷² Since then, the growth of the CHT has been linked to a three-year moving average of GDP growth, with a floor of 3 percent per year. A similar annual escalator was introduced for the CST in 2008, though at a lower rate of 3 percent per year.

The O'Brien panel's report suggested that equalization should be the primary vehicle for equalizing fiscal capacity. The presence of associated equalization to equalize the value of tax point transfers meant that a province that was ineligible for equalization could receive more in per capita cash transfers under the CHT and CST to compensate for the fact that it does not receive equalization funding for its share of the tax point transfer.⁷³ To address concerns about "back-door" equalization, the federal government proposed in its 2007 budget to shift to an equal per capita cash allocation for both the CST and the CHT when these programs came up for renewal.⁷⁴ The practice of equalizing tax point transfers through associated equalization, which was first introduced in 1977 under EPF, was replaced with an equal per capita cash transfer to all provinces under both the CST (in 2008) and the CHT (in 2015).

The Fiscal Stabilization Program

As in the case of the equalization program, the origin of the stabilization program can be traced back to the Second World War. The 1941 tax rental agreement had a built-in stabilization mechanism. The provinces agreed to vacate all income tax and succession duties. In return, the federal government provided fixed annual payments either equivalent to the tax yield for the provinces in 1941 or sufficient to service their debt. Thus, the fixed payment insulated the provinces from annual volatility (though fixed payments would deny provinces any gains as well). The federal government also provided protection for gasoline tax revenues, which were particularly at risk because of wartime rationing. The federal government agreed to fill the gap for provinces whose gas tax revenues fell below their 1940 level. Both the 1947 and 1952 tax rental arrangements guaranteed minimum payments to participating provinces.⁷⁵

Separation of equalization from the tax rental payment in 1957 also brought changes in the stabilization program. The program committed to stabilize the yield on income tax and succession duties at the rates determined by the federal government. If these revenues declined by more than 5 percent relative to the average for the previous two years, the federal government would fill the gap.⁷⁶ Subsequent changes in the program were expansion of the number of provincial tax bases covered, changes in the deductible rates, and the introduction of a per capita cap on the stabilization payment.

72 See Canada, Department of Finance, *supra* note 51.

73 O'Brien report, *supra* note 39, at 47.

74 2007 Budget, *supra* note 65, at 359.

75 Tombe, *supra* note 44, at 7.

76 See Tombe, *supra* note 44.

Today the stabilization program provides support to provinces facing a year-over-year decline on the following basis:

- If natural resource revenues are higher than in the previous year, the fiscal stabilization payment is the difference between the year-over-year reduction in total revenues and 5 percent of total revenues in the previous year.
- If natural resource revenues decline by more than 50 percent, the fiscal stabilization payment is equal to reductions in non-resource revenues and resource revenues in excess of 5 percent and 50 percent of the previous years' revenues from these sources.
- If natural resource revenues decline but by less than 50 percent of the previous year's revenues, the fiscal stabilization payment is the difference between the decline in non-resource revenues and 5 percent of the previous year's non-resource revenues.

The maximum fiscal stabilization payment to a province is subject to a cap of \$60 per capita, which was introduced in 1987. Clearly, the provision of a cap and the higher deductible of 50 percent effectively deny the stabilization support required to resource-rich provinces. For example, Alberta's annual revenues declined by nearly \$9.2 billion during the two-year period of 2016-2017, but the total stabilization payment received by the province was only \$500 million. Similarly, Saskatchewan's revenues fell by \$1.7 billion during the three-year period of 2015-2017, but the province received only \$20 million in stabilization.⁷⁷ Non-availability of effective federal support during the economic downturn has generated a lot of dissatisfaction among the resource-rich provinces toward the federal-provincial transfer arrangements. On the whole, the system of intergovernmental transfers has been able to support the poorer provinces to raise their level of public services. However, immediate reforms are required in the fiscal stabilization program to address the concerns of resource-rich provinces facing a revenue shortfall owing to a decline in commodity prices.

77 *Fiscal Reference Tables 2019*, supra note 2; and Government of Canada, "Historical Transfer Tables: 1980 to Present" (<https://open.canada.ca/data/en/dataset/4eeec1558-45b7-4484-9336-e692897d393f>).

Policy Forum: Editors' Introduction— The Canada Revenue Agency as a Benefits Administrator

In the 2020-21 fiscal year alone, the Canada Revenue Agency (CRA) will deliver an estimated \$55 billion in payments under the Canada emergency response benefit and the Canada recovery benefit, and \$28 billion in payments under the Canada child benefit. It will also disburse the Canada workers benefit (CWB), the climate action incentive, and most provincial child benefits, as well as credits for Canadians with disabilities and other special needs.¹ The CRA's administrative infrastructure has allowed it to deliver these benefits at a low cost while achieving relatively high takeup rates. Moreover, the CRA has been able to deliver benefits without the stigma attached to traditional "welfare" programs.

With CRA-delivered benefits becoming an ever-larger part of Canada's income support landscape, getting the delivery of those benefits right is critical to the well-being of Canadians. An assessment of the CRA's benefit delivery is particularly timely at present, as calls for the introduction of a guaranteed basic income² raise the question of how such a benefit could be delivered. This Policy Forum presents three articles that examine the challenges that the CRA faces in benefit delivery and suggest ways in which the agency's benefit delivery capabilities could be enhanced in the future. The first two articles are by academics specializing in economics and public policy, and the third is by a tax practitioner.

Jennifer Robson and Saul Schwartz open the Forum with a discussion of the CRA's strengths and weaknesses as a benefit agency. While praising "the speed and ease" with which the CRA was able to launch several new income benefits during the COVID-19 pandemic,³ they note two important weaknesses in the CRA's current operations. First, the CRA does not collect within-year income information, and so cannot adjust benefits quickly in response to changes in individuals' circumstances. Second, voluntary compliance in tax filing means that people who do not file an

1 Canada, Department of Finance, Fall Economic Statement, November 30, 2020, at 119, annex 1 (www.budget.gc.ca/fes-eea/2020/report-rapport/anx1-en.html#Fiscal-Projections).

2 Gregory C. Mason, "How To Build a Better Canada After COVID-19: Transform CERB into a Basic Annual Income Program," *The Conversation*, June 28, 2020 (<https://theconversation.com/how-to-build-a-better-canada-after-covid-19-transform-cerb-into-a-basic-annual-income-program-140683>).

3 Jennifer Robson and Saul Schwartz, "Policy Forum: Should the Canada Revenue Agency Also Be a Social Benefits Agency?" at abstract.

income tax return do not get benefits. Robson and Schwartz argue that “a fundamental shift toward tax-agency reconciliation (TAR) is needed.”⁴ This would involve the use of third-party information to determine a taxpayer’s tax liability and credits. With a TAR system, the CRA would be able to deliver benefits even to non-filers, thus reaching the most vulnerable Canadians and those in greatest need of benefits.

Robson and Schwartz are, however, cautious about the ability of the CRA to be all things to all people—to be both a tax collector and a deliverer of benefits. They note that the use of a TAR approach, while desirable from a benefit delivery point of view, might be resisted by for-profit tax preparers, who might face a loss of business. Moreover, the CRA does not have sufficient staff and other resources to provide “soft services,” such as helping benefit recipients with complex needs to navigate the system, especially the appeal process. Robson and Schwartz argue that, when soft service provision is important, the CRA’s best role might be providing information to another government body, rather than taking on a direct role in delivery.

Gillian Petit, Lindsay M. Tedds, David Green, and Jonathan Rhys Kesselman provide a perspective informed by the authors’ recent work on British Columbia’s Expert Panel on Basic Income. They concur with Robson and Schwartz’s view that the CRA has many advantages in benefit delivery, and identify the same key issues: not everyone receives the benefits to which they are entitled, and benefits are not sufficiently responsive to real-time fluctuations in income. Petit et al. are, however, more optimistic than Robson and Schwartz about the possibility of change, pointing to other countries that have successfully implemented pre-filled tax returns (where the tax authority fills out tax returns for taxpayers) and real-time reporting of earnings. They argue that a move toward pre-filled tax returns might take time; for example, it would be easier to implement for the employed than the self-employed. It might also necessitate other changes to the income tax system, such as increased use of standard deductions. However, they argue that these implementation challenges can be overcome with “proper leadership, attention to policy objectives, and learning lessons from other jurisdictions.”⁵

Hugh Neilson’s commentary on the two preceding articles provides a practitioner’s perspective. Neilson expresses concern with the increased burden associated with real-time reporting, and suggests that any requirements for more regular payroll filings be accompanied by simplification measures to offset some of the burden. For example, if real-time reporting were in place, the CRA could eliminate the requirement for employers to file annual T4 slips. Neilson also emphasizes the need for the CRA to be flexible in the setting and enforcement of reporting requirements. For example, the four-week reporting period for claims under the Canada emergency wage subsidy (CEWS) program created challenges for employers whose pay

4 Ibid., at 94.

5 Gillian Petit, Lindsay M. Tedds, David Green, and Jonathan Rhys Kesselman, “Policy Forum: Re-Envisaging the Canada Revenue Agency—From Tax Collector to Benefit Delivery Agent,” at 114.

periods seldom lined up with the four-week, Sunday to Saturday period required to be used for CEWS purposes.

Neilson is less optimistic than Petit et al. about the possibility of implementing real-time reporting for the self-employed. While goods and services tax/harmonized sales tax returns and T4As have been suggested as potential sources for information on self-employment income, Neilson argues that neither is truly satisfactory. Yet, as he points out, some kind of reporting of self-employment income is vital if benefits are to be appropriately targeted toward those in need, as an increasing number of low-income workers—domestic workers, Uber drivers, and so on—are included in the ranks of the self-employed.

Given the challenges in moving toward a system of pre-filled tax returns or a TAR model, Neilson argues that more rapid action needs to be taken to reach out to vulnerable Canadians. He argues for greater outreach by the CRA to intermediaries who deal directly with members of vulnerable populations, to help them to access benefits.

Over the past 25 years, benefits have essentially been an “add-on” to the CRA’s tax collection activities. The structure of benefits—the timing of benefit adjustments, for example, and the calculation of benefit eligibility—has to a greater or lesser extent been determined by the structure of income taxes. Yet the articles in this Policy Forum show that we are reaching the limits of this tax-led model of benefit delivery. If we are to achieve goals such as expanding the CWB so that it forms the foundation of a basic annual income, or expanding the reach of benefits through the use of pre-filled tax returns, we may need to change the tax system, and the mandate and philosophy of the CRA, to better support the benefit system.

Frances Woolley
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Editors

Policy Forum: Should the Canada Revenue Agency Also Be a Social Benefits Agency?

Jennifer Robson and Saul Schwartz*

PRÉCIS

L'Agence du revenu du Canada (ARC) joue un rôle important dans le versement de prestations aux Canadiens, mais devrait-on élargir ce rôle? La rapidité et la facilité avec lesquelles l'ARC a lancé plusieurs nouvelles prestations de revenu pendant la pandémie de COVID-19 ont suscité la question de savoir si l'Agence devrait assumer un rôle beaucoup plus important en tant qu'organisme de prestations sociales, en plus de celui de perceuteur d'impôts. Nous passons en revue les arguments pour et contre cette question, en notant les faiblesses importantes qui entravent déjà le rôle actuel de l'ARC dans le versement des prestations et qui seraient exacerbées si on élargissait ce rôle. Tout compte fait, nous concluons qu'un rôle élargi n'est pas le meilleur choix. Nous suggérons que l'ARC pourrait plutôt consolider l'une de ses forces — la collecte et le partage de renseignements — afin que d'autres organismes puissent administrer plus efficacement les prestations qui ne sont pas directement liées au régime fiscal.

ABSTRACT

The Canada Revenue Agency (CRA) plays an important role in the delivery of benefits to Canadians, but should that role be expanded? The speed and ease with which several new income benefits were launched by the CRA during the COVID-19 pandemic have prompted the question of whether the agency should take on a much larger role as a social benefits agency, in addition to tax collector. We review the arguments for and against, noting important weaknesses that already impair the CRA's current role in benefit delivery and that would be exacerbated in an expanded role. On balance, we conclude that an expanded role is not the better choice. We suggest that the CRA might instead enhance one of its strengths—collecting and sharing information—so that other agencies can more effectively administer benefits not directly tied to the tax system.

KEYWORDS: CANADA REVENUE AGENCY ■ BENEFITS ■ ADMINISTRATION

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INTRODUCTION

The Canada Revenue Agency (CRA) plays at least three central roles in the delivery of benefits to Canadians. First, and perhaps most visibly, the CRA directly administers several benefit programs, determining who is eligible and how much they should get, and then delivering the money. The Canada workers benefit (CWB), the climate action incentive, and both federal and most provincial child benefits—all are run by the CRA. More recently, several COVID-19-related benefits, such as wage subsidies payable to employers, have been distributed by the CRA.

Second, the CRA is an important source of information used by other government agencies to run their own programs. For example, the CRA provides annual income information to Employment and Social Development Canada (ESDC) for use in administering old age security (OAS) and the guaranteed income supplement (GIS), and for registered education savings plans.¹ To give just one provincial example, the government of British Columbia relies on information from the CRA to establish eligibility for its income-tested child-care benefit.²

Third, the CRA acts as a debt collector for other government bodies by enforcing compliance with program and benefit rules. For example, the administrator of the Canada student loans program relies on the CRA to communicate with borrowers in default, to withhold tax refunds as required, and to handle repayment arrangements as necessary.³

The use of tax agencies to deliver benefits, including benefits that have little relationship to the collection of taxes, is motivated by the relative regularity of tax

1 For a discussion of the CRA's role in the OAS and education savings programs, see Stephanie Ben-Ishai, Jennifer Robson, and Saul Schwartz, "Eligible Non-Participation in Canadian Social Welfare Programs" (2020) 64:3 *McGill Law Journal* 499-533.

2 Government of British Columbia, "Consent To Share Information for the Affordable Child Care Benefit" (<https://www2.gov.bc.ca/gov/content/family-social-supports/caring-for-young-children/child-care-funding/child-care-benefit/income-info>). If the person has not filed an income tax return for the last two years, an alternative "Income Declaration Form" can be used.

3 Government of Canada, "Repay a Study Loan—Can't Repay Your Loan" (www.canada.ca/en/services/benefits/education/student-aid/grants-loans/repay/unable-repay.html).

filing.⁴ As a matter of course, most Canadians voluntarily file a tax return every year, reporting on their annual income and providing contact information. Moreover, third parties provide the CRA with additional information such as T4 slips for employment income and T5 slips for social assistance income.⁵

Congdon, Kling, and Mullainathan⁶ argue that, in principle, setting up a separate bureaucratic apparatus to enrol citizens in benefit programs and to then administer those programs would be expensive and, more importantly, inefficient. They compare the takeup rate of 94 percent among eligible Americans for the earned income tax credit (EITC), administered through the tax system, with the 67 percent takeup rate among those eligible for the administratively separate food stamp program.⁷ Here in Canada, Warburton⁸ found that provincial programs to reduce health-care premiums for lower- and modest-income residents had significantly lower takeup rates when they required a proactive application directly to a provincial office compared to programs that were integrated with an annual tax return.

During the COVID-19 pandemic, the CRA took on a significantly expanded role in delivering monthly income support to self-employed workers, as well as wage and rent subsidies payable directly to employers and firms. But should the agency continue that expanded role once the emergency is over? For the CRA, an expanded role in benefit programs may create implementation burdens and may conflict with its primary focus on tax collection. A further shift in effort away from tax collection toward the provision of social benefits may also bring a whole new set of outside influences to bear.

For lower- and modest-income Canadians, interactions with the CRA have been, even pre-pandemic, an essential part of accessing several income benefits. Our own work on the extent to which Canadians lose benefits because they have not filed a tax return has found that an important share of working-age Canadians may not file

4 William J. Congdon, Jeffrey R. Kling, and Sendhil Mullainathan, "Behavioral Economics and Tax Policy" (2009) 62:3 *National Tax Journal* 375-86 (<https://doi.org/10.17310/ntj.2009.3.01>).

5 These third-party forms are important in providing information for the automatic completion of tax returns and in substituting as information sources when a return is not filed or is filed incorrectly. For example, starting in 2019, the CRA has been able to use a new source of third-party information to automatically calculate a taxpayer's eligibility for the CWB, even if the taxpayer does not proactively apply. Canada Revenue Agency, "Canada Workers Benefit (Working Income Tax Benefit Before 2019)" (www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/federal-government-budgets/budget-2018-equality-growth-strong-middle-class/canada-workers-benefit.html).

6 Congdon et al., *supra* note 4.

7 Congdon et al. note that this is the upper limit of estimated takeup rates: *ibid.*, at 382. Public data on EITC takeup in 2016 suggest a lower overall rate of 78 percent: see United States, Internal Revenue Service, "EITC Participation Rate by States" (www.eitc.irs.gov/eitc-central/participation-rate/eitc-participation-rate-by-states).

8 Rebecca N. Warburton, "Takeup of Income-Tested Health-Care Premium Subsidies: Evidence and Remedies for British Columbia" (2005) 53:1 *Canadian Tax Journal* 1-28.

a return and may not receive the ongoing benefits that the CRA directly administers.⁹ In that work, we are primarily motivated, in thinking about the CRA's role, by a concern for benefit recipients rather than concerns about tax compliance. Those who rely most heavily on benefits directly administered by or otherwise verified with the CRA will be lower- and modest-income Canadians, and concerns about tax compliance and closing tax gaps will be less relevant.

TWO IMPORTANT WEAKNESSES

While we are not suggesting that the CRA should get out of the business of directly or indirectly administering benefits, we want to emphasize two important weaknesses in its current operations.

The CRA Does Not Collect Within-Year Income Information

First, in its current role vis-à-vis benefits, both as a provider of information and as a direct administrator, the CRA has been able to offer only end-of-year income information, gathered in a seasonal flurry of tax filing. During the COVID-19 pandemic, the CRA's lack of within-year information has created important constraints on how various relief benefits are designed and administered. For example, the Canada recovery benefit (CRB) aims to support self-employed and other workers unable to qualify for employment insurance (EI). The amount of the CRB should vary according to what work income a beneficiary earns. But because the CRA has information only on annual income, it can adjust the benefits, including the recovery of overpayments, only when beneficiaries file their annual tax return. As others have observed, relying so heavily on attestation and delaying verification until a tax return is filed will almost certainly lead to problems with administration and enforcement.¹⁰

Even pre-pandemic, many Canadians found that they needed to apply for benefits because their personal circumstances had changed in ways that their most recent tax return simply did not reflect. If real-time income information were provided to the CRA, benefits could be adjusted for meaningful fluctuations in income. In provincial social assistance systems and the EI system, benefits paid monthly or biweekly can be and are adjusted for changes in a beneficiary's circumstances, though often the emphasis is on reducing benefits paid in response to other income. But in the case of benefits directly administered by the CRA, amounts are generally adjusted only once a year. As a result, a benefit intended to reduce poverty when it strikes

9 A non-trivial share of Canadians may not file a return, and as a result, benefits are not paid to otherwise eligible people. We have estimated the value of those unpaid benefits at over \$1 billion in 2016. See Jennifer Robson and Saul Schwartz, "Who Doesn't File a Tax Return? A Portrait of Non-Filers" (2020) 46:3 *Canadian Public Policy* 323-39 (<https://doi.org/10.3138/cpp.2019-063>).

10 Robin Boadway, "The Canada Recovery Benefit: Employment Insurance or Basic Income Guarantee?" *Finances of the Nation* (<https://financesofthenation.ca/2020/10/09/crb-ei-or-basic-income-guarantee>).

may be delayed by as much as 18 months following a sudden loss of income.¹¹ One relatively straightforward way to move toward collecting within-year income information for use in benefit administration is to ask employers to augment the monthly payroll information that they are already providing to the CRA. Currently, employers are required to report their aggregate monthly payroll (along with the total number of employees on payroll) and to remit certain deductions (including income and payroll taxes) collected at source.¹² Instead of aggregating payroll information across all employees, however, employers could report individualized information for each of their workers.

In other jurisdictions, detailed payroll information on an employee-by-employee basis is submitted to the tax agency throughout the year, ensuring that the government has detailed and timely individual-level information about workers. For example, this system—sometimes referred to as e-payroll—is in place in the United Kingdom, Ireland, and New Zealand. In the Republic of Ireland during the COVID-19 crisis, e-payroll has allowed employers to quickly and easily request a temporary wage subsidy, calculated by the tax agency, by simply adding a code to their existing monthly e-payroll submission.¹³ By contrast, here in Canada, employers have had to complete a separate 12-step application and calculate their own subsidy each time they request the equivalent COVID-19-related subsidy, the Canada emergency wage subsidy (CEWS).¹⁴ Some observers have noted that the CEWS system is complex and creates uncertainty for employers who worry that they may be asked to repay CEWS money if they have misunderstood the CRA's rules.¹⁵ In the Irish system, the subsidy calculations are all done internally by the tax agency. In New Zealand, the e-payroll system provides detailed information on the employment earnings of individuals, across multiple employers and for specific periods of

11 Benefits such as the Canada child tax benefit, GIS, and goods and services tax (GST) credit are readjusted in July using tax information for the previous calendar year (that is, starting in January of the previous year).

12 Canada Revenue Agency, “Employers’ Guide—Payroll Deductions and Remittances” (www.canada.ca/en/revenue-agency/services/forms-publications/publications/t4001/employers-guide-payroll-deductions-remittances.html).

13 Government of Ireland, Office of the Revenue Commissioners, “General Information on the Temporary COVID-19 Wage Subsidy Scheme,” March 24, 2020 (www.gov.ie/en/publication/f24dcc-general-information-on-the-temporary-covid-19-wage-subsidy-scheme).

14 Canada Revenue Agency, “Canada Emergency Wage Subsidy (CEWS): Application Guide” (www.canada.ca/en/revenue-agency/services/subsidy/emergency-wage-subsidy/cews-apply-guide.html). The application also collects information to identify firms (or their accounting representative) through the usual payroll remittance system, but, unlike Ireland’s approach, the remittance system alone cannot be used to apply for the subsidy.

15 Jim Wilson, “‘Risk, Complexity’ for Employers with CEWS Extension,” *Canadian HR Reporter*, July 29, 2020 (www.hrreporter.com/focus-areas/legislation/risk-complexity-for-employers-with-cews-extension/331939).

time, a useful tool for providing proof of income when benefits depend on real-time rather than last-year's income.¹⁶

We acknowledge that e-payroll cannot, on its own, capture all income from own-account self-employment. We suggest, however, that the missing information might be collected by other means, such as Payments Canada data or more regular and mandatory goods and services tax (GST) reporting on self-employment income.¹⁷ At the very least, we see merit in exploring these and other mechanisms to capture important income flows outside traditional employer-employee relationships.

Voluntary Compliance in Tax Filing Means That Non-Filers Do Not Get Benefits

As noted earlier, another limitation to the CRA's role in benefit administration, even setting aside the issue of within-year income information, is that not all Canadians provide the agency with an annual tax return. In fact, the absence of a complete and up-to-date register of all adult Canadians meant that the government of Canada was forced to use an application-based system to distribute emergency COVID-19 aid, rather than universal and pro-active payments that had been proposed by some.¹⁸ The most recent speech from the throne unambiguously directed the CRA to address non-filing, including a commitment to introduce free and automatic tax filing for Canadians with simple returns.¹⁹

This commitment appears to be an important acceleration of rather modest past efforts to provide simplified filing. As an example of these past efforts, the CRA launched a pilot project in October 2016 to encourage filing to claim benefits among Canadians who had not filed a return in the two previous years. According to internal documents,²⁰ letters were sent to more than 260,000 taxpayers to describe various benefits that could be claimed and how to claim them, beginning

16 New Zealand, Inland Revenue, "Understanding Your Income Summary in myIR" (www.ird.govt.nz/income-tax/income-tax-for-individuals/understanding-your-income-summary-in-myir). While applications for income benefits such as New Zealand's job seeker's benefit (the equivalent to EI regular benefits in Canada) accept an applicant-provided printout from MyIR as proof of income, the benefits system in the country does not yet seem to automatically incorporate e-payroll information into benefits applications. See Government of New Zealand, Work and Income, "Online Application Process" (www.workandincome.govt.nz/online-services/apply/online-application-process-mymisd.html).

17 Currently, most firms are required to complete monthly GST returns, including nil returns. Small suppliers are generally not required to submit returns more frequently than once annually.

18 Jennifer Robson, "Why Can't They Just Send Us All a Cheque," *C.D. Howe Institute Intelligence Memo*, April 3, 2020 (www.cdhowe.org/sites/default/files/IM-Robson-2020-0403.pdf).

19 Canada, Governor General, *A Stronger and More Resilient Canada: Speech from the Throne To Open the Second Session of the Forty-Third Parliament of Canada*, September 23, 2020, at 22.

20 Michael Snaauw, "Memorandum for the Commissioner: Non-Filer Benefit Letter Initiative" (Ottawa: Canada Revenue Agency, 2017). Released under access to information and available from the *Canadian Tax Journal* at www.ctf.ca.

with catching up on tax returns. As a result of this first pilot, 33,937 returns²¹ were completed and \$27.3 million in unpaid benefits was sent to Canadians. CRA staff, however, warned the commissioner (the head of the CRA) that the initiative represented “a significant departure from the primary mandate and traditional program objectives of the [existing] Non-filer program,” which had traditionally aimed to increase “tax recovery” by targeting non-filers with unpaid taxes due.²² The CRA has also introduced a program called “File My Return” that invites selected Canadians expected to have simple returns to complete their tax return through a telephone-based interactive voice system. While some 950,000 Canadians were invited to take part, only 47,195, or less than 5 percent, did so.²³

Since the 2016 tax year, the CRA has allowed taxpayers to automatically complete much of their personal income tax return by accessing third-party information that the CRA already possesses.²⁴ However, this requires that taxpayers use software provided by for-profit firms, including firms that have publicly cautioned against a larger role for tax agencies in filing returns for citizens.²⁵ This is all in addition to the community volunteer income tax program (CVITP), which provides free in-person help with filing a return to qualifying low-income Canadians.

More recently, the Canadian Digital Service (CDS) worked with the CRA to develop an online service that would enable Canadians to file their returns for free.²⁶ Through a custom-built application that framed the return as an opportunity to access income benefits, participating Canadians would have been able to complete a simple return using a free service provided by the CRA. Background information on the project noted that recent and significant expansion of the CVITP program had not translated into a significant increase in returns filed in the low-income target population, for whom access to income benefits is likely to be quite important.²⁷

21 This figure includes returns for two years for the same taxpayer, so it cannot be used to estimate the response rate.

22 Snaauw, *supra* note 20, at 3.

23 Saul Schwartz and Jennifer Robson, “Dear Canada Revenue Agency, Please File My Taxes for Me!” *First Policy Response*, April 22, 2020 (<http://policyresponse.ca/dear-canada-revenue-agency-please-file-my-taxes-for-me>).

24 Canada Revenue Agency, “Auto-Fill My Return” (www.canada.ca/en/revenue-agency/services/e-services/about-auto-fill-return.html).

25 Intuit Inc., United States Securities and Exchange Commission Form 10-K, For the Fiscal Year Ended July 31, 2019, at 9. See also Tax-Filer Empowerment Canada, “Advocacy” (<http://tfec-acdr.ca/advocacy>), which notes that the umbrella organization is seeking to maintain “clear separation between tax preparation and tax collection within Canada’s tax-filing system.”

26 For a description of the project’s purpose and background, see Canadian Digital Service “Claim Tax Benefits” (<https://github.com/cds-snc/cra-claim-tax-benefits>).

27 Canadian Digital Service, *Claim Tax Benefits*, CRA Minister Briefing (Ottawa: CDS, March 2020) (<https://github.com/cds-snc/claim-tax-benefits-documentation/blob/master/assets/pdf/cra-minister-briefing.pdf>).

This supports our conclusion, based on the pilot project using letters to encourage filing, as well as the “File My Return” and “Auto-Fill My Return” projects, that the CRA’s extant efforts to simplify and increase filing so that Canadians can access benefits have had only modest impacts. Development of the CDS software included successful preliminary testing but, according to materials prepared for the minister of national revenue, had not, as of March 2020, been given the authorization to proceed to a pilot test with low-income Canadians.²⁸ Perhaps the 2020 throne speech will result in an acceleration of those plans.

It may be that simplifying a return in this way and reframing the exercise in terms of access to cash benefits will yield a better result than previous efforts by the CRA. As we have written elsewhere,²⁹ we think that a fundamental shift toward tax-agency reconciliation (TAR) is needed. Systems that use TAR and related measures are common across Europe and around the world.³⁰ In those systems, the tax agency uses third-party information (such as the T4 slips already issued by employers) to determine a taxpayer’s tax liability and credits. Here we take particular note of the use of the word “automatic” in the government’s stated plans in the speech from the throne. Starting with lower- and modest-income Canadians who depend most on a tax return to access benefits, and building on the growing body of third-party information provided directly to the CRA, a TAR system would ensure that the benefits are not lost simply because a return was not filed, particularly when the CRA already has the information it needs on hand.

TWO OTHER POTENTIAL WEAKNESSES OF THE CRA AS A BENEFIT ADMINISTRATOR

We have discussed two major weaknesses in the CRA’s efforts at benefit administration: (1) the practice of requesting only aggregated rather than detailed information in existing and regular within-year reporting systems; and (2) the fact that too many Canadians miss out on benefits because they do not file annual returns. To this list we add two more weaknesses that we think bear consideration in any debate over the best scope for the CRA in administering income benefits for Canadians.

The Potential Influence of For-Profit Tax Preparers

We are concerned about the potential influence of the for-profit tax-filing industry on the CRA. Reducing the number of Canadians who do not file taxes and who

28 Ibid. The penultimate slide in the presentation refers to unspecified obstacles in the partnership between the CDS and the CRA for this new application.

29 Schwartz and Robson, *supra* note 23.

30 A pay-as-you-earn (PAYE) system that aims to withhold the correct amount during the tax year is also a key feature. Canada’s withholding system takes a PAYE approach for those without self-employment income and with simple returns. For a discussion of TAR and PAYE, see William G. Gale and Janet Holtzblatt, “On the Possibility of a No-Return Tax System” (1997) 50:3 *National Tax Journal* 475-85.

would benefit by filing means moving further toward TAR. The seasonal flurry of annual filing underpins a multi-billion-dollar tax-filing industry in North America,³¹ in which out-of-pocket costs to consumers have been steadily rising.³² As one of the industry's largest firms recently warned its shareholders, policy changes that would provide free filing services to taxpayers create "competitive challenges," and government efforts to "replace the voluntary compliance tax system" could risk serious "harm [to] our Consumer business."³³ Unsurprisingly, the Canadian tax-filing industry has taken steps to protect its business interests by forming a national umbrella organization that is closely affiliated with its American counterpart³⁴ and by staying in close contact with the CRA.³⁵

Whether these industry efforts have resulted in particular policy outcomes in Canada is impossible to know from public information. The tax-filing industry has made clear its opposition to shifting Canada toward a TAR rather than a voluntary compliance system. Government bodies can be prone to regulatory capture when well-resourced industries, with unique information assets, are able to use incentives, lobbying efforts, and cross-over of personnel between government and industry to help shape a regulator's conduct.³⁶ We see this as an important risk in the current context.

31 H&R Block, "Investor Presentation—July 2020" (<https://investors.hrblock.com>).

32 An estimate of consumer costs for tax preparation services (for individuals, including unincorporated self-employed Canadians) is available from table 18-10-0021-01 (formerly CANSIM table 326-0030), "Accounting Services Price Index, Annual" in Statistics Canada's online data collection, and shows a substantial annual increase in prices (indexed to 2010) between 2010 and 2018.

33 Intuit Inc., *supra* note 25.

34 Tax-Filer Empowerment Canada (TFEC), "About Us," under the heading "Our Members" (<http://tfec-acdr.ca/about-us>). The US counterpart, the American Coalition for Taxpayers' Rights, is a founding member of TFEC and, owing to North American integration of the industry, several individual firms are members of both the Canadian and US organizations.

35 Using lobbying report information published by the Office of the Lobbying Commissioner for Canada (see Office of the Lobbying Commissioner for Canada, "Reports and Publications" (<https://lobbyscanada.gc.ca/en/reports-and-publications>)), we note a pattern of significant and regular meetings between very senior industry representatives and senior government officials at the CRA. For example, the chief executive officer of H&R Block Canada met with senior executives of the CRA or political aides for the minister seven times, or roughly once every eight weeks, in 2019. TFEC also benefits from its engagement of a former commissioner of the CRA (2013-2016) as an executive adviser, reported in a news release issued January 17, 2020: "Andrew Treusch Named Executive Advisor to Tax-Filer Empowerment Canada/Association canadienne des déclarants de revenus," *Tax-Filer Empowerment Canada*, January 17, 2020 (<http://tfec-acdr.ca/andrew-treusch-named-executive-advisor-to-tax-filer-empowerment-canada-association-canadienne-des-declarants-de-revenus>).

36 Ernesto Dal Bó, "Regulatory Capture: A Review" (2006) 22:2 *Oxford Review of Economic Policy* 203-25 (<https://doi.org/10.1093/oxrep/grj013>).

Public-Facing Services

The CRA is not currently structured to handle large volumes of complex benefit caseloads where review of exceptional files and handling appeals may be required. Another large federal body in charge of benefits is ESDC and its Service Canada arm. Comparisons of these agencies and the CRA with respect to several important features are illuminating.

One way to understand how an agency sets and fulfills priorities is to consider how it is resourced. In ESDC, fully 54 percent of the departmental workforce is working on benefit programs administered by the department.³⁷ By contrast, the CRA uses just 3.4 percent of its workforce on benefits, while 82 percent of its workforce is focused on tax compliance and collection.³⁸ While the CRA has some regional offices performing various functions, Canadians must primarily interact with the agency through call centres and online services. This may serve as an important obstacle for those Canadians who do not have the literacy, digital access, or confidence to navigate government services at a distance. By contrast, ESDC maintains a network of 611 local offices where Canadians can receive in-person help with a government program, including income benefit applications.

When Canadians want to dispute a decision on benefits administered by ESDC, they have recourse to an appeals process that includes internal reviews, and an arm's-length tribunal, the Social Security Tribunal (SST), before recourse to the courts.³⁹ For claimants who turn to the SST if they are dissatisfied with the internal review, the tribunal makes available a navigator service, through which appellants can speak with an adviser (a "navigator") who explains the process and answers questions, an important aspect of procedural fairness for clients who cannot find or afford a paid representative.⁴⁰ ESDC also publishes the administrative guidelines and principles that it applies when discretion might be needed to evaluate a claim for benefits.⁴¹ This transparency and personalized guidance reduce the information asymmetries between benefit applicants and administrators, increasing the fairness of the process and supporting the accountability of the decision makers.

37 Authors' calculations using full-time equivalent figures for 2020-21 for the following programs: EI, OAS and GIS, Canada Pension Plan, disability, and the total departmental workforce. Data published at Government of Canada, "GC InfoBase" (www.tbs-sct.gc.ca/ems-sgd/edb-bdd/index-eng.html).

38 Authors' calculations using full-time equivalent figures for 2020-21 for the "benefits" and "tax" areas of operations. Data published at "GC InfoBase," *supra* note 37.

39 Government of Canada, "Request for Reconsideration of an Employment Insurance Decision" (www.canada.ca/en/services/benefits/ei/ei-reconsideration.html).

40 Social Security Tribunal of Canada, "Navigator Service" (www1.canada.ca/en/sst/innovation/nav.html).

41 Employment and Social Development Canada, "Digest of Benefits Entitlement Principles" (www.canada.ca/en/employment-social-development/programs/ei/ei-list/reports/digest.html).

The CRA has an appeals process that begins, like ESDC's, with an internal review, but those dissatisfied with the internal review must use the court system.⁴² The CRA's public information on appeals is written primarily for an audience that wants to appeal the amount of tax they must pay, rather than an audience appealing decisions on income benefits. The CRA appeals process does include, like the EI process, an opportunity to informally present additional information in support of a claim, followed by a time-limited formal objection. However, as reports by the taxpayers' ombudsman have documented, the CRA has not always been clear and transparent in communicating acceptable forms of evidence when appealing eligibility for benefits.⁴³

In the Tax Court of Canada, appellants can face a costly litigation process in which the direct and indirect costs may be much larger than the dollar value of the benefits involved. Although the Tax Court offers informal proceedings designed for self-represented litigants, there is no CRA equivalent of the personalized navigation service provided by the SST. Furthermore, self-represented litigants face a significant information asymmetry in the Tax Court when it comes to appealing a benefit decision. The CRA does not make the full text of its internal guidelines publicly available,⁴⁴ whereas Service Canada does publish a detailed digest of benefit principles.⁴⁵ To be able to complete its mandate on tax compliance, the CRA has an organizational incentive to maximize information asymmetries, so as to discourage tax avoidance. But those imperatives on tax compliance are not compatible with a citizen-oriented approach to appeals on income benefits.

CONCLUSION

We believe that the CRA has an important role to play in delivering benefits to Canadians. But the CRA has important weaknesses. It is not well equipped to provide

42 Canada Revenue Agency, "P148 Resolving Your Dispute: Objection and Appeal Rights Under the Income Tax Act" (www.canada.ca/en/revenue-agency/services/forms-publications/publications/p148.html).

43 J. Paul Dubé, *Proving Your Status: Establishing Eligibility for the Canada Child Tax Benefit*, Ombudsman Special Report (Ottawa: Office of the Taxpayers' Ombudsman, October 2010); and Sherra Profit, "Review of the Impact of the Administration of the Canada Child Benefit," August 7, 2019 (www.canada.ca/en/taxpayers-ombudsperson/programs/reports-publications/memoranda-minister/review-of-the-impact-of-the-administration-of-the-canada-child-benefit.html).

44 The CRA does publish technical information on a range of tax topics such as excise duties and GST. However, after reviewing the current information circulars and tax folios on the CRA's website, Canada Revenue Agency, "Current Publications" (www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax/current-publications.html), we were only able to locate technical information on the disability tax credit and medical expenses tax credit as items that may be of relevance to lower-income filers who rely on refundable credits and income-tested benefits.

45 Supra note 41.

“soft services” to help with complex needs or to provide transparent benefit review. When these features are important, the CRA’s best role might be providing information to another government body, rather than taking on a direct role in delivery. Other agencies can staff local offices to help resolve problems or answer questions, as well as operate well-governed and transparent mechanisms of appeal. In addition to these in-person government services, we also see a need for non-government and community-based organizations to provide more intensive services, particularly for those Canadians who face multiple barriers or have complex needs.

Even without expanding its current role, the CRA can move forward by improving the collection of real-time information and moving more quickly toward a TAR system. Given the CRA’s expertise and proven capacity to issue large volumes of individual payments, it has an important role as the agency that issues cash payments, even if another body determines the amount of those payments.

Improving the CRA’s role in benefit administration would substantially enhance the ability of governments to deliver benefits more responsively.

Policy Forum: Re-Envisaging the Canada Revenue Agency—From Tax Collector to Benefit Delivery Agent

Gillian Petit, Lindsay M. Tedds, David Green, and
Jonathan Rhys Kesselman*

PRÉCIS

Au Canada, le régime fiscal ne sert pas uniquement à percevoir des recettes; c'est aussi un instrument important pour atteindre divers objectifs de politique sociale. Devenu étroitement lié au système de soutien du revenu, il sert maintenant de mécanisme de versement de nombreuses prestations clés de soutien du revenu. En tant qu'outil d'administration des prestations, le système fiscal présente des avantages, mais il est également problématique. Premièrement, il repose sur l'autocotisation, ce qui veut dire qu'il incombe aux déclarants individuels de fournir au gouvernement des informations complètes et précises sur les impôts sur le revenu qu'ils doivent. Cependant, les personnes qui n'ont pas d'impôt à payer ne sont pas légalement tenues de produire une déclaration de revenus et, par conséquent, beaucoup ne le font peut-être pas. Dans le contexte du versement des prestations, le recours à l'autocotisation risque de laisser de côté de nombreuses personnes admissibles à des prestations de revenu. Deuxièmement, les particuliers ne produisent généralement une déclaration de revenus par autocotisation qu'une fois par an. Par conséquent, le système fiscal n'a pas pu réagir aux chocs dramatiques de revenu en cours d'année qui se sont produits pendant la pandémie de COVID-19. Nous indiquons des moyens de moderniser le système fiscal canadien et de le rendre plus réactif et rationalisé pour le versement des prestations. Des réformes telles que des formulaires d'impôt préremplis et des déclarations en temps réel pourraient grandement améliorer la capacité de l'Agence du revenu du Canada à verser les prestations de revenu, ainsi que la capacité des gouvernements fédéral

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et provinciaux à atteindre leurs objectifs sociaux, notamment ceux énoncés dans les stratégies pour la réduction de la pauvreté du Canada et des provinces.

ABSTRACT

In Canada, the tax system is not used just to raise revenue; it is also an important instrument for achieving various social policy objectives. As a result, the tax system has become closely intertwined with the income support system; it now serves as the delivery mechanism for many key income support benefits. As a benefit administration tool, the tax system has advantages, but it is also problematic. First, it relies on self-assessment, which means that the onus is on individual taxpayers to provide complete and accurate information to the government on the income taxes that they owe. However, persons who have no tax liability are not legally required to file tax returns, and therefore many may not do so. In the context of benefit delivery, the reliance on self-assessment risks missing many individuals who are eligible to receive income benefits. Second, individuals generally file a self-assessed tax return only once a year. As a result, the tax system could not respond to the dramatic in-year income shocks that occurred during the COVID-19 pandemic. We identify ways to modernize Canada's tax system and make it more responsive and streamlined for the purposes of benefit delivery. Reforms such as pre-filled tax forms and real-time reporting could greatly improve the ability of the Canada Revenue Agency to deliver income benefits, and the ability of the federal and provincial governments to meet social objectives, including those set out in Canada's and the provinces' poverty reduction strategies.

KEYWORDS: BENEFITS ■ SUPPORT ■ TAX SYSTEMS ■ SOCIAL POLICY ■ CANADA REVENUE AGENCY

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INTRODUCTION

Canada's income tax system is not used just to raise revenue; it is also an important instrument for achieving various social policy objectives. As a result, the tax system is now closely intertwined with the income support system. Many key income benefits are either delivered through the tax system, like the Canada child benefit (CCB), or are dependent on information provided by the tax system, like the guaranteed income supplement.

The incorporation of these social objectives means that the mandate of the Canada Revenue Agency (CRA) has expanded to include the administration of income benefits and related programs in addition to tax administration.¹ As a benefit

1 Canada Revenue Agency, "Mission, Vision, Promise, and Values" (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/mission-vision-promise-values.html).

administrator, the CRA has advantages over other agencies, notably over other governmental entities that administer programs such as provincial social assistance. These advantages include a one-stop shop for benefit access, as opposed to having to navigate a myriad of benefits through different agencies;² lower administrative costs; lower stigma attached to benefit receipt; and the integration of revenue and redistributive objectives into one administration.³ Despite these advantages in benefit delivery, the CRA's current authority and structure hamper its ability to be effective in delivering on social objectives associated with these benefits. In this article, we discuss the principal features that prevent the CRA from being a more effective benefit administrator for the purposes of achieving social objectives. Then, on the basis of a scan of practice in other countries, we suggest reforms that would make the CRA a more effective vehicle for delivering social benefits.

We argue that, in order to be a more effective benefit administrator, the CRA should ensure that everyone who is entitled to benefits receives those benefits. The minister of national revenue's 2019 mandate letter agrees with this sentiment, stating that modernizing the CRA includes proactively contacting Canadians who are entitled to but are not receiving tax benefits.⁴ The Taxpayer Bill of Rights sets out as the first right "the right to receive entitlements."⁵ Regardless of this recognition, the CRA appears to limit its service focus to those who already interact with the agency. In particular, the CRA's mandate includes "[contributing] to the economic and social well-being of Canadians by making sure that . . . clients receive the benefits for which they are eligible."⁶ The term "clients" is not defined, but from the context, it appears to refer to persons and entities that file tax returns. That is, the CRA ensures that persons who interact with the agency receive the benefits for which they apply and are eligible, or for which there is automatic assessment (dependent on the benefit). However, for non-filers who do not interact with the CRA, there appears to be no such assurance.⁷ This interpretation is supported by Macnaughton, who

2 See Gillian Petit and Lindsay M. Tedds, "Overview of the System of Income and Social Support Programs in British Columbia, 2020," research paper commissioned by the Expert Panel on Basic Income, British Columbia (available at <https://bcbasicincomepanel.ca/papers>), for a detailed description and visualizations of the complexity of the system.

3 Lindsay M. Tedds, *Implementing a Basic Income Guarantee Through the Personal Income Tax System: Benefits, Barriers, and Bothers*, Research Paper no. 25 (Thunder Bay, ON: Northern Policy Institute, 2017) (www.northernpolicy.ca/upload/documents/publications/reports-new/tedds_big-and-pit-en.pdf).

4 Canada, Office of the Prime Minister, Minister of National Revenue Mandate Letter, December 13, 2019.

5 Canada Revenue Agency, *Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer* (<https://www.canada.ca/content/dam/cra-arc/formspubs/pub/rc17/rc17-19e.pdf>), at 40.

6 Canada Revenue Agency, *Summary of the Corporate Business Plan 2020-21 with Perspectives to 2022-23* (Ottawa: CRA, 2020), at 2.

7 The community volunteer income tax program, which offers free tax preparation clinics, does attempt to help individuals who would not otherwise file a tax return. However, these clinics

has noted that there is no specific statement in the Taxpayer Bill of Rights regarding direct action that the CRA will take to deliver on the commitment to ensure that taxpayers receive the benefits to which they are entitled under the law, though public statements seem to imply that the CRA does proactively assess tax returns for underclaimed credits.⁸

To be more effective as a delivery vehicle for social benefits, the CRA also needs to be more responsive to real-time fluctuations in income. Currently, there is potentially a large time lag between when persons become eligible for (and need) benefits and when they receive the benefits. For example, consider a person (Ms. A) with a job in an initial year (say, 2017) with pay that is too high to qualify for the Canada workers benefit (CWB). If Ms. A lost that job in February 2018, replacing it with a lower-paid job that did qualify for the CWB, she would not be assessed for that benefit until she filed her next tax return (in the spring of 2019).⁹ This delay may drive Ms. A deeper into financial insecurity: she may not qualify for provincial social assistance (a more timely option) given that she worked in the past and may therefore have assets above social assistance thresholds, and her earnings from the new lower-paid job may be higher than social assistance income eligibility thresholds. Further, given the low benefit rates while on provincial social assistance, quitting even a low-paying job to collect provincial social assistance may make Ms. A worse off financially if she has to divest herself of assets (including savings).¹⁰ She may then resort to other actions that provide timely cash assistance, such as taking out loans, with long-term ramifications.¹¹

Both of these administrative shortcomings—not ensuring that those who are entitled to benefits receive them and the unresponsiveness of benefits—reduce the ability of federal and provincial governments to achieve poverty reduction goals when the CRA is the delivery vehicle. For example, the federal poverty reduction

reach only those who engage with them. Persons who do not engage with either a clinic or the CRA do not receive the benefits that they are entitled to.

- 8 Alan Macnaughton, “Takeup of Social Benefits Delivered Through the Personal Income Tax System: Evidence-Based Analysis,” in Jinyan Li, J. Scott Wilkie, and Larry F. Chapman, eds., *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act* (Toronto: Canadian Tax Foundation, 2017), 18:1-14, at 18:2.
- 9 Unlike other refundable tax credits, like the CCB or the goods and services tax credit, the CWB is claimed and paid out immediately after taxes are filed. Recipients can opt to receive up to 50 percent of the CWB benefit in four separate advance payments.
- 10 In 2019, provincial social assistance rates for single childless adults ranged from \$7,131 per year in New Brunswick to \$11,386 per year in Newfoundland and Labrador. This is less than what can be made working a part-time, full-year job at \$14 per hour. Jennifer Laidley and Hannah Aldridge, *Welfare in Canada, 2019* (Toronto: Maytree, November 2020) (https://maytree.com/wp-content/uploads/Welfare_in_Canada_2019.pdf).
- 11 This example makes no claims about the incentive effects of the CWB and how those effects may be changed (or not) by the responsiveness of the CWB.

strategy's goal of protecting Canadians against falling into poverty¹² will be hard to meet with the type of response lags described in our example. Similarly, if families with low income are not being assessed for the CCB and provincial child benefits because they do not interact with the CRA, the ability of both levels of government to meet their stated child poverty reduction goals is limited.

This article is organized as follows. In the next section, we examine the problem of the lack of receipt of benefits by some eligible persons that arises from self-assessment and the absence of a requirement to file. We examine the use of pre-filled tax forms by other tax authorities, discuss how this could help to ensure that more eligible persons receive CRA-delivered benefits, and suggest what would be required for Canada to implement such a system. We then look at the problem that once-a-year tax filing creates for the responsiveness of CRA-delivered benefits and assess how real-time reporting used by other tax authorities could make benefits more responsive. We examine some notable difficulties with real-time reporting and the assessment of benefits, and how these could be handled.

PRE-FILLED TAX FORMS

The current administration of the tax system is based predominantly on the notion of self-assessment. Self-assessment means that the onus is on individual taxpayers to provide complete and accurate information to the government each year on their income earned and income taxes payable, and generally to do so by April 30 of the subsequent year. The CRA then uses information provided by an impartial third party to verify that provided by the taxpayer, a practice referred to as third-party reporting or matching. For example, all employers are required to report to the tax authority on a T4 information slip the wage income of their employees, on or before the last day of February of the year following that to which the income information applies. While not all income is subject to such reporting, a significant amount is. This means that the CRA knows a fair amount about much, if not all, of the income earned by a significant number of taxpayers.¹³ This self-assessed reporting regime with matching verification has remained fundamentally unchanged since at least 1906, when it was used as a municipal finance tool in Saint John, New Brunswick, and subsequently when it was carried over into provincial income tax legislation.¹⁴

12 Employment and Social Development Canada, *Opportunity for All: Canada's First Poverty Reduction Strategy* (Ottawa: ESDC, 2018), at 6.

13 Canada Revenue Agency, "Income Statistics 2019 (2017 Tax Year), Final Table 2 for All Canada, All Returns by Total Income Class (All Items Are in Thousands of Dollars)" (www.canada.ca/content/dam/cra-arc/prog-policy/stats/t1-final-stats/2017-tax-year/table2_ac-eng.pdf).

14 A 1906 tax report discussed the unfairness of employers' reporting employee payroll to city assessors in Saint John ("New Taxation Scheme for City of Saint John," *Saint John Daily Sun*, November 6, 1906, at 1). Self-assessment and third-party reporting in legislation appeared in 1936 in the Saint John City Assessment Act, 1936 (New Brunswick), c. C95, schedules 47 and 48, and were incorporated into income tax acts in other provinces as they were created (see, for

This process of self-assessment has some advantages; however, as a benefit administration tool, it is problematic. The onus is on the taxfiler to file a tax return, but tax filing may not occur. While there are a number of rules governing who is required to file a tax return,¹⁵ only those individuals with tax payable are legally required to file a tax form. If an individual has no tax liability, either because his or her income is equal to or below the basic personal exemption amount or because sufficient (or more than sufficient) tax was withheld by the employer and remitted to the CRA, either the individual is not obliged to submit a tax return (if no tax is payable) or the failure to file a return would not likely give rise to any financial penalty, even if completing and submitting one would provide a refund. Individuals who do not file a tax return are excluded from being assessed for (and receiving if eligible) any CRA-delivered benefits associated with that tax year. While the CRA has some measures in place to identify and contact individuals who may lose benefits because they have not filed a return,¹⁶ if an individual has not been a client—that is, has not filed a tax return either recently or ever—he or she is unlikely to be included in this initiative.

The requirement to file a tax return in order to receive CRA-delivered benefits imposes a barrier to access, especially for those individuals who are most likely to need such benefits. Robson and Schwartz¹⁷ estimate that about 12 percent of working-age Canadians do not file a tax return, resulting in about \$1.7 billion of unclaimed benefits in 2015. They also find that persons in families with a disposable income below the market basket measure (MBM) poverty line were 8.6 percentage points less likely to file a tax return than persons in families with income greater than 200 percent of the MBM threshold. In the city of Calgary, an estimated 97 percent of the homeless population do not file tax returns,¹⁸ and an estimated one-third of social assistance recipients in Ontario do not file returns.¹⁹ Finally, it has been estimated

example, Ontario's Income Tax Act, SO 1936, c. 1, schedule 39). We thank Shirley Tillotson for her help on this point.

- 15 Government of Canada, "Do You Have To File a Return?" (www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/you-have-file-a-return.html).
- 16 Canada Revenue Agency, "The Canada Revenue Agency Is Resuming Additional Activities: Know When We're Contacting You and How To Avoid Scams," September 17, 2020 (www.canada.ca/en/revenue-agency/news/newsroom/tax-tips/tax-tips-2020/canada-revenue-agency-resuming-additional-activities-know-were-contacting-how-avoid-scams.html).
- 17 Jennifer Robson and Saul Schwartz, "Who Doesn't File a Tax Return? A Portrait of Non-Filers" (2020) 46:3 *Canadian Public Policy* 323-39.
- 18 Alicia Kalmanovitch, Nick Falvo, Britney Ardelli, Laurel Collier, Megan Hodgins, Megan Donnelly, and Joel Sinclair, *Point-in-Time Count Report, Spring 2018* (Calgary: Calgary Homeless Foundation, 2018) (http://calgaryhomeless.com/content/uploads/Calgary_PiT_Report_2018.pdf).
- 19 John Stapleton, *A Fortune Left on the Table: Why Should Low-Income Adults Have To Pass Up Government Benefits?* (Toronto: Open Policy Ontario, 2018) (<https://openpolicyontario.s3.amazonaws.com/uploads/2018/06/INFORMAL-A-Fortune-Left-R3.pdf>).

that 40 percent of eligible First Nations families do not receive the CCB.²⁰ While the federal government has committed to simplifying the CCB application form to help address barriers to new immigrants and indigenous people,²¹ and to increase the tax-filing rate in indigenous communities by at least 10 percent by 2020,²² the ongoing gap impedes the ability of governments to reduce child poverty.

To expand the reach of CRA-delivered benefits, the tax-filing onus could be reversed. Rather than individuals completing their own tax form and the CRA verifying it, tax forms could be pre-filled by the CRA using the information already received through third-party reporting, and then distributed to the individual for verification. During the verification stage, the individual can change the information and add new information to the tax form. This phase is important not only to include income that is not yet subject to third-party reporting, but also to claim important tax credits, such as the medical expenses tax credit, for which the required information is known only by the individual. Many organizations have been actively calling for the government to implement a pre-filled tax form.²³ More recently, in the September 2020 speech from the throne, the Liberal government pledged to “work to introduce free, automatic tax filing for simple returns to ensure citizens receive the benefits they need.”²⁴

As mentioned, the CRA collects third-party information on a large amount of income. Organizations that provide T slips to taxpayers, such as employers who provide T4s stating an employee’s wages/salary, provincial social assistance providers who provide T5007s stating a recipient’s social assistance income, and financial institutions that provide T3s and T5s stating investment income, provide the same information to the CRA. Pre-filled tax forms require the CRA to use this third-party information more efficiently.

20 Prosper Canada, *Increasing Indigenous Benefit Take-Up in Canada: 2018 Federal Budget Submission* (Toronto: Prosper Canada, 2018) (<http://prosperscanada.org/getattachment/f4add5df-0edb-4883-b804-60661f500c56/Increasing-Indigenous-benefit-take-up-in-Canada.aspx>).

21 Jordan Press, “CRA Program That Helps Poor File Taxes Sees Boost in Returns in Push To Lift More People out of Poverty,” *National Post*, July 22, 2019 (<https://business.financialpost.com/personal-finance/taxes/cra-program-to-help-poor-file-taxes-yields-noticeable-bump-in-people-helped>).

22 David McKie, “Many Indigenous Families Not Applying for Canada Child Benefit: Documents,” *CBC*, July 21, 2017 (www.cbc.ca/news/politics/canada-child-benefit-indigenous-1.4211545).

23 “Do You Have To File a Return?” *supra* note 15; Canadian Chamber of Commerce, *50 Years of Cutting and Pasting: Modernizing Canada’s Tax System* (Ottawa: Canadian Chamber of Commerce, 2019) (<https://bellevillechamber.ca/photos/custom/news/190214-50YearsOfCuttingAndPastingModernizingCanadasTaxSystem.pdf>); and Canadians for Tax Fairness, “Platform for Tax Fairness” (www.taxfairness.ca/sites/default/files/resource/c4tf_federal_election_2019_platform_proposals.pdf).

24 Canada, Governor General, *A Stronger and More Resilient Canada: Speech from the Throne To Open the Second Session of the Forty-Third Parliament of Canada*, September 23, 2020, at 22.

A number of countries employ pre-filled tax forms; as of 2017, they were used by 40 out of 58 developing and developed countries examined by the Organisation for Economic Co-operation and Development (OECD), with notable outliers including Canada and the United States.²⁵ Denmark was the first country to adopt pre-filled (paper) tax forms in 1988. In Denmark, 100 percent of taxfilers receive a pre-filled tax form and only 22 percent of those forms are adjusted by the taxfiler.²⁶

Canada has made some advances in moving toward pre-filled forms. Since 2016, the CRA has offered “Auto-fill.” Auto-fill uses available third-party information to pre-fill tax forms for Canadian taxpayers who voluntarily choose to have their tax forms pre-populated, have a My Account through the CRA, and are using certified software.²⁷ Auto-fill is limited: tax forms are not pre-filled automatically, nor is anything done for persons who do not file a return. In 2016, the CRA developed a pilot project that would allow it to prepare tax returns for low- or fixed-income Canadians. The pilot project was quietly cancelled in 2018 after an agreement was signed between the CRA and the tax preparation software industry.²⁸

On the one hand, providing pre-filled tax forms would ensure that persons who are more likely not to file tax returns (for example, low-income persons, social assistance recipients, new immigrants, and indigenous persons) and who are more likely to be eligible for CRA-delivered benefits receive those benefits. On the other hand, there are concerns that pre-filled tax forms may result in increased errors, increased tax evasion (particularly among taxfilers with more complex returns), and increased administrative burdens. Here we discuss how pre-filling may be done in steps, first for those for whom pre-filling is more beneficial, and second for those with more complex returns, along with the concerns related to these steps.

Aligned with the commitment in the speech from the throne, pre-filling could first be implemented for “simple” tax returns—that is, for persons with only employment income or social assistance income in the relevant tax year (such as income for which there is already substantial third-party reporting and income with relatively simple deductions and credits) and for persons who have no or limited tax liability. This would increase access to CRA-delivered benefits for individuals who

25 Organisation for Economic Co-operation and Development, *Tax Administration 2019: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris: OECD, 2019) (<https://doi.org/10.1787/74d162b6-en>).

26 Organisation for Economic Co-operation and Development, *Using Third Party Information Reports To Assist Taxpayers Meet Their Return Filing Obligations—Country Experiences with the Use of Pre-Populated Personal Tax Returns* (Paris: OECD, Centre for Tax Policy and Administration, March 2006) (www.oecd.org/tax/administration/36280368.pdf), at 13.

27 Government of Canada, “Auto-Fill My Return” (www.canada.ca/en/revenue-agency/services/e-services/about-auto-fill-return.html).

28 Christopher Nardi, “‘They Already Have All the Freaking Information’: Federal Government Announces Plan To File Some People’s Taxes for Them,” *National Post*, September 25, 2020 (<https://nationalpost.com/news/politics/they-already-have-all-the-freaking-information-federal-government-revives-plan-to-file-some-peoples-taxes-for-them>).

would be most benefited by them. Also, because of the simplicity of the returns and substantial third-party reporting, the scope for non-compliance would be limited.²⁹

In the second step, to move toward a complete system of pre-filled tax forms, more accurate pre-filled forms would need to be provided. The success of pre-filled tax forms in countries that have adopted them has been attributed to a number of pre-existing factors, including high-integrity taxpayer identifiers, a comprehensive system of third-party reporting, a high degree of automation among information suppliers, and a compatible legislative framework, including limited non-standard deductions.³⁰ Canada already has high-integrity tax identifiers (social insurance numbers). However, Canada is lacking in the other requisite dimensions. First, third-party reporting would need to be expanded. Currently, in most cases, self-employment income is not subject to third-party reporting. As a result, the CRA fails to capture information on the income of an important segment of the Canadian workforce, including those employed in precarious, non-standard, and contract work. However, this shortcoming can be addressed, to some extent, through changes in reporting similar, for example, to the treatment of self-employment income paid by public entities, which is reported on a T4A. Other challenges are posed by foreign income (both earned and investment), rental income, most capital gains, interest on private loans, business income, and cash receipts (which are hard to track under any system).

Along with expanding third-party reporting, timing issues would need to be examined. For example, most third-party reports must be submitted to the CRA by the end of February. However, T3 slips, which report income paid by mutual funds, exchange-traded funds, income trusts, real estate investment trusts, and limited partnerships, do not have to be mailed out until the end of March. Moving to a date earlier in the year may be difficult for trustees.³¹ As a result, the CRA may have to delay the completion of pre-filled tax forms for persons with T3s.

29 California used pre-filled forms for simple returns in its “ReadyReturn” pilot project in 2005 (for the 2004 filing year). See Brian Erard, “California,” in François Vaillancourt, ed., *Pre-filled Personal Income Tax Returns: A Comparative Analysis of Australia, Belgium, California, Quebec, and Spain* (Vancouver: Fraser Institute, June 2011), 39–62. Erard argues that there was little non-compliance among pre-filled forms in California’s ReadyReturn pilot project because of its targeting to those with simple tax returns.

30 Idawati Ibrahim and Jeff Pope, “The Viability of a Pre-Filled Income Tax Return System for Malaysia” (2011) 17:2 *Journal of Contemporary Issues in Business and Government* 85–101; R. Highfield, “Pre-Populated Income Tax Returns: The Next ‘Big Thing’ in Reform of the Administration of Australia’s Personal Income Tax System,” paper presented at the Seventh International Tax Administration Conference, ATAX, University of New South Wales, Australia, 2006; and Organisation for Economic Co-operation and Development, *Third-Party Reporting Arrangements and Pre-Filled Tax Returns: The Danish and Swedish Approaches* (Paris: OECD, Centre for Tax Policy and Administration, January 2008) (www.oecd.org/tax/forum-on-tax-administration/publications-and-products/admin/39948012.pdf).

31 Arthur Drache, “No Quick Fix for T3 Time Lag,” *National Post*, May 29, 2007.

Canada also lacks a compatible legislative framework: deductions, tax credits, and other items of income must be verifiable by the CRA for an effective system of pre-filled returns. The current tax legislation is complex. For example, rental income is not submitted by third parties but is reported by the owner of the rented property, and persons with rental income can deduct related expenses from that income. Currently, both of those items—income and deductions for expenses—would be difficult (if not impossible) to pre-fill on a tax form. In contrast, in Denmark persons renting out a property must use an agency (which includes Airbnb), and the agency must report rental income to the tax administration.³² Further, the owner of the rental can choose to use either a standard deduction or an accounting deduction. Automatic pre-filling of the standard deduction is relatively straightforward. Persons with rental expenses higher than the standard deduction can elect to deduct their actual expenses from rental income, which is not pre-filled.³³

A number of concerns arise with pre-filling and third-party reporting. First, there is a worry that the risk of errors will increase, including overestimating or underestimating tax liabilities.³⁴ That is, the CRA could make an error in pre-populating the tax form and the taxpayer might not notice or choose not to notice (for example, because correcting the error would increase the tax liability). To avoid technology-related errors, particularly in “simple” returns, before implementation the CRA should perform extensive testing of pre-filling. Further, it should be clear that the legal obligation remains on taxfilers to ensure that their tax forms are correct, and that they should double-check their pre-populated information. It has also been shown that the use of behavioural “nudges,” such as a message that pops up when income information entered is different from the norm, can reduce revenue loss from underreporting of income in pre-populated tax forms.³⁵ Extending third-party reporting also raises the possibility of increased errors in submitted information. It will be important to enforce legal obligations related to information filing to ensure that third parties have a stake in the tax filings.

Second, pre-filled returns may alter incentives for full reporting of incomes. Sending individuals a pre-filled tax return for their review and approval or correction would raise a new kind of risk for accurate and complete income reporting.

32 In Denmark, since 2018, persons renting out a property have been encouraged to use an agency, but only Airbnb is required to report rental income to the tax agency. As of 2021, all persons renting out property will be required to use an agency, which will then report the rental income. See Denmark, Customs and Tax Administration, “Renting Out a Room or Property You Live In” (<https://skat.dk/skat.aspx?oid=2285757>).

33 For more information, see *ibid*.

34 Kevin Brookes and Pascale Déry, “Should the Government Pre-Fill Your Tax Return?” *Ideas for a More Prosperous Society*, August 21, 2018 (www.iedm.org/83710-should-government-pre-fill-your-tax-return).

35 Miguel A. Fonseca and Shaun B. Grimshaw, “Do Behavioural Nudges in Pre-Populated Tax Forms Affect Compliance? Experimental Evidence with Real Taxpayers” (2017) 36:2 *Journal of Public Policy & Marketing* 213-26 (<https://doi.org/10.1509%2Fjppm.15.128>).

Under the current system, taxfilers do not know exactly what information on their income the CRA possesses beyond items on T slips that they have received. Thus, taxfilers may feel that it is risky not to report all sources of income, including items for which they did not receive a T slip, such as foreign income or interest on private loans. In contrast, when receiving a pre-filled tax return, taxfilers may assume that the income items on the return are the entirety of what the CRA knows; they may thus perceive less risk in omitting other income sources that were not tracked on T slips. Whether this matter is significant in either quantitative or behavioural terms is unknown.

Third, there is a worry that increasing third-party reporting requirements will increase the cost of compliance by third parties.³⁶ These additional administrative costs can be lessened through third-party consultations before implementation, combined with the development of a third-party reporting system that is integrated with existing payroll software.³⁷ When Ireland rolled out its pay-as-you-earn (PAYE) modernization program effective January 2019, third parties (employers) that already used payroll software faced no additional burdens, given that the data to be reported were limited to those already collected by payroll software, and the reporting system and software were integrated.³⁸ The CRA could take a similar approach, integrating not just the reporting system and payroll software, but also software used to generate (for example) investment income reports and social assistance reports. For employers who manually process payroll and other third-party reporters who manually process relevant reports, payroll software or other software may be an additional overhead cost.

There will also be increased administrative costs to the CRA. Pre-filing shifts the costs from the taxfiler to the payer (third-party reporter) and the CRA. However, these costs should not be substantial since the CRA already checks tax forms after they have been filed and already provides Auto-fill. Further, as evidenced in the rollout of ReadyReturn in California, costs borne by the CRA because of pre-filing would likely be larger in the first year (and the development phase) because of technology adaptations, but those costs would decrease over time.³⁹

Fourth, concerns may arise related to the response rate of individuals verifying their pre-filled tax form. In all jurisdictions where pre-filled tax forms are used, there is a notice period, during which taxfilers can change the pre-populated tax form by including missing information. Some administrations that use pre-filled

36 Brookes and Déry, *supra* note 34.

37 See the next section for discussion of the implementation of Ireland's RTR system. Third parties were extensively consulted, and existing UK software was adapted and integrated with the extant processes.

38 Ireland, Revenue, Irish Tax and Customs, *PAYE Modernisation: Report on Public Consultation Process* (Dublin: Revenue, Irish Tax and Customs, 2017), at 9 (www.revenue.ie/en/corporate/documents/consultations/pay-modernisation-consultation-report.pdf).

39 Erard, *supra* note 29.

tax forms also operate under a system where, if the individual does not change the tax form or provide notification of acceptance, it is deemed “accepted” and filed as is. Of the 40 countries that use pre-filing, 10 use deemed acceptance.⁴⁰ Deemed acceptance can ensure that individuals who do not verify their information have their taxes filed, so that they receive the benefits they are entitled to (that is, benefits that do not require any additional information); however, deemed acceptance may also increase the rate of error.

Fifth, there is a need to ensure that individuals actually receive their pre-filled tax forms for verification and acceptance. Information on individuals often becomes obsolete between tax seasons, as people move, change their names, update their banking information, or die.⁴¹ Another problem would be the delivery of pre-filled tax forms to migrant workers who work part of the year in Canada and then return to their country of origin. The government maintains no super-database of all Canadians, including their bank accounts and addresses. The CRA lacks important real-time information that would allow for seamless delivery of pre-filled tax forms to the entire population. While the CRA may not have access to this information, that is not to say that this information does not already exist across ministries and governments in Canada. An advanced “eGovernment” system would help the implementation of pre-filled tax forms be more successful.⁴²

Estonia and Finland have developed and implemented an advanced system of eGovernment whereby information on the individual is asked for only once by any government agency, and that data point is stored only once, thus minimizing the collection of data. The individual owns and controls the data via an electronic identity card and can change or delete the data at any time; that is, the data are not under institutional control, although each agency is responsible for data privacy.⁴³ In Estonia, as of 2017, 4,196 government services were offered online through the eGovernment information system, with only three services not being available online (that is, having to be obtained in person): getting an ID card, getting married, and conducting real estate transactions.⁴⁴ Because of this detailed information, pre-populated tax forms in Estonia include employment income (via digitized linked employer reporting), the number of days sick and sick leave taken (via the digitized

40 OECD, *Tax Administration 2019*, supra note 25.

41 Jennifer Robson, “Why Can’t They Just Send Us All a Cheque?” *C.D. Howe Institute Intelligence Memo*, April 3, 2020 (www.cdhowe.org/sites/default/files/IM-Robson-2020-0403.pdf).

42 As noted above, the legal obligation to file taxes would remain on the taxfiler even with pre-filing. Thus, if a pre-filled form was not successfully delivered to its intended recipient, this would not excuse the individual from filing taxes (if he or she was legally obligated to do so).

43 Jaan Priisalu and Rain Ottis, “Personal Control of Privacy: Estonian Experience” (2017) 7 *Health and Technology* 441-51. Some data are not controlled by the citizen, particularly data created directly by the government. For example, criminal activity data cannot be altered or deleted by the citizen.

44 Ibid.

linked health-care system), and the exact amount of income (via the digitized linked banking system).⁴⁵ It is clear from current examples of pre-filled tax forms that eGovernment is an important tandem policy that would lead to more information being available for pre-populating tax forms.

Such a system of eGovernment in Canada would require a massive reform, and privacy concerns would have to be appropriately addressed. Canada's eGovernment is currently quite primitive: very few agencies share information, and those that do, share very limited information. In 2019, the Standing Committee on Access to Information, Privacy, and Ethics considered the Estonian model of eGovernment. In a report released in June 2019, the committee concluded that although Canada could learn from the Estonian model, before a similar system could be implemented here, it would be necessary to remedy the deficiency in Canada's privacy laws, increase public trust in government, change the culture of the public service, provide guaranteed access to the Internet (including in rural and remote areas), and improve consultations with indigenous persons (among other things).⁴⁶ These concerns are not trivial; however, with a precisely defined outcome and a well-laid out strategy to get there, movement can be made toward more effective eGovernment in time, and thus more effective CRA benefit administration.

REAL-TIME REPORTING

The COVID-19 pandemic not only highlighted the lack of a super-database on Canadians, as discussed above, but also laid bare the lack of sophistication and marked incapability of the income benefit delivery system to respond adequately in a time of real crisis. Since reporting of income for individuals occurs only once a year,⁴⁷ Canada's system could not respond to the dramatic in-year income shocks that occurred following the onset of the pandemic, especially as the majority of first-wave shocks hit between March and June 2020.⁴⁸ As a result, Canada was forced to instead

45 Jürgen Klemm, "In Estonia, Tax Filing Is Done in One Minute," *KALW*, April 15, 2019 (www.kalw.org/post/estonia-tax-filing-done-one-minute#stream/0).

46 Canada, House of Commons, *Privacy and Digital Government Services: Report of the Standing Committee on Access to Information, Privacy, and Ethics*, chaired by Bob Zimmer, 42d Parl., 1st sess., June 2019.

47 Employers' periodic (monthly or quarterly) reporting of income and tax remittances throughout the year are only on an aggregate basis. Organizations must submit their income information on individuals (for example, T4 information from employers) by the last day of February (for January–December of the previous year). Generally, the filing period for individuals who have a personal tax liability runs from February 18 to April 30 (for the previous calendar year).

48 Additionally, because there is no existing system for third-party reporting of self-employment income, the government struggled to verify income lost by those with self-employment earnings, particularly those in precarious and gig work. Not only is expanded third-party reporting important for a complete system of pre-filled tax forms, but it is also important to be able to deliver real-time income benefits.

provide pandemic support through a less-than-ideal Canada emergency response benefit (CERB) system administered by Service Canada, which required recipients to self-identify. In essence, Canada's tax system proved too clunky and unresponsive to deliver emergency pandemic income support.

To increase benefit responsiveness and ensure timely delivery of benefits, real-time reporting should be adopted. Real-time reporting requires employers to submit employee payroll information to the tax authority on or shortly after the employee's pay date. A number of countries have adopted real-time reporting, including the United Kingdom in 2013⁴⁹ and Ireland in 2019.⁵⁰ In both the United Kingdom and Ireland, real-time reporting was integrated with existing payroll practices; that is, employers could continue to use their payroll software for payroll and, with one additional extra click, the payroll data would be uploaded to a data-gathering system used by the tax authority.⁵¹ Because of this integration with current practices, it was projected that employers already using payroll software would experience no (or very little) additional administrative burden and, in Ireland, where year-end tax forms (similar to Canada's T4) were eliminated, those employers would see administrative cost savings. However, some additional costs were projected to arise for firms not using tax software or professional bookkeepers—namely, small businesses.

A real-time reporting system can aid in benefit administration by better ensuring that benefits are provided when they are needed and allowing for real-time monthly adjustments to benefit amounts. This capability would have greatly aided benefit delivery during the COVID-19 pandemic.

A real-time reporting system would also materially aid tax administration and sharply reduce the number of taxfilers with either tax due or tax refund claims at the time of filing. Canada's system of source withholding by employers assumes that each employee will be earning at the same rate as in the current pay period over the entire year. In effect, the tax rate brackets and tax-free amount are divided into the number of pay periods in the year, and income taxes are withheld on that basis in each pay period, irrespective of how much has been withheld from the employee in other pay periods. Given the progressivity of the rate schedule, this means that employees with variable earnings over the year, with only part-year work for their employer, or with jobs held simultaneously with multiple employers will tend to have their taxes incorrectly withheld.

49 United Kingdom, HM Revenue & Customs, *Real Time Information Programme: Post Implementation Review Report* (London: HM Revenue & Customs, April 2017) (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/664971/Real_Time_Information_programme_-_post_implementation_review_report.pdf).

50 "PAYE Modernisation: Are You Ready for Real-Time Reporting?" *PwC*, October 15, 2018 (www.pwc.ie/services/human-resource-services/insights/2018-pay-modernisation-are-you-ready-for-real-time-reporting.html).

51 *PAYE Modernisation*, supra note 38.

In contrast to the “current” assessment method used in Canada, a “cumulative” assessment method could be used. An example is the PAYE used in the United Kingdom and elsewhere. Under this method, an employer bases tax withholding on the cumulative entitlement to the tax-free amount and the rate schedule, both of which are updated for each pay period.⁵² The employee’s cumulative taxes withheld at that point are compared with what should be due on that basis, and the withheld amount can be increased or decreased accordingly. If the employee’s income falls sufficiently in that pay period, the employer can supplement rather than subtract from the paycheck. The employer can also be used as the agent for timely dispensation of social benefits by the addition of such benefits to paycheques. Real-time reporting is not essential for Canada to adopt a cumulative assessment method, but it would make the system more efficient for workers with multiple employers, since the CRA can coordinate withholding and benefit rates across firms (as HM Revenue & Customs does in the United Kingdom).

Ireland has shown that with a well thought out strategy, sufficient consultation with software providers and third-party information suppliers, and extensive testing of the user interface, a large-scale rollout of real-time reporting can be relatively seamless. In contrast, the United Kingdom’s problems in introducing a universal credit teaches us that rolling out non-transparent benefits too quickly is bad practice.⁵³ Ensuring that CRA-delivered benefits provided in real time are transparent—that is, the recipient can easily understand how eligible income was calculated and where the numbers come from—can ease the transition. Finally, it has been suggested that the United Kingdom’s one-month assessment time for benefits may actually be *too* responsive where there are lags in employer reporting or reporting errors, and does not line up with the payment of wages. Improving upon these implementation concerns as needed in the Canadian context is vital to well-functioning real-time benefits.

52 For example, with monthly pay periods, in the second month of the year the employer compares each employee’s cumulative taxes withheld with the amount that should have been withheld based on 2.5 times the annual tax-free threshold and 2.5 times each tax rate bracket; excesses or deficiencies are addressed. This process is repeated for each successive pay period. Nicholas A. Barr, S.R. James, and Alan Richmond Prest, *Self-Assessment for Income Tax* (London, UK: Heinemann, 1977), at 22-32, describe the operation of PAYE in its early implementation in the United Kingdom prior to its use for delivering social benefits.

53 See “Universal Credit Rollout Delayed Again—to 2024,” BBC News, February 3, 2020 (<https://www.bbc.com/news/uk-51318730>), for the most recent issues with the implementation of the universal credit, including claims that otherwise eligible recipients are “scared” to enrol in the system; and Centre for Public Impact, *Universal Credit System in the UK from 2010 to 2014* (www.centreforpublicimpact.org/case-study/universal-credit-system-uk), for earlier problems with implementation, including a lack of transparency, a lack of public confidence, and poor management.

CONCLUSION

Re-envisioning the CRA as a benefit administrator delivering benefits to meet social objectives requires several types of reform. Current aspects of tax administration, such as self-assessment, the lack of a universal filing requirement, once-a-year third-party income reporting, and a limited eGovernment, hamper the CRA's effectiveness as a benefit administrator. Introducing reforms such as pre-filled tax forms, to ensure that tax-delivered benefits reach all who are entitled to them and not just those who file, and real-time reporting to improve the responsiveness of benefits could greatly improve the ability of the CRA to deliver benefits. Improved benefit delivery would improve the ability of the federal and provincial governments to meet their social policy objectives, including those set out in Canada's and the provinces' poverty reduction strategies. Incidental benefits would be more accurate tax withholding and less frequency of year-end tax refunds. While these administrative changes will encounter various implementation challenges, these can all be overcome with proper leadership, attention to policy objectives, and learning lessons from other jurisdictions.

Policy Forum: Improving the Canada Revenue Agency's Delivery of Social Benefits—A Practitioner's Perspective

Hugh Neilson*

PRÉCIS

Au Canada, le système fiscal est devenu étroitement lié au système de soutien du revenu; de nombreuses prestations clés de soutien du revenu sont versées par l'entremise du système fiscal. D'autres auteurs ont cerné des éléments problématiques dans l'utilisation du système fiscal comme outil d'administration des prestations, ainsi que des préoccupations quant au rôle de l'Agence du revenu du Canada (ARC) en tant qu'organisme de prestations sociales, en plus de son rôle essentiel de perceuteur d'impôts, en partie en raison des questions que soulève la réponse du Canada à la pandémie de COVID-19. Les suggestions visant à améliorer la capacité du système fiscal à fournir des prestations comprennent des formulaires d'impôt préremplis et la déclaration en temps réel. Je suggère que, bien que certaines réformes soient pratiques même à court terme, d'autres exigent une perspective à long terme, voire un changement dans la philosophie de notre système fiscal, pour mettre en œuvre des changements comme la réduction du volume des déductions et des crédits, et l'acceptation de demandes standard plutôt que des calculs précis étayés par des reçus et d'autres documents. De plus, étant donné que nous vivons dans une société spécialisée, je suggère que ces objectifs seraient mieux atteints si l'ARC agissait en collaboration avec d'autres groupes, à l'intérieur et à l'extérieur du gouvernement, afin de mieux rejoindre les populations vulnérables et de leur procurer les avantages auxquels elles ont droit.

ABSTRACT

In Canada, the tax system has become closely intertwined with the income support system; many key income support benefits are delivered through the tax system. Other authors have identified problematic elements of the use of the tax system as a benefit administration tool, and concerns about the role of the Canada Revenue Agency (CRA) as a social benefits agency, in addition to its essential role as a tax collector, stemming in part from issues arising from Canada's response to the COVID-19 pandemic. Suggestions to enhance the tax system's ability to deliver benefits include pre-filled tax forms and real-time reporting. I suggest that, while some reforms are practical even in the short

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term, others require a long-term perspective, or even a shift in the philosophy of our tax system, to implement changes such as reducing the volume of deductions and credits, and accepting standard claims rather than precise calculations supported by receipts and other documentation. Additionally, given that we live in a specialized society, I suggest that these goals would be better achieved by the CRA acting in collaboration with other groups, within and outside the government, to better reach vulnerable populations and deliver the benefits that they are entitled to receive.

KEYWORDS: BENEFITS ■ ADMINISTRATION ■ CANADA REVENUE AGENCY ■ SOCIAL POLICY

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INTRODUCTION

At a practitioners' forum I attended shortly after the 2015 federal election,¹ several Canada Revenue Agency (CRA) representatives noted that the mandate letter issued to the new minister of national revenue directed the CRA to reach out to those Canadians who are not receiving tax benefits to which they are entitled.² Both the CRA representatives and the practitioners in attendance noted that this was a somewhat different mandate than that which is traditionally associated with the CRA.

1 The 2016 Banff Small Practitioners' Forum, held in Banff, Alberta on October 22, 2016.

2 Canada, Office of the Prime Minister, Minister of National Revenue Mandate Letter, December 13, 2019.

However, there is no question that the income tax system is used to deliver social benefits, not just to raise revenues to run the country.

While other government departments or agencies could also be tasked with this role (presuming that they received adequate resources),³ they would doubtless face similar challenges. Improving the benefit delivery process, regardless of whoever may be charged with its management, is therefore well worth pursuing.

The two preceding articles in this Policy Forum⁴ provide an excellent discussion of possible improvements and will, I hope, stimulate further contributions on this topic. While I believe that many of the authors' recommendations for enhancing the CRA's ability to deliver benefits merit further review and implementation, I question the practicality of others. I will discuss the reasons for my reservations under the broad themes set out in the two articles.

REACTING FASTER TO ECONOMIC SHOCK WAVES: REAL-TIME INFORMATION

As noted in both articles, the collection of taxpayers' information annually means that benefits are, in large part, payable in arrears rather than as the need actually arises. We have seen this in many of the COVID-19 pandemic relief programs, including the Canada emergency wage subsidy (CEWS) and the Canada emergency rent subsidy (CERS), which adopted four-week periods, rather than being based on the full taxation year, allowing payments to businesses to be delivered more rapidly than if the subsidy was claimed only when income tax returns for the relevant periods were filed. This parallels the four-week periods adopted for the Canada emergency response benefit (CERB) and the two-week periods for the subsequent Canada recovery benefit (CRB), both of which evolved from the model of the employment insurance (EI) system. However, this has led to the payment of benefits without a thorough review of eligibility and the need for post-payment audits and reviews.

Is real-time information, or at least closer to real-time information, a viable option? It seems clear that other countries have managed to implement real-time information in some respects, particularly in the area of employment income.

3 The recent experience of Employment and Social Development Canada being overwhelmed by claims for relief at the onset of the COVID-19 pandemic showed us that few government groups possess the resources available to the CRA.

4 Jennifer Robson and Saul Schwartz, "Policy Forum: Should the Canada Revenue Agency Also Be a Social Benefits Agency?" in this issue of the journal, at 87-98; and Gillian Petit, Lindsay M. Tedds, David Green, and Jonathan Rhys Kesselman, "Policy Forum: Re-Envisaging the Canada Revenue Agency—From Tax Collector to Benefit Delivery Agent," in this issue of the journal, at 99-114.

Employment Income

Employers in Canada are generally required to remit source deductions on a monthly (or more frequent) basis. Providing details of each employee's payroll should therefore be possible. Is it practical?

Small Employers: Quarterly Reporting

I note, first, that some of the smallest employers—generally, those with average source deductions of less than \$3,000 per month—are permitted to remit those deductions quarterly rather than monthly. Therefore, monthly data would not be received from those employers. Employers using this alternative are fairly uncommon. As the amount of minimal monthly remittances suggests, they generally have very few employees, and often have only one. However, these limited remittances also indicate relatively small salaries, and therefore lower-income employees—that is, employees who are most likely to qualify for benefits, and therefore for whom real-time data collection is most useful.

Increased Reporting Burden

Any change to increase the extent of information reported for each payroll remittance period would need to consider the additional burden imposed on employers. The annual process of preparing T4 slips is onerous for some employers, and Canada's system recognizes this in providing a two-month window after the end of each calendar year for the completion of these filings. What costs would be created if similar reporting on a monthly basis were required? Many smaller businesses engage third parties to prepare their T4 slips and would therefore face an increased cost if they were required to file more frequently—especially businesses that maintain manual payroll records, requiring summarization and reconciliation when T4 slips are filed. These business owners (or their payroll services or accountants) would be required to complete monthly, rather than annual, data entry on an employee-by-employee basis.

To the extent that more regular payroll filings were accompanied by simplification measures to offset some of the burden, this approach may be more practical. For example, employers might be permitted to file for each pay period (whether weekly, biweekly, semi-monthly, monthly, or on some other schedule), rather than using standard periods for all employers. This would permit payroll filing to be undertaken with the same data being used for each paycheck—information that employers are already preparing in order to remunerate their employees.

At present, the CRA makes online T4 filing available. Providing a similar online model that would allow employers to enter data and have withholdings and net paycheques computed automatically might make this more practical for computer-literate employers. However, using such a facility would be more problematic for many smaller employers that still maintain manual payroll records and file T4 slips on paper.

Perhaps the CRA might also assume the responsibility of issuing aggregate reporting slips for the tax year in its entirety. Such a model might function best if implemented in conjunction with a “pay-as-you-earn” (PAYE) system (which would eliminate annual tax return filing for many employees) or with the implementation of pre-filled returns, avoiding the need for annual T4 slips.

A review of the various forms of payroll reporting to other government bodies would also be desirable. If data for individual employees must be provided with source deduction remittances, could this also replace the current record of employment filings used for EI purposes? Could the information also be shared with provincial authorities for the purposes of payroll taxes and workers' compensation administrators?

If increased real-time payroll reporting also extended the benefits of reduced reporting for other purposes, employers might well embrace, rather than resist, these changes. If the various government departments (federal, provincial, and territorial) are challenged by the implementation of a single reporting system, perhaps this might highlight the administrative burden currently faced by employers that are expected to comply with the requirements of multiple departments.

Basis of Payroll Reporting

Would real-time reporting deliver the desired results? As is the case with most tax issues, the answer is, I suggest, “It depends.”

Payroll remittances, and therefore payroll reporting, are required on a cash basis (that is, “as paid”). The CEWS program is based on remuneration paid in respect of a period (that is, on an accrual or “as-earned” basis). The use of a different basis for payroll-related benefits than for payroll reporting requires employers to report on two different bases, imposing a significant additional burden.

There have been many complaints from employers regarding the added administration required to allocate payroll to four-week periods for CEWS claims. Allocating the earnings of an employee who is paid monthly to four-week periods is a more obvious issue. However, even employers with weekly or biweekly pay periods have found that their pay periods seldom align with the four-week, Sunday to Saturday periods required to be used for CEWS purposes.

This does not sound like much of a problem, but consider the apportionment of a monthly salary earned, say, from November 22 to December 19, 2020 (one of the four-week CEWS periods). Is the correct allocation $\frac{1}{13}$ of the annual salary? This would omit one day a year (two days in leap years), since $52 \times 7 = 364$. Would the allocation more correctly be $\frac{2}{30}$ of November's salary plus $\frac{1}{31}$ of December's, or $\frac{28}{365}$ of an annual salary? Now toss in an annual bonus or quarterly commission payment. Or consider a restaurant owner who has a biweekly payroll for hourly workers, from Monday to Sunday during the weeks of November 16-29, November 30-December 13, and December 14-27, and is required to recalculate those periods to align with the CEWS period.

Designing future programs to be compatible with existing payroll requirements would reduce the administrative costs of accessing CEWS and similar benefits.

Impact of the Administrative Burden

Taken alone, none of the individual elements of payroll seems overly onerous. However, as each element builds on the others, the result (as described by more than one small employer) grows into “death by a thousand cuts.”

Many businesses have attempted to transition some or all of their workforce from employee to independent contractor status, in some cases motivated in whole or in part by a desire to avoid the existing burdens of payroll administration. Increasing that burden would encourage more businesses to attempt to classify their workforce as self-employed contract workers, rather than as employees. These workers lose access to labour protections such as EI,⁵ parental and similar leave, workers’ compensation, etc.⁶ As well, many such arrangements likely remain employment at law. The Tax Court of Canada already hears numerous “employee versus independent contractor” cases each year, and reclassification can result in a significant, and unanticipated, cost to a business that is found to be an employer.

Self-Employment Income

As noted by both Robson and Schwartz, and Petit et al., the challenges of gathering real-time data are greater for the self-employed than for employees.

Goods and Services Tax/Harmonized Tax (GST/HST) Returns

Petit et al. suggest the use of GST/HST filings as a source of information on self-employment income. In my view, several issues render this a less-than-viable solution.

Many smaller businesses file GST/HST returns on a quarterly or annual basis, reducing or eliminating the desired real-time reporting. For example, although Uber and Lyft drivers must register, they will not typically file monthly GST/HST returns. Many of the smallest businesses are small suppliers and are not required to register for GST/HST. Child-care providers and other domestic workers are common examples. The proprietors of these, the smallest businesses, include many low-income individuals who are most in need of social benefits.

5 Although self-employed individuals can opt into special benefits under the EI program, in practice this is seldom done. The September 2020 speech from the throne announced the intention to transition to a new EI system that will include the self-employed: Canada, Governor General, *A Stronger and More Resilient Canada: Speech from the Throne To Open the Second Session of the Forty-Third Parliament of Canada*, September 23, 2020, at 12.

6 In at least some provinces, self-employed individuals can purchase workers’ compensation coverage on their own account.

Requiring all registrants to file monthly would create a substantial administrative burden. Even annual returns can be onerous for many businesses—asking for monthly returns is simply not realistic.

Further, GST/HST returns currently report revenues but not expenses. Expenses cannot be reliably extrapolated from input tax credit (ITC) claims. Not all expenses generate ITCs, and not all ITCs arise from expenses (such as those relating to capital asset acquisitions). As well, significant sectors of the economy are GST-exempt (for example, many suppliers in the health-care and financial sectors). Expanding reporting to include both revenues and expenses would essentially require businesses to prepare monthly, rather than annual, income tax filings. I suggest that this is a key reason why pandemic-related relief measures have focused on revenue declines and not on more detailed computations such as cash flow or income.

Third-Party Reporting

A second approach to the collection of information on self-employment income is third-party reporting, such as the T4A slip. Both Robson and Schwartz, and Petit et al. note the possibility of expanding this reporting. In my opinion, that suggestion is largely impractical. For many years now, T4A slips have included a box to report fees for services. At present, the CRA does not penalize failures related to that box, and it has been unable to provide guidance as to exactly what is expected to be reported. The CRA has never suggested that it requires strict compliance, in that it has always limited this reporting requirement to business-to-business services.

Owing, at least in part, to this lack of clarity and enforcement, other filings noted by Petit et al. have been implemented. These include slips currently issued to federal government contractors and mandatory reporting slips to be issued by businesses in the construction sector (the T5018).⁷

A substantial portion of self-employment income is earned from individual consumers. It is sobering to consider that, if the T4A filing requirement were strictly enforced, it would require Canadians to file these forms for such services as accounting, law, medicine, landscaping, snow removal, taxi services, post-secondary education, and housecleaning, to mention only a tiny sample. As one example, I have practised public accounting for more than 30 years, and have never heard of anyone (business or consumer) issuing a T4A for the fees that he or she pays for accounting services.

Even if the T4A requirements were strictly enforced, they would still not cover all self-employment situations. For example, only fees for services are reported; there is no reporting requirement for retail purchases. Full enforcement of the T4A requirements would result in a vast increase in required filings, carrying a significant administrative burden, but it would still fall well short of delivering the kind of information required to accurately assess the self-employment income of individual Canadians.

7 CRA form T5018, "Statement of Contract Payments."

Here too, however, only revenue information would be obtained. With no knowledge of the expenses incurred to earn this revenue, the taxpayer's need and eligibility for benefits cannot be readily determined. In my view, there is no escaping the need for a self-assessment system for this part of the population under the current tax regime for self-employment income. I address suggested changes to that regime, such as the use of standard deductions, below.

Other Income Sources

The discussion above focuses on employment and self-employment income. Many other forms of income could be addressed similarly. For example, pensions, investment earnings, and social assistance could certainly be reported more frequently, like payroll information. Reporting of these other forms of income would raise challenges similar to the recognition of self-employment expenses—in this case, how to recognize carrying charges relating to investment income, for example, or the cost of securities in determining capital gains. Rental income is similar to self-employment income; while reporting on a form like a T4A could be mandated, extending such a requirement to every residential tenant in Canada seems less than practical, and again expenses related to the rental income would not be captured. Investment income is often registered as payable to one individual when the investment property (for example, an account holding a securities portfolio) is actually owned by multiple taxpayers, often family members. In some instances, the registered owner has no interest in the investment. For example, investments originally acquired for children are often held in their parents' names.

Petit et al. cite the example of Denmark, where (as of 2021) all rental activity must be undertaken through an agency, which must report revenues to the tax authorities. The concept of requiring all individuals earning rental income to engage an agency, presumably incurring additional costs, may not be well received by Canadian landlords. I would be curious to know the extent of known or suspected non-compliance with these requirements in Denmark. For a landlord unwilling to incur the costs of an agency, would this prove a further incentive to fail to report rental income at all?

Deductions and Credits

Similar to the reporting of income, the CRA would need mechanisms to capture deductions and credits. Alternatively, it would be left up to the taxpayer to make these claims. Persons with disabilities are a key vulnerable group to be encouraged to claim the benefits available to them. However, as addressed below, the problem of ensuring that benefits such as the disability tax credit (DTC) are claimed cannot be resolved solely by addressing non-filers, such as parents who fail to claim the Canada child benefit.

At present, few deduction or credit claims are subject to third-party reporting to the CRA. While this policy may be logical from the perspective of a tax agency focused on revenue collection, it does not assist in ensuring that benefits are delivered.

Outside the income tax system, low-income families can obtain grants and bonds for registered education savings plans for their children, and for registered disability savings plans where an individual is eligible for the DTC. A CRA program to make lower-income individuals and persons with disabilities more aware of these options presents an opportunity for partnering with intermediaries (discussed in further detail below)—in this case, financial institutions or investment advisers, who would assist these individuals in opening appropriate accounts and accessing these funds.

The CRA's ability to determine income without reference to an income tax return is, in my view, markedly impeded by the numerous minor deductions and credit items potentially relevant to each taxpayer. Streamlining the system would greatly facilitate the use of pre-filled returns. While I cannot speak to the tax systems of many other countries, I have had frequent informal discussions with staff at an organization that operates in Canada, Australia, and New Zealand, and offers a service that will pay for the costs of responding to information requests from the relevant tax agency. Staff have observed that the array of minor deductions and credits in Canada, as well as the Canadian tendency to deliver social programs through the income tax system, is unusual.

Standard Deductions/Credits

Petit et al. refer to Denmark's provision of a standard deduction, rather than itemized expenses, against rental income, which facilitates the tax agency's determination of income without reference to a taxpayer-filed return (since Denmark uses pre-filled returns). Essentially, the Danish model provides a base deduction of approximately Cdn\$6,000 and taxes only 60 percent of the remainder; presumably, the other 40 percent is a proxy for further expenses. It seems fairly clear that, under such a system, the taxpayer would be motivated to claim actual expenses on heavily financed properties, or in years of substantial repairs, and would use the standard model in years of lower costs.

The Canadian tax system tends to a "fairness above all" philosophy, which allows only real, supported expenses to be claimed. The CRA resists even a per-kilometre proxy for driving costs, instead requiring that each expense be documented with receipts and allocated between income-generating and personal costs based on detailed mileage records. The CRA's recent guidance on the apportionment of Internet fees between personal and employment use, as communicated through CPA Canada, provides another example of this philosophy.⁸ Clearly, a significant philosophical shift would be essential to move to more standardized deductions.

Certainly, many taxpayers would receive a larger standard claim than itemization might provide. This would be an inequity in the system. However, the administrative savings if Canadians could choose a single, standardized deduction and/or credit in lieu of many of the specific amounts afforded under our tax system may

8 See <https://www.cpacanada.ca/en/business-and-accounting-resources/taxation/blog/2021/january/employee-home-office-expenses-2020>.

merit acceptance of such an inequity. If the standard amount were comparable to, or greater than, the claims of, say, 75 percent of the population, how many more Canadians would choose the path of simplicity and certainty, even if they may forgo some minor tax benefits? There would be a loss of tax revenue, to be sure, but also a reduction in the expense of administering and enforcing the tax system. This, too (at least in my opinion), merits consideration.

It would be necessary to determine which expenses would be encompassed in any standard claim, and it is unlikely that this treatment could be extended to all forms of credits or deductions. For example, a standard deduction sufficient to enable many taxpayers to forgo the deduction of child-care and moving expenses would provide a substantial benefit for many taxpayers incurring no such costs, or would fall well short of the real expenses incurred by many Canadians in this regard.

While I believe that the alternative should be reviewed, in my opinion it would be preferable to move away from the “micro-credit” approach that characterizes the current tax system. Practically, much of the complexity that deters some filings arises from the array of credits for digital news services, teachers providing school supplies, volunteer firefighting and search-and-rescue work, and so on. Each of these credits adds another item that the CRA cannot realistically determine without taxpayer input. Even the ability to contribute to a registered retirement savings plan and claim the deduction in the current or a subsequent year reduces the CRA’s ability to accurately determine income without taxpayer input.

A standard deduction model could still afford taxpayers the choice to claim the detailed deductions and credits available. Perhaps this might come with the caveat that if, on audit or review, the supported claims fell short of the standard amounts, only those lower claims would be permitted. A return to the standard claim would not be permitted once the taxpayer chose to impose the higher costs of administration on the tax system.

On December 15, 2020, the CRA announced that it would permit the deduction of a temporary flat rate claim for individuals working from home in 2020.⁹ Alternatively, individuals may compute a claim under the normal rules for such deductions. While such claims are comparatively modest, experience from this initiative may provide some lessons to guide the implementation of similar “flat rate with no receipts” alternatives to fully documented and supported deduction claims—or may indicate that the benefits of such an approach are not sufficient to justify its adoption.

Pre-Filled Tax Returns

Petit et al. echo a common suggestion that Canada could consider moving to pre-filled tax returns. Many of the issues discussed above, particularly in respect of income

9 Canada Revenue Agency, “Introducing a Simplified Process for Claiming the Home Office Expenses for Canadians Working from Home due to the COVID-19 Pandemic,” *News Release*, December 15, 2020.

reporting and numerous credits and deductions, pose similar challenges to the adoption of this reform.

A focus on sending a pre-filled paper return to the taxpayer also ignores the efficiencies of electronic filing. The CRA has indicated that over 90 percent of 2019 tax returns were filed electronically.¹⁰ The data that the CRA would use for pre-filled returns are available through its “Auto-fill” service, and are more current when accessed in March or April than they could be if the CRA printed pre-filled forms to be sent to taxpayers and returned in accordance with the present filing deadlines.

Practically, if the CRA had the timely information needed to pre-fill a return with confidence that it could be accepted without further review, those data could be used for direct outreach to individuals who are entitled to benefits, with no return being required at all. As a consequence, the question of moving to pre-filled returns is largely separate from the issue of how to encourage individuals, especially non-filers in vulnerable populations, to claim available benefits. Accordingly, with some regret, I will leave the topic of pre-filled returns for future discussion.

VULNERABLE POPULATIONS: ADDRESSING THE PROBLEM OF NON-FILERS

Many Canadians who do not file tax returns are failing to comply with a legal obligation to do so, and that legal obligation could certainly be extended to all Canadians who are currently losing access to benefits as a result of their failure to file. However, it seems counterproductive to assess a financial penalty against Canadians who fail to claim financial benefits. The point is to distribute benefits, not collect cash.

As Robson and Schwartz note, invitations to file have experienced limited success. It may be interesting to ask the CRA how many of the 950,000 Canadians invited to use “File My Return” instead filed their returns in more conventional fashion. Surely they were not all non-filers. Still, some Canadians received benefits that they otherwise would have forfeited, averaging approximately \$800 each.¹¹ Perhaps that will motivate future filings—for example, if those individuals encourage non-filing friends and family to claim their benefits. This might be a suitable topic for the annual series of government advertisements during the personal tax filing season.

Focusing Outreach Efforts

Many of the Canadians not receiving the benefits to which they are entitled are members of vulnerable populations. As noted by both Robson and Schwartz, and Petit et al., these are primarily lower- and modest-income Canadians, including

10 See Canada Revenue Agency, www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/individual-income-tax-return-statistics.html.

11 See Robson and Schwartz, *supra* note 4, text accompanying note 21.

marginalized individuals, who are in greatest need of assistance. I submit that addressing this issue should be the most immediate focus. Any expansion of information reporting, a PAYE system, and/or pre-filled returns will not come quickly. More rapid action can be taken to reach out to vulnerable Canadians.

I will confess to a certain temptation to refer to the ivory towers of academia in my comments. However, my own tower of glass and steel affords me no greater insights into the circumstances, or the perspective, of Canadians who rely on or need social assistance or income support in the form of tax benefits. Likewise, I am far from certain that well-paid, housing-secure individuals such as specialists in taxation and economics, or civil servants at the Department of Finance or the CRA, are best suited to assess how government outreach to these communities could be made more effective.

We as tax experts are quick to note the need for specialist advice on complex tax issues. What would lead us to believe that we also possess the appropriate expertise to provide outreach, guidance, assistance, and support to vulnerable Canadians? That requires a very different skill set, one that is just as specialized. Perhaps the skills and experience of individuals drawn from and working with those communities would be a more valuable resource in any outreach effort.

While I believe that I was invited to write this article because of my activity in the tax community, as both a practitioner and a former governor of the Canadian Tax Foundation, I find myself wondering if my role as a member of the Board of the Center for Public Legal Education of Alberta might afford more useful insights.

That organization's experience over many years has shown that legal experts reaching out to vulnerable populations generally fall short. But outreach to intermediaries who deal directly with members of those vulnerable populations has proved to be far more effective. As Robson and Schwartz, and Petit et al. observe, the CRA's previous efforts to encourage more filings by lower- and modest-income Canadians have been largely unsuccessful.

Leveraging Other Intermediaries

Practically, the CRA is already highly compartmentalized. Auditors faced with more complex tax issues regularly obtain advice from the Rulings Division. A group within the CRA could liaise with intermediaries who work with vulnerable Canadians, providing technical support and engaging the assistance of individuals with more specialized knowledge as needed.

For example, instead of sending letters to individual non-filers in First Nations communities, could the CRA work with chiefs, councils, and elders to organize on-reserve groups of residents who could help members of their communities to access benefits? Similarly, given the difficulty of reaching homeless individuals directly, the CRA might work with local organizations, enhancing the ability of intermediaries to assist vulnerable Canadians with whom they already interact in identifying and accessing benefits. Likewise, groups that work with disabled persons can more effectively reach those individuals. Since social workers already support individuals and families receiving social assistance, could they not assist their clients in

accessing benefits to which they are entitled under the income tax system? Provincial social assistance offices, Service Canada, child protection services—the list of groups that already work with vulnerable populations is extensive, and they possess skills, knowledge, and contacts that could be invaluable in bridging the gap between the CRA and the individuals it needs to reach.

Bridging the Complexity Gap

I suggest that an eight-page tax return, backed up by a guide that is more than 50 pages long and contains references to a myriad of other publications, may intimidate intermediaries and their clients alike. Free software packages, as noted below, might be a less intimidating choice. The infrastructure currently used to engage tax professionals in volunteer tax clinics could be repurposed to enable those on the front lines who are working with vulnerable Canadians to assist with tax preparation directly, expanding the reach of current volunteer tax clinic initiatives.

The organizers of many volunteer initiatives provide simplified guidance and brief training sessions to assist volunteer tax preparers. These could also assist intermediary groups, and could focus on issues most relevant to each specific group. Existing volunteers might be willing to act as telephone or e-mail contacts where more complex tax issues are encountered. Alternatively, or additionally, the CRA might provide intermediaries with direct e-mail or telephone access to appropriate CRA resources to address any questions—or might fund one or more appropriate non-profit organizations to fill this role.

This needs to be a two-way street. The CRA needs to listen to those intermediaries, and learn what impediments discourage or prevent vulnerable Canadians from accessing available benefits. Neither we, nor the CRA, understand what these impediments are—otherwise, outreach programs overcoming them would have been undertaken—so we need to ask. Once the barriers to access have been identified, they need to be removed. Whether or not we, the CRA, or anyone else believes that they are valid reasons for not filing, they are preventing benefits from reaching their intended recipients.

Overall, I suggest that the CRA's efforts to encourage members of vulnerable populations who are not currently receiving benefits to which they are entitled will be more successful if the CRA stops trying to go it alone. Collaboration with people and organizations that better understand these vulnerable populations will leverage their existing knowledge, expertise, and connections to those populations. The CRA could focus its efforts on enhancing the ability of intermediaries to assist vulnerable Canadians in identifying and accessing the benefits to which they are entitled. As with the impediments to access to benefits, we need to identify the tools that would assist the intermediaries in more effectively helping these populations—whether those tools are in the form of funding, time, information, or something else that I have not even considered. Again, if we don't ask, we will never know.

As Robson and Schwartz note, one concern that is commonly raised is the CRA's substantial withdrawal of in-person service options. This concern tends to be raised more frequently by those delivering tax services in major centres, where CRA offices

were historically located, than by those practising in rural areas, which have always lacked convenient access to CRA offices. I am curious to know whether non-filing, especially among more vulnerable Canadians entitled to benefits, has grown since these in-person options were eliminated. This seems to be an area that could be reviewed by the CRA.

A greater concern may be the lack of access to computer and Internet services for many vulnerable Canadians. This could also be addressed by making greater use of the services of intermediaries. While Robson and Schwartz note that Employment and Social Development Canada maintains 611 local offices, I question what proportion of vulnerable Canadians can be served by these offices. By comparison, Canada Post has approximately 6,100 offices, reflecting much broader coverage.¹² Public libraries and community centres may be other viable locations.

If some form of in-person/local office is considered valuable, perhaps these locations could be equipped with computer kiosks and direct phone lines to CRA agents. Of course, security and confidentiality issues would need to be addressed. However, given the limited success of outreach efforts to vulnerable populations, it seems unreasonably optimistic to expect that the provision of additional venues that the taxpayer must choose to visit will have a significant impact.

Facilitating Tax Return Filing

Could the CRA provide taxpayers, and/or the intermediaries discussed above, with an online calculator in some form? This could be provided within the My Account portal or through the locations suggested above, and/or could be made available to appropriate intermediaries. With the necessary safeguards for data security, the filer could effectively import the same information currently available through the Auto-fill My Return process into an electronic calculator and attest that it reflects all of the individual's income. The CRA's electronic calculators released for CEWS and CERS demonstrate that this is feasible, although a calculator capable of handling a full personal tax return would be much more ambitious. The calculator could be limited to income, expenses, and credits, and need not compute a balance payable or a refund, although this seems a simple enough inclusion.

An "authorized intermediary" status could be created, which would require an intermediary to obtain a signed authorization from the individual whom it is assisting, allowing the intermediary to (1) access the individual's tax-related data (similar to "Represent a Client" access), which can be filed through tax software almost instantaneously; (2) transfer data to a calculator for the individual; and (3) attest that the individual has authorized the filing.

Some system that is practical for taxpayers and intermediaries, and that addresses the well-founded privacy and security concerns that the CRA would doubtless have, would need to be developed.

12 As reported in Canada Post's 2019 annual report (www.canadapost.ca/cpc/en/our-company/about-us/financial-reports/2019-annual-report/story-of-2019.page).

It bears noting that the CRA's website provides links to a diverse array of tax preparation software programs, some of which are accessible free of charge.¹³ Perhaps the CRA might provide non-filers and/or intermediaries with a list of software that has been certified for netfiling, and is available at no cost, rather than the CRA itself creating a calculator to serve this purpose.

OVERALL CONCLUSIONS

My own view is that outreach to non-filers to bring them into the fold, and deliver their benefits, can be implemented more simply and more rapidly than a shift to real-time information across the economy. This would work toward the more pressing objective of delivering benefits not currently reaching vulnerable Canadians in need of such support.

A shift to increased real-time information is more challenging. That is not to say that it does not merit pursuit, but it may require a longer-term focus. A first step would be evaluating the problems encountered in the delivery of benefits implemented during the COVID-19 pandemic, identifying the key points where difficulties were encountered, and designing better systems to overcome such difficulties in the future.

The development of any new system needs to be the subject of detailed stakeholder consultation, input, and feedback. Imposing an excessive burden on any stakeholder group will only serve to build resentment and reduce compliance, ultimately undermining the effectiveness of any new measures.

13 Canada Revenue Agency, "File Your Taxes Online: Certified Tax Software" (www.canada.ca/en/revenue-agency/services/e-services/e-services-individuals/netfile-overview/certified-software-netfile-program.html).

Douglas J. Sherbaniuk Distinguished Writing Award

MICHAEL H. LUBETSKY

Michael Lubetsky is the 2020 recipient of the Canadian Tax Foundation's Douglas J. Sherbaniuk Distinguished Writing Award. His article, "Income Tax Disputes Involving Loss Years: Pitfalls, Foibles, and Possible Reforms," was published in (2019) 67:3 *Canadian Tax Journal* 499-531. The article was selected by a committee of experienced tax professionals as the best writing published by the Foundation in 2019-20. The award, which is conferred annually, is named for the Foundation's late director emeritus.

Michael H. Lubetsky is a partner in the Litigation and Taxation groups at Davies Ward Phillips & Vineberg LLP. His practice focuses on tax litigation, and he also acts regularly in complex commercial disputes and cases involving novel questions of constitutional and comparative law. He has pleaded before the Supreme Court of Canada; the Federal, Ontario, and Quebec Courts of Appeal; and various trial-level courts and tribunals across Canada and beyond. He has also authored or co-authored articles on a wide range of legal topics that have been cited by the Supreme Court of Canada; the Federal, Quebec, and British Columbia Courts of Appeal; and trial-level courts. He earned an AB from Princeton University and BCL, LLB, and MBA degrees from McGill University. Prior to becoming a lawyer, he worked as a researcher with an investment company in Japan and later as an officer in the Canadian Foreign Service, serving in Haiti, the Dominican Republic, and China.

Prix d'excellence en rédaction Douglas J. Sherbaniuk

MICHAEL H. LUBETSKY

Michael Lubetsky est le récipiendaire 2020 du Prix d'excellence en rédaction Douglas J. Sherbaniuk de la Fondation canadienne de fiscalité. Son article intitulé « Income Tax Disputes Involving Loss Years: Pitfalls, Foibles, and Possible Reforms » a été publié dans (2019) 67:3 *Revue fiscale canadienne* 499-531. Son article a été retenu par un comité composé de professionnels en fiscalité à titre de meilleur article publié par la Fondation en 2019-20. Ce prix, décernée annuellement, est nommé à la mémoire du défunt directeur emeritus de la Fondation.

Michael H. Lubetsky est un associé au sein des groupes de pratique Règlement de différends et Différends en matière fiscale chez Davies Ward Phillips & Vineberg S.E.N.C.R.L./s.r.l. Sa pratique se concentre sur les litiges fiscaux, et il intervient également régulièrement dans des litiges commerciaux complexes et des affaires impliquant de nouvelles questions de droit constitutionnel et comparatif. Il a plaidé devant la Cour suprême du Canada; les Cours d'appel fédérale, ontarienne et québécoise; et divers cours et tribunaux de première instance partout au Canada et ailleurs. Il est également l'auteur ou le coauteur d'articles portant sur des sujets juridiques variés qui ont été cités par la Cour suprême du Canada; les Cours d'appel fédérale, québécoise et de la Colombie-Britannique; et les tribunaux de première instance. Il est détenteur d'un baccalauréat de l'Université Princeton, d'un LL.B./B.C.L. et d'un M.B.A. de l'Université McGill. Avant de devenir avocat, il a travaillé comme chercheur au sein d'une société d'investissement au Japon, puis comme agent du Service extérieur du Canada, servant en Haïti, en République dominicaine et en Chine.

Canadian Tax Foundation Regional Student-Paper Awards

Each year, the Canadian Tax Foundation awards up to four regional student-paper prizes. Depending on the merit of the papers received, one prize may be awarded for each of four regions of the country: Atlantic Canada (the Canadian Tax Foundation-McInnes Cooper Award); Quebec (the Canadian Tax Foundation-Osler Hoskin Harcourt Award); Ontario (the Canadian Tax Foundation-Fasken Martineau DuMoulin Award); and western Canada (the Canadian Tax Foundation-Bert Wolfe Nitikman Foundation Award). Papers must be written as a requirement of a tax-related course, including directed research courses, and can address any aspect of the Canadian tax system, including comparative analyses, tax policy, tax compliance, tax planning, and tax system design. Papers may be written in either English or French and must be recommended for award consideration by the professor or instructor of the course.

Papers will be reviewed by three independent reviewers, and abstracts (of 400 words or less) of the award-winning papers will be published in the *Canadian Tax Journal*. The authors of the winning papers will also receive a cash prize from the firms or institutions sponsoring the awards and a one-year membership in the Foundation, entitling them to receive complimentary copies of many of the currently issued Foundation publications, including the *Canadian Tax Journal*, *Canadian Tax Focus*, *Tax for the Owner-Manager*, *Perspectives on Tax Law & Policy*, and the annual tax conference report, along with one year of complimentary access to TaxFind, the Foundation's online research database. As members of the Foundation, winners can also take advantage of generous discounts on other publications as well as discounted registration fees for Foundation conferences and courses.

Submissions to the student-paper competition should be addressed to the Canadian Tax Foundation, Student-Paper Competition, 145 Wellington Street West, Suite 1400, Toronto, ON M5J 1H8, or e-mailed to CTF_Awards@ctf.ca. Entries must be accompanied by a letter of recommendation from the professor or instructor of the tax course for which the paper was written and must include the student's name and e-mail address if known. The submission deadline for the 2020-21 academic year is July 15, 2021.

THE CANADIAN TAX FOUNDATION-OSLER HOSKIN HARCOURT AWARD FOR QUEBEC

Marie-Audrey Kirouac (2019-20 Recipient)

The Canadian Tax Foundation is pleased to announce that Marie-Audrey Kirouac is the winner of the Canadian Tax Foundation-Osler Hoskin Harcourt Award for the best Quebec paper of 2019-20 dealing with an aspect of Canadian taxation.

Ms. Kirouac's paper, "Analyse des mesures fiscales fédérales adoptées en 2019 et de l'admissibilité du journal La Presse à celles-ci," was written for the Master in Taxation program at the University of Sherbrooke.

Holder of an LLB and a Masters in notarial law, Ms. Kirouac quickly became interested in taxation and also worked at Revenu Québec for the two years after completing her LLB until she began her MTax studies at the University of Sherbrooke in 2018-19. With this knowledge and experience, she has now held the position of senior tax adviser at PwC for almost a year, where she participates in reorganization mandates and in government tax incentive applications.

ABSTRACT

The journalistic environment has undergone profound upheavals in recent years, notably due to the significant shift in advertising revenues to the Web giants, such as Facebook and Google. Considering the presence of reliable and quality media in Canada as being essential, the federal government's budget tabled on February 27, 2018 provided nearly \$595 million in financial support to the journalistic community over five years.

In the wake of these statements, Pierre-Elliott Levasseur, president of the newspaper La Presse, announced a corporate reorganization of the newspaper in order to adopt "a non-profit structure." The newspaper's management therefore relies on the philanthropic contribution of readers as well as state financial support to ensure its survival.

The government subsequently unveiled the new measures, which include a refundable tax credit for eligible labour equivalent to 25 percent of the money spent on compensation, and the addition of the concept of "registered journalism organizations" to the list of recognized donors covered in subsection 149.1(1) of the Income Tax Act.

The purpose of this current trial is to detail these two measures introduced in the Income Tax Act and then analyze the eligibility of La Presse's new structure for them. This will ultimately lead me to reflect upon the achievement of the objectives pursued by the daily newspaper and finally, to provide certain recommendations.

THE CANADIAN TAX FOUNDATION-FASKEN MARTINEAU DUMOULIN AWARD FOR ONTARIO

Allen Yi (2019-20 Recipient)

The Canadian Tax Foundation is pleased to announce that Allen Yi is the winner of the Canadian Tax Foundation-Fasken Martineau DuMoulin Award for the best Ontario paper of 2019-20 dealing with an aspect of Canadian taxation.

Mr. Yi's paper, "A New Decade: Revisiting Tax Consolidation in Canada, Mate," was written for Professor Jinyan Li's Introduction to the Taxation of Corporations and Shareholders class in the LLM in Tax Law program at Osgoode Hall Law School.

Mr. Yi obtained his BSc from the University of Victoria and his JD from the University of Toronto. He became interested in tax law while in private practice, working as an M & A lawyer. Mr. Yi began his MTax at Osgoode Hall Law School in 2016.

ABSTRACT

The last time the Canadian government was on the verge of formalizing a loss-transfer system for Canadian corporate groups was in 2010. With the dawn of a new decade, it seems appropriate to re-examine some of the policy options for the income tax treatment of corporate groups in Canada. This paper examines why this issue has been a vexed one for Canadian tax policy and what, if anything, should be done about it. It is argued that a stronger application of the enterprise doctrine does not necessarily mean a better regime on policy grounds, and therefore any implementation by Canada should proceed with caution. The paper first explores the history of the rise of corporate groups in the modern economy and why the enterprise doctrine is appropriate for the taxation of corporate groups. The paper then examines the current system in Canada with respect to loss utilization and the provincial considerations that are unique to Canada. Using Australia as a case study of a country that has embraced the single entity concept to its fullest, I then apply it to the Canadian context. Through this exercise I argue that while Australia's model may address neutrality and equity grounds, the cost to administer it is too burdensome for it to be a viable solution. In the end, Canada should not adopt a full consolidation tax system. If Canada is to move on this issue, it should proceed with caution and at most formalize the existing loss-utilization rules. This will make the system more transparent and allow the government to monitor the actual costs to the provinces.

Prix régionaux du meilleur article par un étudiant de la Fondation canadienne de fiscalité

Chaque année, la Fondation canadienne de fiscalité (FCF) décerne jusqu'à quatre prix régionaux pour des articles rédigés par des étudiants. Selon la qualité des articles qui ont été soumis, un prix peut être décerné pour chacune des quatre régions du pays : le Canada atlantique (le Prix FCF-McInnes Cooper); le Québec (le Prix FCF-Osler Hoskin Harcourt); l'Ontario (le Prix FCF-Fasken Martineau DuMoulin); et l'Ouest canadien (le Prix FCF-Bert Wolfe Nitikman Foundation). Les articles doivent avoir été rédigés dans le cadre d'un cours lié à la fiscalité, comprenant les cours de travaux dirigés, et ils peuvent porter sur tout aspect du régime fiscal canadien, y compris les analyses comparatives, la politique fiscale, l'observation des règles fiscales, la planification fiscale et la conception du régime fiscal. Les articles peuvent être rédigés en anglais ou en français et une lettre de recommandation du professeur ou du chargé d'enseignement du cours doit être au dossier.

Les articles sont évalués par trois examinateurs indépendants, et des précis (de 400 mots ou moins) des articles primés seront publiés dans la *Revue fiscale canadienne*. Les auteurs des articles primés recevront aussi une récompense en argent des organismes ou des sociétés qui commanditent le prix ainsi qu'une adhésion d'une année à la FCF, leur donnant le droit de recevoir des exemplaires gratuits d'un grand nombre d'ouvrages publiés par la FCF, dont *Revue fiscale canadienne*, *Canadian Tax Focus*, *Actualités fiscales pour les propriétaires exploitants*, *Perspectives en fiscalité et en politique fiscale* ainsi que le rapport de la conférence annuelle en fiscalité, avec un accès d'un an à TaxFind en ligne, l'outil de recherche électronique de données de la FCF. À titre de membre de la FCF, les lauréats bénéficient également de réductions appréciables sur le prix d'autres publications ainsi que sur les frais d'inscription aux conférences et aux cours offerts par la FCF.

Les dossiers de participation au concours du meilleur article rédigé par un étudiant doivent être transmis par la poste à la FCF, Concours du meilleur article rédigé par un étudiant, 145 Wellington Street West, bureau 1400, Toronto, ON M5J 1H8, ou par courriel à CTF_Awards@ctf.ca. Les dossiers doivent être accompagnés d'une lettre de recommandation du professeur ou du chargé d'enseignement du cours en fiscalité dans le cadre duquel l'article a été rédigé ainsi que des nom et adresse courriel de l'étudiant si connue. La date d'échéance de présentation des dossiers pour l'année universitaire 2020-21 est le 15 juillet 2021.

PRIX DE LA FONDATION CANADIENNE DE FISCALITÉ-OSLER HOSKIN HARCOURT POUR LE QUÉBEC

Marie-Audrey Kirouac (récipiendaire 2019-20)

La Fondation canadienne de fiscalité a le plaisir d'annoncer que Marie-Audrey Kirouac est la lauréate du Prix Fondation canadienne de fiscalité-Osler Hoskin Harcourt pour le meilleur article de 2019-20 de la province de Québec qui traite d'un aspect de la fiscalité canadienne.

L'article de M^{me} Kirouac intitulé « Analyse des mesures fiscales fédérales adoptées en 2019 et de l'admissibilité du journal La Presse à celles-ci » a été rédigé dans le cadre du programme de maîtrise en fiscalité de l'Université de Sherbrooke.

Titulaire d'un baccalauréat en droit et d'une maîtrise en droit notarial, M^{me} Kirouac s'est rapidement intéressée à la fiscalité et a d'ailleurs travaillé à Revenu Québec pendant les deux années qui ont suivi la fin de son baccalauréat en droit, et ce, jusqu'à ce qu'elle commence sa maîtrise en fiscalité à l'Université de Sherbrooke en 2018-19. Grâce à ces connaissances et à cette expérience, elle est maintenant conseillère principale en fiscalité chez PwC depuis près d'un an, où elle participe notamment à des mandats de réorganisation et à des demandes de mesures incitatives gouvernementales.

PRÉCIS

Le milieu journalistique a connu de profonds bouleversements au cours des dernières années, notamment en raison du déplacement important des revenus publicitaires vers les géants du Web, que l'on pense à Facebook et Google. Estimant essentielle la présence de médias fiables et de qualité au Canada, le gouvernement fédéral prévoyait, dans son budget déposé le 27 février 2018, un soutien financier au milieu journalistique de près de 595 millions de dollars sur cinq ans.

Dans la foulée de ces déclarations, Pierre-Elliott Levasseur, président du journal La Presse, a annoncé une réorganisation corporative du journal afin d'adopter « une structure sans but lucratif ». La direction du journal mise dès lors sur la contribution philanthropique des lecteurs ainsi que sur l'appui financier étatique pour assurer sa survie.

Le gouvernement a par la suite dévoilé les nouvelles mesures qui consistent notamment à un crédit d'impôt remboursable pour la main d'œuvre admissible équivalant à 25 pour cent des sommes dépensées à titre rémunérateur ainsi que l'ajout du concept d'« organisation journalistique enregistrée » à la liste des donataires reconnus visés au paragraphe 149.1(1) de la Loi de l'impôt sur le revenu.

Le présent essai vise à détailler ces deux mesures introduites dans la Loi pour ensuite analyser l'admissibilité de la nouvelle structure de La Presse à celles-ci. Ceci mènera ultimement à une réflexion quant à l'atteinte des objectifs poursuivis par le quotidien puis finalement, à certaines recommandations.

PRIX DE LA FONDATION CANADIENNE DE FISCALITÉ- FASKEN MARTINEAU DUMOULIN POUR L'ONTARIO

Allen Yi (récipiendaire 2019-20)

La Fondation canadienne de fiscalité a le plaisir d'annoncer que Allen Yi est le lauréat du Prix Fondation canadienne de fiscalité-Fasken Martineau DuMoulin pour le meilleur article 2019-20 qui traite d'un aspect de la fiscalité canadienne.

L'article de M. Yi intitulé « A New Decade: Revisiting Tax Consolidation in Canada, Mate » a été rédigé dans le cadre du cours *Introduction to the Taxation of Corporations and Shareholders* d'Osgoode Law School donné par la professeure Jinyan Li.

M. Yi a obtenu son baccalauréat ès sciences de l'Université de Victoria et son doctorat en droit de l'Université de Toronto. Il s'est intéressé au droit fiscal alors qu'il était en pratique privée, travaillant comme avocat spécialisé en fusions et acquisitions. M. Yi a commencé sa maîtrise en fiscalité à la Faculté de droit d'Osgoode Hall Law School en 2016.

PRÉCIS

La dernière fois que le gouvernement canadien était sur le point d'officialiser un système de transfert de pertes pour les groupes d'entreprises canadiennes, c'était en 2010. À l'aube d'une nouvelle décennie, il semble approprié de réexaminer certaines des options stratégiques pour le traitement de l'impôt sur le revenu des groupes de sociétés au Canada. Le présent document examine pourquoi cette question en est une des plus délicates pour la politique fiscale canadienne et ce qui, le cas échéant, devrait être fait à ce sujet. On soutient qu'une application plus forte de la doctrine de l'entreprise ne signifie pas nécessairement un meilleur régime pour des raisons de politique générale et que, par conséquent, toute mise en œuvre par le Canada devrait se faire avec prudence. Le document explore d'abord l'histoire de l'essor des groupes d'entreprises dans l'économie moderne et pourquoi la doctrine de l'entreprise est appropriée pour l'imposition des groupes d'entreprises. Le document examine ensuite le régime actuel au Canada en ce qui concerne l'utilisation des pertes et les considérations provinciales propres au Canada. En utilisant l'Australie comme étude de cas d'un pays qui a adopté pleinement le concept d'entité unique, je l'applique ensuite au contexte canadien. Dans le cadre de cet exercice, je soutiens que même si le modèle de l'Australie peut aborder les motifs de neutralité et d'équité, le coût pour l'administrer s'avère trop lourd pour qu'il soit une solution viable. En fin de compte, le Canada ne devrait pas adopter un régime fiscal de consolidation complet. Si le Canada veut aller de l'avant dans ce dossier, il devrait procéder prudemment et, tout au plus, officialiser les règles existantes en matière d'utilisation des pertes. Cela rendra le système plus transparent et permettra au gouvernement de surveiller les coûts réels pour les provinces.

Best Newsletter Article by a Young Practitioner Award

For a sixth year, the Canadian Tax Foundation has presented the Best Newsletter Article by a Young Practitioner Award. The winners were announced in November 2020. Newsletter articles, in addition to being a valuable service to the profession in their own right, are often a stepping stone to lengthier pieces of writing, such as contributions to Canadian Tax Foundation conferences and articles in the *Canadian Tax Journal*. Early success in writing newsletter articles as a young practitioner (YP) may lead to a career in tax in which writing is a regular and ongoing part of one's contribution to the profession.

The Foundation defines a YP as an individual who has 10 years or less of experience working in the taxation field after becoming fully qualified (for example, receiving their professional designation). The award is given for the best newsletter article that (1) was written solely by one or more authors who was a YP at the time of publication, and (2) appeared in any of the three newsletters published by the Foundation in 2019: *Canadian Tax Focus*, *Canadian Tax Highlights*, or *Tax for the Owner-Manager*. Most of these articles appeared in *Canadian Tax Focus*, which generally publishes only articles for which the author (or one of the co-authors) is a YP. In all, 73 newsletter articles were eligible for the award.

A total of 11 of the articles eligible for the award were reviewed by a three-member committee consisting of, among others, recently graduated ex-YPs who have been extensively involved in publishing with the Foundation. The criteria applied by the committee were essentially the same as those used for the Foundation's Douglas J. Sherbaniuk Distinguished Writing Award. The members of the committee were:

- Mark Dumalski, Deloitte LLP, Ottawa
- Olivier Fournier, Deloitte Legal LLP, Montreal
- Michelle Moriartey, Legacy Tax + Trust Lawyers, Vancouver

The committee gave the awards to five authors in respect of the following articles:

- Michael Dolson (Felesky Flynn LLP, Edmonton: mdolson@felesky.com) and Kyle Ross (Felesky Flynn LLP, Calgary: kross@felesky.com), "Windups, PUC Reductions, and GAAR: Implications of the CRA's 2018 Commentary" (2019) 19:4 *Tax for the Owner-Manager* 5-7.
- Thanusan Raveendran (LRK Tax LLP, Kitchener, ON: thanusan.raveendran@lrktax.ca) and Anjali Navkar (PricewaterhouseCoopers LLP, Toronto: anjali.navkar@pwc.com), "The Rise of Crypto Funds and the Offshore Investment Fund Property Rules" (2019) 27:12 *Canadian Tax Highlights* 13-15.

- Henry Shew (Cadesky Tax, Toronto: HShew@cadesky.com), “Post Mortem Pipeline Fails for Non-Resident Beneficiaries” (2019) 9:1 *Canadian Tax Focus* 1.

Young practitioners (and anyone else) interested in writing for the Foundation’s newsletters are invited to contact the newsletter editors: Alan Macnaughton (amacnaughton@uwaterloo.ca) for *Canadian Tax Focus*, Thomas McDonnell (1tmcdonnell2@rogers.com) for *Tax for the Owner-Manager*, and Jeffrey Trossman (jeffrey.trossman@blakes.com) for *Perspectives on Tax Law & Policy*. In Quebec, they are invited to also contact Lucie Bélanger (lbelanger@ctf.ca) of the Quebec office.

Individuals interested in participating in any of the events and activities of the Foundation’s Young Practitioners chapters across Canada are invited to contact the chair of the steering committee of the local chapter or Robyn Corrigan (rcorrigan@ctf.ca) of the national office.

There are Young Practitioners chapters in Calgary, Edmonton, Halifax, Kelowna, Kitchener-Waterloo, Mississauga, Montreal, Ottawa, Quebec City, Saskatoon, Toronto, Vancouver, and Winnipeg.

Prix pour le meilleur article de bulletin rédigé par un jeune fiscaliste

Pour une sixième année, la Fondation canadienne de fiscalité a remis le prix pour le meilleur article de bulletin rédigé par un jeune fiscaliste. Les gagnants ont été annoncés le 20 novembre 2020. Les articles de bulletin, en plus d'apporter un service précieux à la profession en tant que telle, sont souvent un tremplin vers des écrits plus longs, comme des contributions aux conférences de la Fondation canadienne de fiscalité et aux articles dans la *Revue fiscale canadienne*. Obtenir du succès pour la rédaction d'articles de bulletin tôt dans sa carrière en tant que jeune fiscaliste (JF) peut mener à une carrière en fiscalité dans laquelle l'écriture constituera une part régulière et continue comme contribution à la profession.

La Fondation définit un JF comme une personne ayant dix ans ou moins d'expérience dans le domaine de la fiscalité, et ce, après l'obtention de ses qualifications (par exemple, avoir reçu son titre professionnel). Le prix est décerné pour le meilleur article de bulletin qui (1) a été rédigé exclusivement par un ou plusieurs auteurs qui étaient de JF au moment de la publication, et (2) a été publié dans l'un des trois bulletins de la Fondation en 2019 : *Canadian Tax Focus*, *Faits saillants en fiscalité canadienne* ou *Actualités fiscales pour les propriétaires exploitants*. La plupart de ces articles sont parus dans *Canadian Tax Focus*, qui ne publie généralement que des articles pour lesquels l'auteur (ou l'un des coauteurs) est un JF. En tout, 73 articles de bulletin étaient admissibles au prix.

Parmi les articles admissibles au prix, 11 articles ont été examinés par un comité de trois membres composé, entre autres, d'anciens JF récemment diplômés qui ont participé activement à des rédactions auprès de la Fondation. Les critères appliqués par le comité étaient essentiellement les mêmes que ceux utilisés pour le Prix d'excellence en rédaction Douglas J. Sherbaniuk de la Fondation. Les membres du comité étaient :

- Mark Dumalski, Deloitte S.E.N.C.R.L./s.r.l., Ottawa
- Olivier Fournier, Deloitte Legal Canada, Cabinet d'avocats S.E.N.C.R.L./s.r.l., Montréal
- Michelle Moriartey, Legacy Tax + Trust Lawyers, Vancouver

Le comité a décerné les prix à cinq auteurs pour les articles suivants :

- Michael Dolson (Felesky Flynn LLP, Edmonton : mdolson@felesky.com) et Kyle Ross (Felesky Flynn LLP, Calgary : kross@felesky.com), « Windups, PUC Reductions, and GAAR: Implications of the CRA's 2018 Commentary » (2019) 19:4 *Actualités fiscales pour les propriétaires exploitants* 5-7.

- Thanusan Raveendran (LRK Tax LLP, Kitchener, ON : thanusan.raveendran@lrktax.ca) et Anjali Navkar (PricewaterhouseCoopers LLP, Toronto : anjali.navkar@pwc.com), « The Rise of Crypto Funds and the Offshore Investment Fund Property Rules » (2019) 27:12 *Faits saillants en fiscalité canadienne* 13-15.
- Henry Shew (Cadesky Tax, Toronto : HShew@cadesky.com), « Post Mortem Pipeline Fails for Non-Resident Beneficiaries » (2019) 9:1 *Canadian Tax Focus* 1.

Les jeunes fiscalistes (et toute autre personne) intéressés à rédiger des articles pour les bulletins de la Fondation sont invités à communiquer avec les rédacteurs en chef des bulletins : Alan Macnaughton (amacnaughton@uwaterloo.ca) pour *Canadian Tax Focus*, Thomas McDonnell (1tmcdonnell2@rogers.com) pour *Actualités fiscales pour les propriétaires* et Jeffrey Trossman (jeffrey.trossman@blakes.com) pour *Perspectives en fiscalité et en politique fiscale*. Au Québec, ils sont invités à communiquer également avec Lucie Bélanger (lbelanger@ctf.ca) du bureau québécois de la FCF.

Les personnes intéressées à participer aux événements et aux activités de l'une des divisions des jeunes fiscalistes de la Fondation du Canada sont invitées à communiquer avec le président ou la présidente du comité directeur de la section locale ou avec Robyn Corrigan (rcorrigan@ctf.ca) du bureau national de la FCF.

Il y a des divisions de jeunes fiscalistes à Calgary, Edmonton, Halifax, Kelowna, Kitchener-Waterloo, Mississauga, Montréal, Ottawa, ville de Québec, Saskatoon, Toronto, Vancouver et Winnipeg.

Canadian Tax Foundation Lifetime Contribution Award

As of 2016, the Canadian Tax Foundation honours each year individuals who, through their volunteer efforts and body of work, have made substantial and outstanding contributions to the Foundation during their careers. The Lifetime Contribution Award is the most prestigious award conferred by the Foundation. The selection committee takes into account the individual's contributions to Foundation publications and conferences, service on the board of governors and other committees, and participation in other organizations and activities that further the Foundation's purposes.

The 2020 recipients were Shawn D. Porter and David A. Ward, QC.

For further information about the nomination and selection process for this award, see the Foundation website.

Prix pour une contribution exceptionnelle de la Fondation canadienne de fiscalité

Depuis 2016, la Fondation canadienne de fiscalité rend hommage chaque année à des personnes qui, par leur travail bénévole et leurs réalisations, ont contribué de façon importante et exceptionnelle à la Fondation au cours de leur carrière. Le Prix pour une contribution exceptionnelle est le prix le plus prestigieux décerné par la Fondation. Le comité de sélection prend en compte la contribution de la personne aux publications et aux conférences de la Fondation, son travail au sein du conseil des gouverneurs et d'autres comités, ainsi que sa participation à d'autres organisations et activités qui contribuent à la réalisation des objectifs de la Fondation.

Les lauréats de 2020 étaient Shawn D. Porter and David A. Ward, QC.

Pour obtenir de plus amples renseignements sur le processus de nomination et de sélection pour ce prix, consultez le site Web de la Fondation.

FINANCES OF THE NATION

David Lin*

SURVEY OF PROVINCIAL AND TERRITORIAL BUDGETS, 2020-21

For almost 60 years, the Canadian Tax Foundation published an annual monograph, Finances of the Nation, and its predecessor, The National Finances. In a change of format, the 2014 Canadian Tax Journal introduced a new “Finances of the Nation” feature, which presents annual surveys of provincial and territorial budgets and topical articles on taxation and public expenditures in Canada. This article surveys the 2020-21 provincial and territorial budgets.

The underlying data for the Finances of the Nation monographs and for the articles in this journal will be published online in the near future.

KEYWORDS: BUDGETS ■ PROVINCIAL TAXES ■ TERRITORIAL ■ GOVERNMENT FINANCE ■ GOVERNMENT EXPENDITURES ■ PROGRAM BUDGETING

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INTRODUCTION

This article has two distinct parts. First, it sets out tables and charts that show aggregate figures related to projected 2020-21 budget or fiscal update revenues and expenditures for the various provinces and territories, as well as tables that show corporate income tax rates, personal income tax brackets and rates, and other matters. Second, the article summarizes the projected budget or fiscal update revenues and expenditures in tabular form and also summarizes the tax changes in narrative form, for each province and territory.

SUMMARY INFORMATION

What a year 2020 turned out to be. We heard political leaders telling us to social distance and stay home, and that unprecedented times called for unprecedented measures. These unprecedented measures will leave a mark on provincial and territorial finances for years to come.

Most of the provinces and territories brought down their 2020-21 fiscal-year budgets between January and March 2020. However, it was soon evident that these budgets did not properly account for the impact of COVID-19, and seven

provinces issued significant revisions to their budgets by way of economic and fiscal updates delivered later in the year. Several provinces delayed the issuance of their 2020-21 fiscal-year budget while they prioritized the development of an action plan for COVID-19. At the end of 2020, after all budgets and fiscal updates had been delivered, every province in Canada was, unsurprisingly, forecasting a substantial budgetary deficit for the 2020-21 fiscal year.

The territories delivered their budgets early in 2020, with the Northwest Territories and Yukon forecasting a budgetary surplus and Nunavut forecasting a deficit. A fiscal update address delivered by the Northwest Territories Finance Minister Caroline Wawzonek on October 16, 2020 indicated that the forecasted budgetary surplus for the 2020-21 fiscal year would decrease from \$203 million to \$60 million as a result of COVID-19.¹ On September 23, 2020, Nunavut released a supplemental appropriation for operations, maintenance, and capital that budgeted an additional \$23 million in expenditures not accounted for in the 2020 budget, further increasing the forecasted deficit of \$30 million in the 2020 budget. On October 1, 2020, Yukon also released supplementary estimates showing a revised deficit of \$32 million instead of the \$4 million surplus initially forecasted for the 2020-21 fiscal year.² As a result, the only jurisdiction in Canada forecasting a budgetary surplus for the 2020-21 fiscal year is the Northwest Territories.

Many provinces and territories were also hesitant to issue medium-term fiscal outlooks in their budgets or fiscal updates, given that the end of the COVID-19 pandemic was nowhere in sight. Among the few that attempted to look ahead, Saskatchewan is the only province that is forecasting an expected return to a budgetary surplus, in fiscal year 2024-25.

In British Columbia, the provincial election held on October 24, 2020 delivered a majority government to the incumbent New Democratic Party. British Columbia's Fall 2020 Economic & Fiscal Update, issued on December 17, 2020, shows a projected deficit in the 2020-21 fiscal year of \$13.6 billion and does not provide an estimate of the surplus or deficit forecast for future fiscal years. British Columbia's outlook assumes that

provincial, national, and global economic activity does not return to pre-pandemic levels by the end of the next year [2021]. It is assumed that a return to pre-pandemic levels will occur between late 2022 and early 2023, once there is a large-scale global immunization campaign well underway and an easing of global travel restrictions.³

1 Northwest Territories, Caroline Wawzonek: Fiscal Update, Ministers' Statements and Speeches, October 16, 2020 (www.gov.nt.ca/en/newsroom/caroline-wawzonek-fiscal-update).

2 Yukon, "2020-21 Supplementary Estimates No. 1 Financial Summary," October 1, 2020 (yukon.ca/en/2020-21-supplementary-estimates-no-1-financial-summary).

3 British Columbia, Ministry of Finance, Fall 2020 Economic & Fiscal Update, December 17, 2020, at 45.

Alberta's economy struggles to recover from the 2015-16 recession, and COVID-19 does not improve the province's path to recovery. Alberta's 2020-21 Mid-Year Fiscal Update and Economic Statement, issued on November 24, 2020, shows a projected deficit of \$21.3 billion in the 2020-21 fiscal year and does not provide an estimate of the surplus or deficit forecast for future fiscal years. Alberta's 2020 budget had initially continued implementation of the government's plan to return to a balanced budget by the 2022-23 fiscal year. However, the mid-year fiscal update indicates "that government cannot adhere to the plan to balance the budget in 2022-23."⁴

In Saskatchewan, the provincial election held on October 26, 2020 delivered a fourth consecutive majority government to the Saskatchewan Party. Saskatchewan's 2020-21 First Quarter Budget Update and Medium-Term Outlook, issued on August 27, 2020, shows a projected deficit of \$2.1 billion in the 2020-21 fiscal year and provides a medium-term outlook indicating that the province expects its economy to return to its pre-crisis levels in 2022. However, the government warns that "[a]ny variation from this expected path of recovery—either to the upside or downside—will alter fiscal balances over the medium term."⁵ A budgetary surplus of \$125 million is forecasted for the 2024-25 fiscal year in the province's medium-term outlook. However, the first quarter budget update, issued before the election, does not factor in numerous tax changes and incentives announced in late 2020 to fulfill election promises.

Manitoba's 2020/21 Mid-Year Report—Fiscal and Economic Update, issued on December 17, 2020, shows a projected deficit of \$2.0 billion in the 2020-21 fiscal year and does not provide a medium-term fiscal outlook. In previous budgets, the government committed to returning to budgetary balance through spending restraint, but COVID-19 throws a wrench into that plan. However, Manitoba's fiscal update does reaffirm the commitment to balance and states that "the province's fiscal strategy continues to be refined as we work towards Budget 2021 over the coming months. Furthermore, legislative work to amend the Fiscal Responsibility and Taxpayer Protection Act continues to present a path for Manitoba's fiscal recovery."⁶

Ontario's 2020 budget, issued on November 5, 2020, shows a projected deficit of \$38.5 billion, one of the largest budgetary deficits in the province's history. The medium-term outlook forecasts continued deficits in the 2021-22 and 2022-23 fiscal years of \$33.1 billion and \$28.2 billion, respectively, and shows no timeline for a return to a balanced budget. Ontario's Fiscal Sustainability, Transparency and Accountability Act, 2019⁷ (FSTAA) requires that the government plan for a balanced

4 Alberta, Treasury Board and Ministry of Finance, 2020-21 Mid-Year Fiscal Update and Economic Statement, November 24, 2020, at 11.

5 Saskatchewan, Ministry of Finance, Budget Update 20-21, First Quarter Budget Update and Medium-Term Outlook, August 27, 2020, at 4.

6 Manitoba, Department of Finance, 2020/21 Mid-Year Report—Fiscal and Economic Update, December 17, 2020, at 15.

7 SO 2019, c. 7, schedule 30.

budget. However, in extraordinary circumstances, the government can plan for a deficit, as long as (1) doing so is consistent with the principles governing Ontario's fiscal policy and (2) the government can provide a rationale for its decision to allow a deficit. The Ontario government is proposing amendments to the FSTAA to pause the requirement to include a recovery plan in the 2020 budget. Accordingly, Ontario is going "to continue assessing the volatile and uncertain economic situation and put forward a longer-term outlook and path to balance the budget, based on the most recent data, when the health and economic situation stabilizes."⁸

The Quebec government's Update on Québec's Economic and Financial Situation—Fall 2020, issued on November 12, 2020, shows a projected deficit of \$338 million in the 2020-21 fiscal year, which includes the application of a stabilization reserve and excludes any deposits of dedicated revenues in the Generations Fund, a fund dedicated exclusively to repaying the provincial debt. The medium-term outlook forecasts deficits in the 2021-22 and 2022-23 fiscal years of \$5.3 billion and \$3.8 billion, respectively, when deposits of dedicated revenues in the Generations Fund are excluded. Quebec has a Balanced Budget Act⁹ (BBA) that requires any budgetary surplus to be allocated to a stabilization reserve, which can be used when the province forecasts a budgetary deficit. At March 31, 2020, the stabilization reserve's balance was approximately \$12 billion. The entire balance of the stabilization reserve was applied to the 2020-21 budget. If the application of the stabilization reserve from the BBA were excluded, Quebec would be reporting a deficit of \$12.3 billion for the 2020-21 fiscal year. The government indicates that "[p]ublic finances will continue to be under pressure in 2021-2022"¹⁰ and that it "will have to control spending growth while maintaining funding for services"¹¹ to ensure that the budget is balanced within five years as required by the BBA. Prior to these comments, Quebec announced a wide variety of tax incentives and changes in the 2020 budget that was released on March 10, 2020.

The Atlantic provinces are all reporting significant budgetary deficits for the 2020-21 fiscal year, relative to the surpluses and deficits reported in recent years. Prince Edward Island's budget, issued on June 17, 2020, includes a medium-term outlook showing forecasts of continued deficits in the 2021-22 and 2022-23 fiscal years. The provincial election held in New Brunswick on September 14, 2020 delivered a majority government to the incumbent Progressive Conservative Party. However, no new tax measures or incentives were announced after the election.

In 2019, there were significant discussions and developments in the provincial and territorial jurisdictions with respect to carbon pricing. Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality

8 Ontario, Ministry of Finance, 2020 Ontario Budget, November 5, 2020, at 10.

9 CQLR c. E-12.00001.

10 Quebec, Finances Québec, Update on Québec's Economic and Financial Situation—Fall 2020, November 12, 2020, at A.25.

11 Ibid.

of the Greenhouse Gas Pollution Pricing Act¹² (the federal carbon tax legislation). The Supreme Court completed hearings in September 2020. British Columbia, Manitoba, Quebec, and New Brunswick all had intervenor status in the cases and made submissions as part of the hearings. In a 6-3 decision released in March 2021, the Supreme Court ruled that the carbon-pricing regime is constitutional.¹³ The majority noted that the carbon-pricing regime imposes a regulatory charge rather than a tax. Despite the court's ruling, Manitoba has indicated that it will move forward with its own legal challenge of the carbon-pricing regime, noting that its legal challenge is based on different grounds.

Overall, the budgets as delivered were neither good news nor bad news for most taxpayers: most of the tax changes made either created, extended, or improved tax credits targeting very specific initiatives, or increased the basic personal amount. However, with almost all jurisdictions reporting a budgetary deficit in the 2020-21 fiscal year, provincial and territorial governments will be under pressure to either raise further revenue or reduce spending in an effort to return to a balanced budget. With tax revenues making up the majority of provincial and territorial revenues, significant tax changes are likely to be announced in the upcoming budgets.

Table 1 aggregates the projected revenue and expenditure items in each province and territory for the 2020-21 fiscal year. The figures reflect the budget and fiscal update summaries presented in the second part of this article. The different jurisdictions' projections are not strictly comparable, owing in part to accounting differences across the provinces and territories.¹⁴ This is especially true for the 2020-21 fiscal year as a result of potential variations in the reporting of COVID-19 expenditures and federal revenues received for a safe restart of the economy, as well as differences in the timing of the issuance of budget projections or fiscal updates. However, the placement of the various jurisdictions' figures in a single table illustrates trends and distinctions that are intended to stimulate discussion. The provinces and territories are listed in table 1 in descending order based on each jurisdiction's budget or fiscal update projection of its expected tax revenue.

Figure 1 presents similar information and includes surpluses and deficits at the right of the figure. Each projected revenue source amount is shown as a percentage of total revenues, and the projected surplus or deficit is shown as a percentage of total expenditures. Figure 2 shows projected tax revenues by source as a percentage of total revenues. Figure 3 shows projected expenditures by spending category as a percentage of total expenditures, and health-care expenditures per capita.

12 SC 2018, c. 12, section 186.

13 *Reference re Greenhouse Gas Pollution Pricing Act*, 2021 SCC 11.

14 For a discussion of accounting differences between Canadian jurisdictions, see Colin Busby and William B.P. Robson, *Credibility on the (Bottom) Line: The Fiscal Accountability of Canada's Senior Governments*, 2013, C.D. Howe Institute Commentary no. 404 (Toronto: C.D. Howe Institute, March 2014). For a reconciliation of changes in the Alberta budget, see Ron Kneebone and Margarita Wilkins, "Recent Changes to Provincial Government Budget Reporting in Alberta" (2018) 10:1 *SPP Communiqué* [University of Calgary School of Public Policy] 1-8 (<http://dx.doi.org/10.11575/sppp.v11i0.43275>).

TABLE 1 Provincial and Territorial Revenues and Expenditures, Projections, ^a Fiscal Year 2020-21

Province /territory	Tax revenue	Federal transfers	Other sources of revenue ^b	Total revenues	Total expenditures	Adjustments ^c	Surplus/ (deficit)
				<i>millions of dollars</i>			
Ontario	97,462	33,360	20,252	151,074	(187,042)	2,500	(38,468)
Quebec ^d	70,505	30,296	17,932	118,733	(127,080)	8,009	(338)
British Columbia	31,234	12,680	13,510	57,424	(70,067)	(1,000)	(13,643)
Alberta	18,227	11,337	11,850	41,414	(60,743)	(2,000)	(21,329)
Manitoba	7,478	5,811	4,076	17,365	(19,413)		(2,048)
Saskatchewan	7,203	3,152	3,692	14,047	(16,177)		(2,130)
Nova Scotia	5,593	4,273	1,544	11,410	(12,324)	135	(779)
New Brunswick	4,740	3,745	1,502	9,987	(10,286)		(299)
Newfoundland and Labrador	3,733	1,482	1,914	7,129	(8,967)		(1,838)
Prince Edward Island	1,062	1,007	224	2,293	(2,416)	50	(173)
Northwest Territories	277	1,785	124	2,186	(1,896)	(87)	203
Nunavut	145	1,837	366	2,348	(2,328)	(50)	(30)
Yukon	132	1,117	277	1,526	(1,522)		4

a The amounts shown are taken from the province's or territory's budget or fiscal update, whichever was released later in the year. See table 10 for further details.

b Other sources of revenue included resource royalties; premiums, fees, and licences; commercial Crown corporation transfers; and investment income.

c Adjustments included consolidation numbers (in some cases) and transfers to and from reserve funds.

d Taxfilers in Quebec qualify for the Quebec abatement, which reduces their federal income tax by 16.5 percentage points. Of this amount, 13.5 percentage points relates to opting-out arrangements for certain federal-provincial programs, such as hospital care and social welfare, where Quebec increased its personal income taxes by an equivalent amount. Quebec receives the value through increased provincial tax revenue, while other provinces receive the corresponding amounts in cash. The remaining 3.0 percentage points relates to the youth allowances recovery, which the federal government recovers each year from Quebec. None of the amounts presented in this table and elsewhere in this article are adjusted for the Quebec abatement.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

FIGURE 1 Projected Provincial and Territorial Revenues by Source, as a Percentage of Total Revenues, and Projected Surplus/Deficit as a Percentage of Projected Expenditures, Fiscal Year 2020-21

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24 and the data summary in table 1.

FIGURE 2 Projected Provincial and Territorial Tax Revenues by Source as a Percentage of Total Revenues, Fiscal Year 2020-21

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

FIGURE 3 Projected Provincial and Territorial Expenditures by Spending Category as a Percentage of Total Expenditures, Fiscal Year 2020-21

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 4 and 12-24.

The provinces and territories have the primary responsibility for education, health, and social services expenditures. Across all jurisdictions, health-care expenditures for the 2020-21 fiscal year averaged 36.5 percent of total expenditures, as shown in table 2. For example, for the 2020-21 fiscal year, Ontario projected health-care and long-term-care expenditures of \$64,646 million or 34.56 percent of total expenditures (\$187,042 million, as shown in table 16). The decrease in the average compared to the average of approximately 39 percent for the 2019-20 fiscal year can be attributed to the increased amount of total expenditures in 2020-21. In contrast, in the territories, projected spending on health care in 2020-21 accounted for 21.31 percent of total expenditures for Nunavut, 27.53 percent for the Northwest Territories, and 30.29 percent for Yukon. However, on a per capita basis, the results for the territories vis-à-vis Ontario appeared to reverse. These trends are reflected in table 3, which sets out the health-care expenditures (as projected in the 2014-15 to 2020-21 budgets) as a percentage of total expenditures and per capita in Ontario and the territories.

Table 4 sets out the health-care expenditure projections for all the provinces and territories for 2020-21 as a percentage of total expenditures and per capita. Again, these amounts may not be strictly comparable, given accounting differences in the way COVID-19-related health-care expenditures are reported. Some provinces and territories have carved out COVID-19-related health-care expenditures into separate line items that are not reflected in the health-care expenditures reported in this table.

Table 5 shows the provincial and territorial surpluses and deficits since the (revised) budget projections for 2015-16¹⁵ and also shows figures set out in the most recently issued 2020-21 budgets or fiscal updates for planned or targeted surpluses or deficits for up to the ensuing four fiscal years. Owing to uncertainty resulting from COVID-19, most provinces and territories did not provide planned or targeted surpluses or deficits in their most recently issued budget or fiscal update. Every jurisdiction that provided a projection planned for deficits in the upcoming fiscal years, except for Saskatchewan, which (as noted earlier) plans a return to surplus by the 2024-25 fiscal year.

On the basis of budget projections in the tables set out in the second part of this article, projected aggregate income tax revenue in the 2020-21 budgets or fiscal updates of all provinces and territories was \$107.2 billion from personal income tax and \$26.0 billion from corporate income tax, for total revenue of \$133.2 billion from income tax. Projected aggregate sales tax revenue was \$60.4 billion, for a total of \$86.4 billion from sources other than personal income tax (that is, corporate income tax and sales tax). Thus, as has been the case since 2014, in 2020-21 the provinces and territories expected to collect more tax revenue from personal income

15 See Vivien Morgan, "Survey of Provincial and Territorial Budgets 2015-16," *Finances of the Nation* feature (2016) 64:1 *Canadian Tax Journal* 147-206, at 150, table 1.

TABLE 2 Provincial and Territorial Health-Care Expenditures, Budget Projections, Fiscal Years 2017-18 to 2020-21

Province /territory	Health-care expenditures				Percentage of total expenditures			
	2017-18	2018-19	2019-20	2020-21 ^a	2017-18	2018-19	2019-20	2020-21 ^a
					<i>millions of dollars</i>			
Ontario	53,763	61,678 ^b	63,831 ^c	64,646	38.12	38.13 ^b	38.97 ^c	34.56
Quebec	40,223	43,013	45,433	52,459	38.78	39.57	40.19	41.28
British Columbia	20,747	21,651	22,983	24,595	40.01	40.38	39.44	35.10
Alberta	21,449	22,057	22,105	20,616	39.10	39.26	39.10	33.94
Manitoba	6,681	6,751	6,651	7,460	39.17	38.75	38.05	38.43
Saskatchewan	5,627	5,765	5,888	6,248	38.02	39.46	39.28	38.62
Nova Scotia	4,214	4,367	4,639	5,285	40.02	40.09	41.62	42.88
New Brunswick	2,679	2,770	2,828	2,946	28.56	28.81	28.79	28.64
Newfoundland and Labrador	2,768	2,985	3,021	3,352	34.10	35.72	35.85	37.38
Prince Edward Island	640	710	750	808	35.32	35.79	34.11	33.44
Northwest Territories	423	462	496	522	25.00	26.97	27.52	27.53
Yukon	451	431	443	461	35.18	32.21	30.88	30.29
Nunavut	353	414	467	496	18.03	18.81	21.54	21.31

Note: Owing to accounting differences between provinces and territories, direct comparison of the above numbers is not strictly appropriate. This is especially true for the 2020-21 fiscal year as a result of potential variations in the reporting of COVID-19 expenditures and differences in timing of the issuance of budget projections or fiscal updates.

- a The amounts shown are taken from the province's or territory's budget or fiscal update, whichever was released later in the year. See table 10 for further details.
- b Numbers are from Ontario, Ministry of Finance, 2018 Fall Economic Outlook and Fiscal Review, November 15, 2018.
- c Numbers are from Ontario, Ministry of Finance, 2019 Fall Economic Outlook and Fiscal Review, November 6, 2019.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24. See those tables for further details.

TABLE 3 Health-Care Expenditures in Ontario and the Territories as a Percentage of Total Expenditures and per Capita, 2014-15 to 2020-21

	Health-care expenditures as a percentage of total expenditures				Health-care expenditures per capita	
		Northwest Territories				Territorial (Nunavut, Northwest Territories, Yukon) range
Fiscal year	Ontario	Nunavut	Yukon		Ontario	
	<i>percent</i>				<i>dollars</i>	
2020-21	34.56	21.31	27.53	30.29	4,400	11,000-12,600
2019-20	38.97	21.54	27.52	30.88	4,400	10,900-12,000
2018-19	38.13	18.81	26.97	32.21	4,300	10,400-11,200
2017-18	38.12	18.03	25.00	35.18	3,800	9,500-12,100
2016-17	38.67	19.48	24.70	37.97	3,700	9,100-12,300
2015-16	38.49	20.07	24.70	30.32	3,700	9,100-10,200
2014-15	38.39	20.29	24.30	29.60	3,700	8,600-9,200

Sources: Numbers for 2014-15 through 2018-19 are from Vivien Morgan, "Survey of Provincial and Territorial Budgets, 2014-15," *Finances of the Nation* feature (2015) 63:1 *Canadian Tax Journal* 157-215; "Survey of Provincial and Territorial Budgets, 2015-16," *Finances of the Nation* feature (2016) 64:1 *Canadian Tax Journal* 147-206; "Survey of Provincial and Territorial Budgets, 2016-17," *Finances of the Nation* feature (2017) 65:1 *Canadian Tax Journal* 87-145; "Survey of Provincial and Territorial Budgets, 2017-18," *Finances of the Nation* feature (2018) 66:1 *Canadian Tax Journal* 37-109; and "Survey of Provincial and Territorial Budgets, 2018-19," *Finances of the Nation* feature (2019) 67:1 *Canadian Tax Journal* 81-160. Numbers for 2019-20 are from David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," *Finances of the Nation* feature (2020) 68:1 *Canadian Tax Journal* 185-250. Numbers for 2020-21 are from this article. The population data were taken from Statistics Canada, as of the end of 2020. Because the budget numbers were estimated and the population data were taken at slightly different dates, the per capita numbers are rounded to the nearest hundred dollars.

tax than from corporate income tax and sales tax combined. The difference in revenue collected from personal income tax compared to corporate income tax and sales tax combined is substantial in 2020-21, as a result of the impact of COVID-19 on businesses, as well as reductions in corporate income tax rates in several jurisdictions. In comparison, the 2020-21 federal fall economic statement projected \$162.1 billion of revenue from personal income tax, \$39.2 billion from corporate income tax, and \$9.9 billion from non-resident income tax, for a total of \$211.2 billion from income tax, plus \$29.4 billion from sales tax¹⁶—for a total of \$78.5 billion from sources other than personal income tax (corporate income tax, non-resident income tax, and sales tax). The trend of personal income tax raising twice as much

16 Canada, Department of Finance, *Supporting Canadians and Fighting COVID-19: Fall Economic Statement 2020*, November 30, 2020, at 127, table A1.6.

TABLE 4 Health-Care Expenditures as a Percentage of Total Expenditures and per Capita, Budget Projections or Fiscal Updates, 2020-21

Province/territory	Health-care expenditures	Population	Health-care expenditures as a percentage of total expenditures	Health-care expenditures per capita
	<i>millions of dollars</i>	<i>'000s</i>	<i>%</i>	<i>dollars</i>
British Columbia	24,595	5,147.7	35.10	4,800
Alberta	20,616	4,421.9	33.94	4,700
Saskatchewan	6,248	1,178.7	38.62	5,300
Manitoba	7,460	1,379.3	38.43	5,400
Ontario	64,646	14,374.0	34.56	4,400
Quebec	52,459	8,574.6	41.28	6,100
New Brunswick	2,946	781.5	28.64	3,800
Nova Scotia	5,285	979.4	42.88	5,400
Prince Edward Island	808	159.6	33.44	5,100
Newfoundland and Labrador	3,352	522.1	37.38	6,400
Northwest Territories	522	45.2	27.53	11,600
Yukon	461	42.1	30.29	11,000
Nunavut	496	39.4	21.31	12,600

Note: Owing to accounting differences between provinces and territories, direct comparison of the above numbers is not strictly appropriate. This is especially true for the 2020-21 fiscal year as a result of variations in the reporting of COVID-19 expenditures and differences in timing of the issuance of budget projections or fiscal updates.

Sources: Table 2; and population data from Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1st, by Age and Sex" (<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000501>).

revenue as corporate income tax, non-resident income tax, and goods and services tax (GST) combined continues in fiscal 2020-21. The federal fall economic statement also shows a similar dip in federal corporate income tax revenues that the provinces and territories are forecasting as a result of "[l]ower corporate profitability and general economic weakness due to . . . COVID-19."¹⁷ See table 6 for a tabular and detailed presentation. Table 6A shows the projected tax revenues for each province and territory as detailed in the 2020-21 budgets or fiscal updates, including total and per capita amounts.

Table 7 shows the corporate income tax rates in the provinces and territories for 2020.

From a personal income tax perspective, most jurisdictions have established a higher tax rate bracket for high income earners over the past decade: British Columbia (for 2014, 2015, and from 2018 onward), Ontario (from 2012), Quebec

17 Ibid., at 128.

TABLE 5 Revised, Projected, and Planned Provincial and Territorial Surpluses and Deficits, 2015-16 and Onward

Province /territory	2015-16 budget [revised]	2016-17 budget [revised]	2017-18 budget [revised]	2018-19 budget [revised]	2019-20 budget [revised]	2020-21 budget ^a	2021-22 plan	2022-23 plan	2023-24 plan	2024-25 plan
<i>millions of dollars</i>										
British Columbia	730 [379]	1,458 [2,737]	246 [151]	219 [374]	274 [1,354]	(13,643)				
Alberta	(6,118) [(6,492)]	(10,421) [(3,077)]	(10,344) [(9,066)]	(8,802) [(6,711)]	(8,704) [12,152]	(21,239)	(15,524)	(9,865)		
Saskatchewan	107 [(427)]	(434) [(1,289)]	(685) [(595)]	(365) [(380)]	34 [(319)]	(2,130)	(1,350)	(855)	(340)	125
Manitoba	(422) [(1,012)]	(911) [(890)]	(840) [(775)]	(521) [(470)]	(360) [(325)]	(2,048)				
Ontario	(8,512) [(5,686)]	(4,306) [(1,000)]	nil	(14,544) [(7,435)]	(9,024) [(8,672)]	(38,468)	(33,100)	(28,200)		
Quebec	1,586 [1,431]	2,028 [2,292]	2,488 [850]	904 [5,606]	2,504 [2,638]	(338)	(5,266)	(3,781)		
New Brunswick	(477) [(466)]	(231) [(249)]	(192) [(152)]	(189) [5]	23 [98]	(299)				
Nova Scotia	(98) [(71)]	17 [150]	21 [26]	29 [28]	34 [41]	(779)				
Prince Edward Island ^b	28 [(28)]	(35) [(17)]	0.6 [1]	2 [14]	2 [(4)]	(173)	(70)	(38)		

(Table 5 is concluded on the next page.)

TABLE 5 Concluded

Province /territory	2015-16 budget [revised]	2016-17 budget [revised]	2017-18 budget [revised]	2018-19 budget [revised]	2019-20 budget [revised]	2020-21 budget ^a	2021-22 plan	2022-23 plan	2023-24 plan	2024-25 plan
<i>millions of dollars</i>										
Newfoundland and Labrador	(1,093) [(2,093)]	(1,830) [(1,717)]	(778) [(2,042)]	(683) [(521)]	1,924 [1,114]	(1,838)				
Northwest Territories	147 [110]	119 [155]	167 [75]	23 [40]	60 [(70)]	203				
Yukon	23 [14]	9 [(8)]	7 [6]	(5) [(7)]	(6) [(19)]	4				
Nunavut	23 [(14)]	(11) [(11)]	23 [(67)]	(54) [(105)]	(34) [(56)]	(30)				

a The amounts shown are taken from the province's or territory's budget or fiscal update, whichever was released later in the year. See table 10 for further details.

b Prince Edward Island's accounting for the 2016-17 fiscal year was changed; reclassifications for the preceding year appear in appendix III of the estimates.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

TABLE 6 Comparison of Projected Revenues from Personal and Corporate Income Tax, Sales Tax, and Non-Resident Tax — Federal, Provincial, and Territorial Jurisdictions, 2014-15 to 2020-21

Fiscal year	Federal				Provincial and territorial						
	PtT (1)	CtT (2)	Non- resident tax (3)	Sales tax (4)	Income tax (1 + 2 + 3) (2 + 3 + 4)	Non-PtT (2 + 3 + 4)	PtT (5)	CtT (6)	Sales tax (7)	Income tax (5 + 6)	Non-PtT (6 + 7)

CIT = corporate income tax; PIT = personal income tax.

Sources: Numbers for 2014-15 through 2018-19 are from Vivien Morgan, "Survey of Provincial and Territorial Budgets, 2014-15," *Finances of the Nation* feature (2015) 63:1 *Canadian Tax Journal* 157-215; "Survey of Provincial and Territorial Budgets, 2015-16," *Finances of the Nation* feature (2016) 64:1 *Canadian Tax Journal* 147-206; "Survey of Provincial and Territorial Budgets, 2016-17," *Finances of the Nation* feature (2017) 65:1 *Canadian Tax Journal* 87-145; "Survey of Provincial and Territorial Budgets, 2017-18," *Finances of the Nation* feature (2018) 66:1 *Canadian Tax Journal* 37-109; and "Survey of Provincial and Territorial Budgets, 2018-19," *Finances of the Nation* feature (2019) 67:1 *Canadian Tax Journal* 81-160. Numbers for 2019-20 are from David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," *Finances of the Nation* feature (2020) 68:1 *Canadian Tax Journal* 185-250. Numbers for 2020-21 are from this article and from Canada, Department of Finance, *Supporting Canadians and Fighting COVID-19: Fall Economic Statement* 2020, November 30, 2020, at 127, table A1.6.

TABLE 6A Projected Tax Revenues for Provinces and Territories,^a by Category and per Capita, 2020-21

Province/territory	PIT	CIT	Sales tax	Other	Total	Per capita
	<i>millions of dollars</i>					<i>dollars</i>
British Columbia	10,964	3,673	6,746	9,851	31,234	6,100
Alberta	10,753	2,188	na	5,286	18,227	4,100
Saskatchewan	2,605	781	1,996	1,821	7,203	6,100
Manitoba	3,726	498	1,977	1,277	7,478	5,400
Ontario	36,901	9,941	24,879	25,741	97,462	6,600
Quebec	35,298	7,667	20,002	7,538	70,505	8,200
New Brunswick	1,877	308	1,468	1,087	4,740	6,100
Nova Scotia	2,889	396	1,916	392	5,593	5,700
Prince Edward Island	400	86	330	246	1,062	6,700
Newfoundland and Labrador	1,595	408	1,105	625	3,733	7,100
Northwest Territories	106	25	na	146	277	6,100
Yukon	80	14	na	38	132	3,100
Nunavut	31	21	na	93	145	3,700
Total and per capita average	107,225	26,006	60,419	57,635	266,229	6,500

CIT = corporate income tax; PIT = personal income tax.

- a The amounts shown are taken from the province's or territory's budget or fiscal update, whichever was released later in the year. See table 10 for further details.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24. Population data are from Statistics Canada, table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1st, by Age and Sex" (<https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000501>).

(from 2013), Nova Scotia (from 2010), and Alberta, New Brunswick, Newfoundland and Labrador, and Yukon (all from 2015). Ontario also imposes a surtax and additional surtax on high income earners. Newfoundland and Labrador imposed a temporary deficit reduction levy that increased with higher tax brackets and was in effect until December 31, 2019. In 2020, British Columbia created a new top personal income tax bracket imposing provincial tax at 20.5 percent on taxable income exceeding \$220,000. In 2019, the top personal income tax rate in British Columbia was 16.8 percent on taxable income exceeding \$153,900. The new tax bracket results in an increase in the top combined federal and provincial personal tax rate in British Columbia from 49.8 percent to 53.5 percent.

Manitoba and Prince Edward Island have not established a higher tax rate bracket for high income earners, given that in both provinces the highest marginal tax rate applies at relatively lower levels of income. However, Prince Edward Island imposes a surtax on high income earners.

In 2020, other than the new top personal income tax bracket introduced in British Columbia, there were no changes made to provincial or territorial personal

TABLE 7 Provincial and Territorial Corporate Income Tax Rates, 2020

Province/territory	General rate	M & P rate	Small business rate	Small business limit ^a
		<i>percent</i>		<i>dollars</i>
British Columbia	12.0	12.0	2.0	500,000
Alberta	10.0/8.0 ^b	10.0/8.0 ^b	2.0	500,000
Saskatchewan ^c	12.0	10.0	2.0	600,000
Manitoba	12.0	12.0	0.0	500,000
Ontario	11.5	10.0 ^d	3.2 ^e	500,000
Quebec ^f	11.5	11.5	5.0 or 4.0	500,000
New Brunswick	14.0	14.0	2.5	500,000
Nova Scotia ^g	16.0/14.0	16.0/14.0	3.0/2.5	500,000
Prince Edward Island	16.0	16.0	3.0 ^h	500,000
Newfoundland and Labrador	15.0	15.0	3.0	500,000
Northwest Territories	11.5	11.5	4.0	500,000
Yukon	12.0	2.5	2.0 or 1.5 ⁱ	500,000
Nunavut	12.0	12.0	3.0	500,000

M & P = manufacturing and processing.

- a The small business limit is reduced by the greater of \$0.10 (\$0.12 in Saskatchewan) for every \$1.00 of taxable capital employed in Canada in the preceding year by the Canadian-controlled private corporation (CCPC) on an associated basis in excess of \$10 million, and \$5.00 (\$6.00 in Saskatchewan) for every \$1.00 of passive investment income earned by the CCPC on an associated basis in excess of \$50,000 (except in Ontario and New Brunswick). This business limit is shared by all associated CCPCs.
- b As previously announced, in the 2019 budget, Alberta's general rate, which also applies to M & P corporations, decreased from 11 percent to 10 percent effective January 1, 2020. In response to the COVID-19 pandemic, the implementation of scheduled reductions to the general rate in future years was accelerated. As a result, Alberta's general rate decreased again from 10 percent to 8 percent effective July 1, 2020.
- c Saskatchewan restored its general rate to 12 percent and its M & P rate to 10 percent as of July 1, 2017, and the small business threshold was raised to \$600,000 after 2017; the combined federal and Saskatchewan rate applicable to income between \$500,000 and \$600,000 is 17 percent.
- d In Ontario, the M & P rate applies to income from manufacturing, processing, farming, mining, logging, and fishing operations carried on in Canada and allocated to the province.
- e Ontario's small business rate decreased from 3.5 percent to 3.2 percent effective January 1, 2020.
- f As previously announced in the 2018 budget, Quebec's general rate decreased from 11.6 percent to 11.5 percent and the small business rate decreased from 6.0 percent to 5.0 percent effective January 1, 2020. Small businesses in the primary and manufacturing sectors are subject to a net 4.0 percent small business rate after an additional deduction.
- g Nova Scotia's 2020 budget reduced the general rate, which also applies to M & P corporations, from 16 percent to 14 percent and the small business rate from 3.0 percent to 2.5 percent effective April 1, 2020.
- h As previously announced in the 2019 budget, Prince Edward Island's small business rate decreased from 3.5 percent to 3.0 percent effective January 1, 2020.
- i In Yukon, the 1.5 percent rate applies to M & P income of a CCPC up to the small business limit.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

tax rates and brackets and an adjustment for inflation in provinces and territories where this is applicable. Saskatchewan's 2020 budget indicated that the government intended to reintroduce automatic annual indexation of personal income tax system amounts for inflation starting in 2021. Once automatic annual indexation is introduced by Saskatchewan, there will be only three provinces remaining in Canada that do not index personal income tax amounts for inflation: Alberta, Nova Scotia, and Prince Edward Island. Continuing the trend from 2019, provinces and territories that wanted to reduce personal income taxes for their residents in 2020 generally did so by providing new targeted tax credits or by increasing the basic personal amount to allow all taxpayers to benefit from a tax reduction.

Surtaxes are sometimes applied in addition to regular provincial or territorial personal income tax. All federal, provincial, and territorial marginal personal income tax rates on ordinary income and interest, as well as surtaxes, are shown in graphic form in figure 4 as a function of taxable income. Table 8 sets out the provincial and territorial personal income tax brackets and rates for 2020.

Table 9 shows the sales tax rates in each jurisdiction for 2020. British Columbia, Saskatchewan, and Manitoba imposed a separate provincial sales tax (PST). Ontario and the Atlantic provinces—Newfoundland and Labrador, Nova Scotia, New Brunswick, and Prince Edward Island—are harmonized sales tax (HST) participating provinces, which harmonize sales taxes with the federal GST. Quebec has its own Quebec sales tax (QST), which applies in a manner similar to the GST. Alberta and the three territories do not impose sales taxes. In 2019, Manitoba reduced its PST rate to 7 percent effective July 1, 2019. Manitoba's 2020 budget proposed a further reduction to the PST rate from 7 percent to 6 percent, to be effective on July 1, 2020, as a way of returning to Manitobans revenues collected under a proposed new green levy. However, as a result of COVID-19, both the green levy and the PST reduction were deferred until further notice and were not implemented in 2020. Accordingly, there were no changes to provincial or territorial sales tax rates effected in 2020.

PROVINCIAL AND TERRITORIAL BUDGETS BY JURISDICTION

Table 10 summarizes the various dates for the 2020-21 budgets and fiscal updates, if applicable, in each province and territory, the name and title of the person who announced the budget or fiscal update, and the announced estimated surplus or deficit.

Table 11 sets out the research and development (R & D) tax credits in each province and territory available in 2020. The 2019 Alberta budget eliminated the province's R & D tax credit for all expenditures incurred after December 31, 2019; accordingly, the Alberta scientific research and experimental development (SR & ED) tax credit will no longer be available from 2020 onward. However, in late 2020, Alberta's recovery plan introduced the innovation employment grant, which is similar to the province's discontinued R & D tax credit and will be available effective

**FIGURE 4 Personal Income Tax Marginal Rates
Applicable to Taxable Income, 2020**

(Figure 4 is concluded on the next page.)

FIGURE 4 Concluded

- a The federal basic personal amount is reduced when a taxpayer's net income is \$150,473 or more. The federal rates presented do not reflect this clawback of the basic personal amount.
- b Surtax calculations assume that the only credit claimed by the taxpayer is the basic personal amount.
- c Federal income tax has been reduced by 16.5 percentage points to reflect the provincial abatement.
- d Nova Scotia's basic personal amount is increased by up to \$3,000 if taxable income is under \$75,000. The provincial rates do not reflect the tax savings from an increased basic personal amount.
- e The Yukon basic personal amount is reduced when a taxpayer's net income is \$150,473 or more. The territorial tax rates presented do not reflect this clawback of the basic personal amount.

Source: Data compiled by the author.

TABLE 8 Provincial and Territorial Personal Income Tax Brackets and Rates, 2020

Province/territory	Tax bracket	Rate	Surtax (percentage of regular tax) and top combined rate ^a
	<i>dollars</i>	<i>percent</i>	
British Columbia ^b	0 to 41,725	5.06	
	over 41,725 to 83,451	7.70	
	over 83,451 to 95,812	10.50	
	over 95,812 to 116,344	12.29	
	over 116,344 to 157,748	14.70	
	over 157,748 to 220,000	16.80	
	over 220,000	20.50	Top combined rate of 53.50%
Alberta ^c	0 to 131,220	10.00	
	over 131,220 to 157,464	12.00	
	over 157,464 to 209,952	13.00	
	over 209,952 to 314,928	14.00	
	over 314,928	15.00	Top combined rate of 48.00%
Saskatchewan ^c	0 to 45,225	10.50	
	over 45,225 to 129,214	12.50	
	over 129,214	14.50	Top combined rate of 47.50%
Manitoba	0 to 33,389	10.80	
	over 33,389 to 72,164	12.75	
	over 72,164	17.40	Top combined rate of 50.40%
Ontario	0 to 44,740	5.05	Surtax equal to 20% of basic provincial tax greater than \$4,830
	over 44,740 to 89,482	9.15	Additional surtax equal to 36% of basic provincial tax greater than \$6,182
	over 89,482 to 150,000	11.16	
	over 150,000 to 220,000	12.16	
	over 220,000	13.16	Top combined rate of 53.53%
Quebec	0 to 44,545	15.00	
	over 44,545 to 89,080	20.00	
	over 89,080 to 108,390	24.00	
	over 108,390	25.75	Top combined rate of 53.31%
New Brunswick	0 to 43,401	9.68	
	over 43,401 to 86,803	14.82	
	over 86,803 to 141,122	16.52	
	over 141,122 to 160,776	17.84	
	over 160,776	20.30	Top combined rate of 53.30%
Nova Scotia ^c	0 to 29,590	8.79	
	over 29,590 to 59,180	14.95	
	over 59,180 to 93,000	16.67	
	over 93,000 to 150,000	17.50	
	over 150,000	21.00	Top combined rate of 54.00%

(Table 8 is concluded on the next page.)

TABLE 8 Concluded

Province/territory	Tax bracket	Rate	Surtax (percentage of regular tax) and top combined rate ^a
	<i>dollars</i>	<i>percent</i>	
Prince Edward Island ^c	0 to 31,984	9.80	Surtax equal to 10% of basic provincial tax in excess of \$12,500
	over 31,984 to 63,969	13.80	
	over 63,969	16.70	Top combined rate of 51.37%
Newfoundland and Labrador	0 to 37,929	8.70	
	over 37,929 to 75,858	14.50	
	over 75,858 to 135,432	15.80	
	over 135,432 to 189,604	17.30	
	over 189,604	18.30	Top combined rate of 51.30%
Northwest Territories . . .	0 to 43,957	5.90	
	over 43,957 to 87,916	8.60	
	over 87,916 to 142,932	12.20	
	over 142,932	14.05	Top combined rate of 47.05%
Yukon	0 to 48,535	6.40	
	over 48,535 to 97,069	9.00	
	over 97,069 to 150,473	10.90	
	over 150,473 to 500,000	12.80	
	over 500,000	15.00	Top combined rate of 48.00%
Nunavut	0 to 46,277	4.00	
	over 46,277 to 92,555	7.00	
	over 92,555 to 150,473	9.00	
	over 150,473	11.50	Top combined rate of 44.50%

a The top federal rate, used to arrive at the top combined rate, is 33 percent.

b British Columbia's 2020 budget introduced a new top personal income tax bracket of 20.5 percent for taxable income exceeding \$220,000 effective January 1, 2020.

c Not indexed for inflation. Saskatchewan's personal income tax rates were frozen at 2018 levels for 2019 and 2020. Saskatchewan's 2020 budget announced that the government intended to reintroduce automatic annual indexation for inflation effective 2021.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

TABLE 9 Provincial and Territorial Sales Tax Rates, Percent, 2020

Province/territory	GST or federal portion of HST	Provincial portion of HST	PST and QST	Combined ^a
British Columbia	5		7	12
Alberta	5			5
Saskatchewan	5		6	11
Manitoba	5		7 ^b	12
Ontario	5	8		13
Quebec	5		9.975	14.975
New Brunswick	5	10		15
Nova Scotia	5	10		15
Prince Edward Island	5	10		15
Newfoundland and Labrador	5	10		15
Northwest Territories	5			5
Yukon	5			5
Nunavut	5			5

GST = goods and services tax; HST = harmonized sales tax; PST = provincial sales tax; QST = Quebec sales tax.

- a The rates shown do not yield comparable tax burdens for all jurisdictions. For example, GST and HST allow input tax credits for underlying taxes, eliminate sales tax on exports, and also cover a wider range of goods and services than PST.
- b Manitoba's 2020 budget proposed a reduction in the PST rate to 6 percent effective July 1, 2020; however, this was subsequently deferred until further notice.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12-24.

TABLE 10 Provincial and Territorial Surplus/(Deficit) Projections, Fiscal Year 2020-21

Province/territory	Budget or economic update date	Finance minister	Projected surplus/(deficit)
			<i>millions of dollars</i>
British Columbia	February 18, 2020	Carole James ^a	227
	December 17, 2020 ^b	Selina Robinson	(13,643)
Alberta	February 27, 2020	Travis Towes ^c	(6,810)
	November 24, 2020 ^d	Travis Towes ^c	(21,329)
Saskatchewan	June 15, 2020	Donna Harpauer	(2,426)
	August 27, 2020 ^e	Donna Harpauer	(2,130)
Manitoba	March 19, 2020	Scott Fielding	(220)
	December 17, 2020 ^f	Scott Fielding	(2,048)
Ontario	March 25, 2020 ^g	Rod Phillips	(20,510)
	November 5, 2020	Rod Phillips	(38,468)
Quebec	March 10, 2020	Eric Girard	2,729
	November 12, 2020 ^h	Eric Girard	(338)
New Brunswick	March 10, 2020	Ernie Steeves ⁱ	92
	May 21, 2020 ^j	Ernie Steeves ⁱ	(299)
Nova Scotia	February 25, 2020	Karen Casey ^k	55
	December 17, 2020 ^l	Karen Casey ^k	(779)
Prince Edward Island	June 17, 2020	Darlene Compton ^m	(173)
Newfoundland and Labrador	September 30, 2020	Siobhan Coady ⁿ	(1,838)
Northwest Territories	February 25, 2020	Caroline Wawzonek	203
Yukon	March 5, 2020	Sandy Silver ^o	4
Nunavut	February 19, 2020	George Hickes	(30)

a Minister of finance and deputy premier.

b British Columbia, Ministry of Finance, Fall 2020 Economic & Fiscal Update, December 17, 2020. Both the budget and the economic update figures are listed in the British Columbia summary, table 12.

c President of the Treasury Board and minister of finance.

d Alberta, Treasury Board and Ministry of Finance, 2020-21 Mid-Year Fiscal Update and Economic Statement, November 24, 2020. Both the budget and the fiscal update figures are listed in the Alberta summary, table 13.

e Saskatchewan, Ministry of Finance, Saskatchewan Budget Update 20-21, First Quarter Budget Update and Medium-Term Outlook, August 27, 2020. Both the budget and the budget update figures are listed in the Saskatchewan summary, table 14.

f Manitoba, Department of Finance, 2020/21 Mid-Year Report—Fiscal and Economic Update, December 17, 2020. Both the budget and the fiscal update figures are listed in the Manitoba summary, table 15.

g Ontario, Ministry of Finance, March 2020 Economic and Fiscal Update, Ontario's Action Plan 2020: Responding to COVID-19, March 25, 2020. Both the economic update and the budget figures are listed in the Ontario summary, table 16.

h Quebec, Finances Québec, Update on Québec's Economic and Financial Situation—Fall 2020, November 12, 2020. Both the budget and the economic update figures are listed in the Quebec summary, table 17.

(Table 10 is concluded on the next page.)

TABLE 10 Concluded

- i Minister of Finance and Treasury Board.
- j New Brunswick, Department of Finance and Treasury Board, Fiscal and Economic Update, May 21, 2020. Both the budget and the fiscal update figures are listed in the New Brunswick summary, table 18.
- k Minister of Finance and Treasury Board and deputy premier.
- l Nova Scotia, Department of Finance and Treasury Board, Forecast Update, December 17, 2020. Both the budget and forecast update figures are listed in the Nova Scotia summary, table 19.
- m Minister of finance and deputy premier.
- n Minister of finance and deputy premier.
- o Premier and minister of finance.

Source: Based on provincial and territorial budget documents or fiscal updates cited in the source notes for tables 12–24.

January 1, 2021. The table details rates and indicates whether the credit is refundable and otherwise eligible for a carryforward period. In some cases, the credit is also available to an individual. An article in this feature in 2017 focused on the policy behind these subsidies from an economics viewpoint.¹⁸

The second part of this article shows, for each province and territory, selected fiscal figures, highlights of tax changes, and a narrative summary of tax changes with accompanying tables. The figures for any particular jurisdiction are difficult to compare across jurisdictions. Where relevant, and where the information is accessible, notes that refer to differences in accounting and/or presentation are appended to the tables; it is beyond the scope of this article to analyze differing accounting practices of each jurisdiction and the differences in those practices between jurisdictions. Notes to each table also refer to the jurisdiction's significant resource revenue, if any. The "tax highlights" box at the beginning of each provincial/territorial section contains some of the more important tax changes and, where possible, lists them in order of precedence. The narrative summaries of tax changes are categorized under the following eight headings:

1. **Corporate income tax:** rates, credits, deductions, inclusions, reporting, business income matters, and other items.
2. **Personal income tax:** rates, credits, deductions, inclusions, and other items. This category may include the taxation of unincorporated businesses.
3. **Sales tax:** HST, GST, PST, QST.
4. **Excise taxes:** alcohol, tobacco, cannabis, and carbon taxes.
5. **Resource-related matters:** resource deductions, credits, royalties, and other items.

18 Daria Crisan and Kenneth J. McKenzie, "Tax Subsidies for R & D in Canada" (2017) 65:4 *Canadian Tax Journal* 951–81.

TABLE 11 Provincial and Territorial Research and Development (R & D) Tax Credits, 2020^a

Province/territory	R & D tax credit rate (%)	Is credit refundable?	Unused credits		Who can claim the credit?
			Carryback (taxation years)	Carryforward (taxation years)	
Alberta ^b	na	na	na	na	
British Columbia					
Qualifying CCPC ^c	10	✓	na	na	Corporation ^d
Other corporation . . .	10	✗	3	10	Corporation
Manitoba	15	✓ ^e /✗	3	20	Corporation
New Brunswick	15	✓	na	na	Corporation
Newfoundland and Labrador	15	✓	na	na	Corporation and individual
Northwest Territories . . .	na	na	na	na	
Nova Scotia	15	✓	na	na	Corporation
Nunavut	na	na	na	na	
Ontario					
Innovation tax credit ^f	8	✓	na	na	Corporation
Business research institute tax credit ^g	20	✓	na	na	Corporation
R & D tax credit	3.5	✗	3	20	Corporation
Prince Edward Island . . .	na	na	na	na	
Quebec ^h					
R & D wage tax credit ⁱ	14 to 30	✓	na	na	Corporation and individual
University R & D tax credit ^j	14 to 30	✓	na	na	Corporation and individual
Private partnership pre-competitive tax credit ^k	14 to 30	✓	na	na	Corporation and individual
Tax credit on fees paid to a research consortium	14 to 30	✓	na	na	Corporation and individual
Saskatchewan ^l					
Qualifying CCPC ^m	10	✓	na	na	Corporation
Other corporation . . .	10	✗	3	10	Corporation
Yukon	15 ⁿ	✓	na	na	Corporation and individual

(Table 11 is continued on the next page.)

TABLE 11 Continued

CCPC = Canadian-controlled private corporation.

- a Provincial and territorial tax credits are government assistance for federal tax purposes and thus reduce expenditures eligible for the federal R & D deduction and federal tax credit.
- b In the 2019 budget, the Alberta government withdrew the R & D tax credit. Eligible expenses incurred after December 31, 2019 will no longer qualify for any Alberta R & D tax credit in 2020. Alberta's recovery plan released in late 2020 announced a new innovation employment grant, which is similar to the previous Alberta R & D tax credit and will be available effective January 1, 2021.
- c British Columbia's refundable R & D tax credit is 10 percent of the lesser of (1) eligible BC R & D expenditures and (2) the federal R & D expenditure limit (to a maximum annual credit of \$300,000).
- d When R & D is carried on by a partnership, the R & D credit can generally be claimed by corporate partners except in Newfoundland and Labrador, Quebec, and Yukon, where an individual partner can also claim the credit. However, the credit cannot ever be claimed from a partnership that carries on its R & D in other provinces, such as Ontario (except for certain programs).
- e Manitoba's credit is (1) fully refundable for eligible R & D expenditures incurred in Manitoba by a corporation that has a Manitoba permanent establishment and a contract with a qualifying research institute, and (2) 50 percent refundable for in-house R & D expenditures.
- f The Ontario innovation tax credit is available on up to \$3 million of expenditures for a corporation that has taxable income under \$500,000 and taxable capital under \$25 million (to a maximum annual credit of \$240,000). A corporation is eligible for a partial credit if its taxable income is over \$500,000 but less than \$800,000 or its taxable capital is between \$25 million and \$50 million. All current expenditures are eligible. Taxable income and taxable capital thresholds are set in the previous year on a worldwide associated basis.
- g The Ontario business research institute tax credit applies to 20 percent of qualifying payments (up to \$20 million annually on an associated basis) to an Ontario eligible research institute (to a maximum annual credit of \$4 million).
- h For all Quebec R & D tax credits, the following rates and conditions apply:
 - 1. Quebec Canadian-controlled corporations that have fewer than \$50 million in assets can claim the 30 percent rate on up to \$3 million of R & D wages and/or eligible R & D expenditures for each credit; if assets held are between \$50 million and \$75 million, the rate is gradually reduced to 14 percent, which is the rate for all other taxpayers. The rates are higher in certain cases. Asset thresholds are set in the previous year on a worldwide associated basis (consolidated).
 - 2. The tax credit rate is 14 percent for Quebec corporations controlled by non-residents. Asset thresholds do not apply.
 - 3. An exclusion threshold is allocated among the Quebec R & D tax credits proportionally to the amount of eligible expenditures of each R & D tax credit. For each R & D tax credit, the eligible R & D expenditures are reduced by the allocated exclusion, which varies depending on the company's assets: the exclusion is
 - a. \$50,000 for a corporation whose assets are \$50 million or less,
 - b. an amount that increases linearly between \$50,000 and \$225,000 for a corporation whose assets are between \$50 million and \$75 million, and
 - c. \$225,000 for a corporation whose assets are \$75 million or more.
 Asset thresholds are set in the previous year and are not on an associated basis.
- i A payment may be eligible for the Quebec R & D wage tax credit if the payment was made to (1) an arm's-length subcontractor (up to 50 percent of the payment) or (2) a non-arm's-length subcontractor (100 percent for wages paid and 50 percent of a payment to an arm's-length subcontractor if the payment was made under the non-arm's-length contract).

(Table 11 is concluded on the next page.)

TABLE 11 Concluded

- j Quebec's university R & D tax credit may be available on 80 percent of a payment to an eligible entity such as a university, a public research centre, or a research consortium.
- k For the Quebec private partnership pre-competitive tax credit, a qualified expenditure may include (1) wages paid relating to R & D, (2) 80 percent of a payment to an arm's-length subcontractor (generally excluding a university, a public research centre, and a research consortium contract), (3) payment for some materials, or (4) payment for an overhead (or proxy) amount.
- l Saskatchewan's total refundable and non-refundable tax credits are capped at \$1 million per taxation year.
- m Saskatchewan's refundable R & D tax credit is 10 percent of the lesser of (1) eligible Saskatchewan R & D expenditures and (2) \$1 million in qualifying expenditures (maximum annual refundable credit is \$100,000).
- n Yukon's rate is 20 percent for R & D expenditures made to Yukon College.

Source: Based on table 11 in David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," *Finances of the Nation* feature (2020) 68:1 *Canadian Tax Journal* 185-250, at 209-11, updated by the author to include changes for 2020.

6. Real estate taxes: land transfer taxes and property taxes.

7. Pensions: includes proposed studies.

8. Other: a catchall category that includes corporate capital tax, general anti-avoidance rule and other anti-avoidance initiatives, partnership and trust matters not covered above, and other items.

These categories have been selected for organizational purposes and for ease of reference only. Some categories may overlap (for example, categories 1, 2, 4, and 5).

BRITISH COLUMBIA (TABLE 12)

Tax Highlights

- New top personal income tax bracket introduced
- Various corporate and personal tax credits extended

Tax Changes

1. Corporate Income Tax

No changes to corporate income tax rates were announced.

The training tax credit for employers was extended for three years, to the end of 2022.

The farmers' food donation corporate tax credit was extended three years, to the end of 2023.

The administration of the production services tax credit was changed. Effective July 1, 2020, corporations intending to claim the tax credit must notify the certifying authority of their intent within 60 days of first incurring an eligible expenditure.

TABLE 12 Projected Revenues and Expenditures, British Columbia, Fiscal Year 2020-21

	February 2020	December 2020
	<i>millions of dollars</i>	
Total revenues	60,585	57,424
Total expenditures	(60,058)	(70,067)
Reserve	(300)	(1,000)
Surplus/(deficit)	<u>227</u>	<u>(13,643)</u>
Revenue sources		
Personal income tax	11,771	10,964
Corporate income tax	4,739	3,673
Sales tax	7,905	6,746
Other taxes	<u>10,929</u>	<u>9,851</u>
Total tax revenue	35,344	31,234
Federal transfers	9,963	12,680
Other revenues	<u>15,278</u>	<u>13,510</u>
Total revenues	<u>60,585</u>	<u>57,424</u>
Expenditures		
Education	15,178	15,558
Health	24,285	24,595
Debt servicing	2,723	2,724
Other expenditures	<u>17,872</u>	<u>27,190</u>
Total expenditures	<u>60,058</u>	<u>70,067</u>

Notes: Expenditure figures were estimated by function. Revenue includes net income of commercial Crown corporations. Sales tax includes provincial sales tax (PST), harmonized sales tax (HST)/PST housing transition tax, and HST related to prior years. COVID-19 expenditures presented in the fall economic and fiscal update, which includes pandemic response and economic recovery expenditures in both health care and education, were presented as separate contingency line items and are included within “other expenditures” in this table.

Sources: British Columbia, Ministry of Finance, 2020 Budget, February 18, 2020; and Fall 2020 Economic & Fiscal Update, December 17, 2020.

Also, effective February 19, 2020, the accreditation certificate fee for the tax credit is increased to \$10,000.

On September 17, 2020, the government presented its economic recovery plan,¹⁹ which introduced, among other measures, a temporary PST program. Corporations may apply to receive a refund equal to the amount of PST paid between September 17, 2020 and September 30, 2021 on the acquisition of qualifying machinery and equipment. Applications for the program will be accepted online starting on April 1, 2021.

19 British Columbia, “StrongerBC for Everyone: BC’s Economic Recovery Plan,” September 17, 2020 (news.gov.bc.ca/files/StrongerBC_BCs-Economic-Recovery-Report.pdf).

The economic recovery plan also introduced the BC increased employment incentive (IEI). The IEI is a temporary refundable tax credit for employers, calculated as 15 percent of the amount of the employer's qualifying BC remuneration that exceeds the employer's base BC remuneration. Put simply, the IEI encourages employers to create new jobs or increase the pay of their existing low-income or medium-income employees, since the tax credit is awarded if BC remuneration is higher in the fourth quarter of 2020 than in the third quarter of 2020. Applications for the IEI will be accepted online starting in March 2021.

2. Personal Income Tax

The 2020 budget introduced a new top personal income tax bracket, effective January 1, 2020. Taxable income exceeding \$220,000 is subject to a provincial personal income tax rate of 20.5 percent. As a result of this change, the charitable donation tax credit is increased to 20.5 percent for charitable donations over \$200 in respect of the individual's income that is subject to the new top personal income tax rate.

The training tax credit for apprentices was extended for three years, to the end of 2022.

The farmers' food donation tax credit was extended for three years, to the end of 2023.

3. Sales Tax

The 2020 budget proposed the elimination of the PST exemption for food products for human consumption, for all carbonated beverages that contain sugar, natural sweeteners, or artificial sweeteners. To simplify administration, PST will now apply to all beverages that are dispensed through soda fountains, soda guns, or similar equipment, along with all beverages dispensed through vending machines (except vending machines that dispense only beverages other than sweetened carbonated beverages). These changes were to come into effect on July 1, 2020. However, in response to the COVID-19 pandemic, the government announced on April 1, 2020 that these changes were postponed and would not take effect until April 1, 2021.²⁰

The 2020 budget also introduced new PST registration requirements for Canadian sellers of goods, along with Canadian and foreign sellers of software and telecommunication services, if specified BC revenues exceed \$10,000. This change was to come into effect on July 1, 2020. However, in response to COVID-19, the government announced on April 1, 2020 that this change was postponed and would not take effect until April 1, 2021.²¹ In addition, Canadian sellers of vapour products are required to register for PST if they deliver vapour products to BC consumers, effective July 1, 2020. This change was not postponed in response to COVID-19.

20 British Columbia, Ministry of Finance, "COVID 19—Sales Tax Changes," *Tax Notice 2020-002*, April 1, 2020 (www2.gov.bc.ca/assets/download/C7A2D4038D324A989CF963A8CF320542).

21 Ibid.

The 2020 budget announced changes to specific rules relating to PST exemptions and refunds. The exemptions for machinery and equipment purchased or leased by qualifying manufacturers and resource industry businesses for use in pollution control or waste management are amended to eliminate restrictions regarding the location at which the machinery and equipment are used. Electric aircraft are now exempt from PST. In addition, a refund is added for PST paid for non-electric aircraft obtained for the purpose of converting the aircraft to operate solely on electricity, as well as for the related parts and related services obtained for the same purpose. Also, real property contractors who perform value-added work on goods and then install those goods in real property outside British Columbia can apply for a refund of the PST paid on those goods. All of these changes are effective February 19, 2020.

4. Excise Taxes

At the end of 2019, the BC government announced that the rate of PST on sales of vapour products would increase from 7 percent to 20 percent, effective January 1, 2020. Vapour products include vaping devices, vaping cartridges, vaping parts and accessories, and vaping substances.²²

The 2020 budget indicated that effective April 1, 2020, the BC carbon tax rates for 2020 and 2021 would be increased to be aligned with the federal carbon-pricing backstop methodology. The refund rates for international fuel tax agreement licensees would also be adjusted to reflect the alignment of the BC carbon tax with the federal carbon-pricing backstop methodology. However, in response to COVID-19, the government announced on April 1, 2020 that the carbon tax rate changes originally scheduled for April 1, 2020 and April 1, 2021 would be delayed by a full year, until April 1, 2021 and April 1, 2022, respectively.²³ Carbon tax rates will remain at their current level until March 31, 2021. The refund rates for international fuel tax agreement licensees will also remain at current rates until further notice.

The 2020 budget also introduced a default tax of 29.5 cents per heated tobacco product (a product that contains tobacco and is designed to be heated, but not combusted, in a tobacco heating unit to produce a vapour for inhalation).

5. Resource-Related Matters

The 2020 budget announced that the new mine allowance would be extended for five years to the end of 2025 to be effective on a date to be specified by regulation.

22 British Columbia, Ministry of Finance, "Notice to Sellers of Vapour Products: PST Rate Increase to 20%," *Provincial Sales Tax (PST) Notice 2019-005*, November 2019 (www2.gov.bc.ca/assets/gov/taxes/sales-taxes/publications/notice-2019-005-sellers-vapour-products-pst-rate-increase.pdf).

23 Supra note 20.

6. Real Estate Taxes

The 2020 budget announced that a new exemption from additional property transfer tax would be introduced for qualifying Canadian-controlled limited partners to be effective on a date to be specified by regulation. The 2020 budget indicated that the threshold for the phaseout of the homeowner grant is decreased from \$1,650,000 to \$1,525,000 for the 2020 tax year, a change that was previously announced on January 3, 2020.

The 2020 budget introduced a change that will give municipalities the flexibility to create a distinct municipal tax rate for designated port properties when the municipal major industry tax rate is below the upper tax rate threshold; however, this new tax rate for designated port properties cannot be higher than the municipality's 2017 major industry tax rate. This change is effective for the 2020 tax rate.

Effective for the 2021 property tax year, the port land valuation regulation under the Assessment Act will be amended to increase the annual land valuation from consumer price index (CPI) inflation to CPI inflation plus 1 percentage point.

The average residential class school property tax increased in 2020 by the province's inflation rate in the previous year in accordance with longstanding policy in place since 2003. Rates were to be set when revised assessment roll data became available in the spring.

Non-residential school property tax rates increased in 2020 by inflation plus tax on new construction, except for the rate for the industrial property classes, in accordance with longstanding policy in place since 2005. Rates were to be set when revised assessment roll data became available in the spring. However, in response to COVID-19, the government reduced the school property tax rates for commercial properties (classes 4, 5, 6, 7, and 8) for the 2020 tax year by 50 percent.²⁴

The single rural area residential property tax rate increased in 2020 by the province's inflation rate in the previous year, in accordance with longstanding policy. Similarly, rural area non-residential property tax rates increased by inflation plus the tax on new construction. Rates were to be set when revised assessment data became available in the spring.

7. Pensions

No changes were announced.

8. Other

The 2020 budget introduced a number of technical amendments to various tax acts, including the Income Tax Act, the Land Tax Deferment Act, the Provincial Sales Tax Act, and the Property Transfer Tax Act, for clarity and certainty.

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution

24 British Columbia, Ministry of Finance, "New COVID-19 Supports for Businesses, Local Governments," *News Release*, April 16, 2020 (news.gov.bc.ca/releases/2020FIN0020-000703).

Pricing Act (the carbon tax). British Columbia had intervenor status in the cases. The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

ALBERTA (TABLE 13)

Tax Highlights

- Acceleration of previously announced general corporate tax rate reductions
- New R & D refundable tax credit, effective 2021
- Introduction of vaping products tax

Tax Changes

1. Corporate Income Tax

In 2019, Alberta enacted legislation (the Alberta Corporate Tax Amendment Act) implementing scheduled reductions in the general corporate tax rate to take effect in the 2020–2022 taxation years. In accordance with the act, on January 1, 2020, the general corporate tax rate was reduced from 11 percent to 10 percent. The rate was to be further reduced from 10 percent to 9 percent on January 1, 2021 and from 9 percent to 8 percent on January 1, 2022. Manufacturing and processing corporations in Alberta pay tax at the general corporate tax rate and will benefit from the announced reductions.

On June 29, 2020, the government unveiled Alberta’s recovery plan,²⁵ which accelerated the scheduled rate reductions. As a result, the general corporate tax rate was reduced from 10 percent to 8 percent effective July 1, 2020.

Alberta’s recovery plan also announced the innovation employment grant (IEG) to support small and medium-sized businesses that invest in R & D. The IEG effectively replaces Alberta’s previous SR & ED tax credit, which was discontinued as of December 31, 2019. The IEG is a refundable tax credit, calculated as 8 percent of the corporation’s eligible R & D expenditures incurred in a taxation year plus a 12 percent incremental amount for the corporation’s eligible R & D expenditures incurred in the taxation year that exceeds its base amount of expenditures. The base amount of expenditures is generally the corporation’s average eligible R & D expenditures for the two immediately preceding taxation years. Eligible R & D expenditures for the IEG will be the same as those that qualify for the federal SR & ED tax incentive program. Similar to the previous SR & ED tax credit, the annual expenditure limit for the IEG is \$4 million, and a phaseout of the expenditure limit exists when the taxable capital of the corporation in the prior taxation year is between \$10 million and \$50 million. The IEG comes into effect on January 1, 2021.

25 Alberta, “Alberta’s Recovery Plan,” June 29, 2020 (www.alberta.ca/recovery-plan.aspx).

TABLE 13 Projected Revenues and Expenditures, Alberta, Fiscal Year 2020-21

	February 2020	November 2020
	<i>millions of dollars</i>	
Total revenues	49,979	41,414
Total expenditures	(56,039)	(60,743)
Reserve for crude-by-rail and contingency/disaster assistance	(750)	(2,000)
Surplus/(deficit)	<u>(6,810)</u>	<u>(21,329)</u>
Revenue sources		
Personal income tax	12,566	10,753
Corporate income tax	4,539	2,188
Sales tax	na	na
Other taxes	5,782	5,286
Total tax revenue	22,887	18,227
Federal transfers	9,110	11,337
Other revenues	17,982	11,850
Total revenues	<u>49,979</u>	<u>41,414</u>
Expenditures		
Education	13,448	13,448
Health	20,616	20,616
Debt servicing	2,505	2,413
Other expenditures	19,470	24,266
Total expenditures	<u>56,039</u>	<u>60,743</u>

Notes: The budget was presented on a fully consolidated basis, which includes school boards, universities and colleges, health entities, and the Alberta Innovates corporations. The presentation of “education” expenditures was updated in the current year to include expenditures for post-secondary education. The government issued a fiscal plan update on March 20, 2020 that indicated that it was revising the 2020 budget to provide an additional \$500 million in the 2020-21 fiscal year to the Ministry of Health for the provincial response to the COVID-19 pandemic, in addition to the \$20,616 million of health expenditures previously forecasted in the 2020 budget. Other expenditures presented in the November fiscal update and economic statement include \$4,843 million of COVID-19-related spending, with \$3,534 million being allocated to operating expenses (including \$1,006 million for health and \$276 million for education), \$607 million to capital grants, and \$702 million to inventory consumption (for personal protective equipment). The government did not present revised expenditures by ministry in the November fiscal update and economic statement; as a result, the “ordinary” (pre-COVID-19) education and health expenditures are assumed to be the same as presented in the 2020 budget.

Sources: Alberta, Treasury Board and Ministry of Finance, 2020 Budget, Budget Plan, February 27, 2020; Fiscal Plan 2020-23 Update, March 20, 2020; and 2020-21 Mid-Year Fiscal Update and Economic Statement, November 24, 2020.

2. *Personal Income Tax*

As announced in the 2019 budget, the Alberta child and family benefit (ACFB) came into effect on July 1, 2020, replacing the Alberta family employment tax credit and the Alberta child benefit. The amount that families can receive depends on the number of children under the age of 18, the family's employment income, and the family's net income. The ACFB includes a base component and a working component. The maximum combined annual benefit is \$5,120. The value of the base component ranges from \$1,330 to \$3,325, depending on the number of children, and begins to phase out when family net income exceeds \$24,467. The base component is fully phased out when family net income exceeds approximately \$41,000. The working component starts to phase in when family employment income exceeds \$2,760 and rises by 15 percent as that income increases, to a maximum of \$681 to \$1,795, depending on the number of children. The working component phases out when family net income exceeds \$41,000 and is fully phased out when family net income reaches \$61,000. The ACFB is paid quarterly, and the amounts are non-taxable.

No new changes to personal income tax were announced in 2020; however, given the substantial decreases to the general corporate tax rate effected in 2020, the change to decrease the Alberta dividend tax credit has also been accelerated to maintain integration of the tax system. This change effectively increases the taxes that individuals in Alberta will pay on eligible dividends received on or after January 1, 2021.

3. *Sales Tax*

No changes were announced with respect to a PST. Alberta does not impose a general tax on retail sales.

Alberta does, however, impose a tourism levy of 4 percent on temporary accommodation rentals. As announced in the 2019 budget, the government intends to extend the tourism levy to apply to the rental of all short-term rentals listed in online marketplaces, by removing the current exemption for establishments with fewer than four bedrooms available for rent. A new exemption will be introduced for properties that are not listed in any online marketplace where the purchase price of the rental is less than \$30 per day or \$210 per week, or the operator has annual gross revenue from the rental of temporary accommodations in Alberta of less than \$5,000. Online marketplaces will be authorized to collect and remit the tourism levy on behalf of operators. The 2020 budget indicated that the changes were expected to take effect in the spring of 2020 and that additional details would be provided at that time. This measure was included in the Fiscal Measures and Taxation Act, 2020, which received royal assent on March 20, 2020. At the time of writing, no additional details on the tourism levy had been provided by the government.

Furthermore, in 2020, the government recognized the exceptional circumstances and challenges that temporary accommodation providers in Alberta were facing and announced that operators could retain all amounts collected from persons paying the tourism levy on accommodations purchased between March 1, 2020 and March 31, 2021. However, operators must continue to report the amounts of

tourism levy collected during the abatement period by continuing to file tourism levy returns.²⁶

4. Excise Taxes

The 2020 budget announced the government's intention to implement a 20 percent vaping products tax on the retail sales price of vaping products, which will apply to all vaping liquids (including cannabis liquids) as well as vaping devices. Online sales to Albertans from other jurisdictions will be subject to the vaping products tax, but Alberta retailers will not be required to collect the tax on online sales that they make to individuals in other jurisdictions. The 2020 budget indicated that the date of implementation for the vaping products tax, as well as other details, would be announced with the introduction of the legislation and regulations later in 2020. However, at the time of writing, legislation to effect these changes had not yet been introduced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

The 2020 budget indicated that education property tax rates will increase by 3.1 percent in 2020-21 to account for population and inflation adjustment. The residential/farmland rate will increase from \$2.56 per \$1,000 of equalized assessment to \$2.64 per \$1,000 of equalized assessment. The non-residential rate will increase from \$3.76 per \$1,000 of equalized assessment to \$3.88 per \$1,000 of equalized assessment.

However, on March 23, 2020, the government announced that it would cancel the increase in the education property tax announced in the 2020 budget, because of the COVID-19 crisis.²⁷

7. Pensions

No changes were announced.

8. Other

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

26 Alberta, Treasury Board and Ministry of Finance, "Tourism Levy Special Notice Vol. 7 No. 11: Extension of Tourism Levy Abatement," December 7, 2020 (<https://open.alberta.ca/publications/tourism-levy-special-notice-vol-7-no-11-extension-of-tourism-levy-abatement>).

27 Alberta, "Additional Financial Support for Albertans and Employers," March 23, 2020 (www.alberta.ca/release.cfm?xID=699045A66118C-FA03-F4F5-959455E3316B8564).

SASKATCHEWAN (TABLE 14)**Tax Highlights**

- New tax credits for resource businesses and reintroduction of indexation of the personal income tax system to inflation
- New temporary PST rebate for new home construction
- Post-election amendments providing a temporary reduction in the small business corporate tax rate and new personal income tax credits

Tax Changes**1. Corporate Income Tax**

No changes to corporate income taxes were announced in the 2020 budget. However, after the 2020 Saskatchewan election, on December 7, 2020, the government introduced legislation that provides for a temporary reduction to the small business corporate income tax rate. The legislation proposes the following changes: a decrease in the tax rate, from 2 percent to 0 percent, effective October 1, 2020; an increase, from 0 percent to 1 percent, effective July 1, 2022; and a further increase, from 1 percent to 2 percent, effective July 1, 2023. The small business limit of \$600,000 remains unchanged.²⁸ This measure received royal assent on December 10, 2020.

2. Personal Income Tax

The 2018 budget temporarily froze tax rate reductions; thus, personal tax rates were frozen at 2018 levels: 10.5, 12.5, and 14.5 percent. The 2020 budget announced the government's intention to reintroduce automatic annual indexation of the personal income tax system for inflation starting with the 2021 taxation year.

After the 2020 Saskatchewan election, the government introduced legislation for numerous commitments made in the election campaign. Legislation for a new Saskatchewan home renovation tax credit was introduced on December 3, 2020, which provides homeowners with a 10.5 percent tax credit on up to \$20,000 of eligible expenses incurred between October 1, 2020 and December 31, 2022 for the renovation of a Saskatchewan taxpayer's principal residence located in Saskatchewan. All renovations must be substantially completed by December 31, 2022 to qualify for the tax credit. Total qualified expenses incurred between October 1, 2020 and December 31, 2021 in excess of \$1,000 but not more than \$12,000 (representing a maximum claim of \$11,000) can be claimed on the individual's 2021 tax return. Total qualified expenses incurred between January 1, 2022 and December 31, 2022 in excess of \$1,000 but not more than \$10,000 (representing a maximum claim of

28 Saskatchewan, "Lower Taxes for Small Businesses Will Help Economic Recovery," December 7, 2020 (www.saskatchewan.ca/government/news-and-media/2020/december/07/lower-taxes-for-small-businesses-will-help-economic-recovery).

TABLE 14 Projected Revenues and Expenditures, Saskatchewan, Fiscal Year 2020-21

	June 2020	August 2020
	<i>millions of dollars</i>	
Total revenues	13,649	14,047
Total expenditures	(16,075)	(16,177)
Surplus/(deficit)	<u>(2,426)</u>	<u>(2,130)</u>
Revenue sources		
Personal income tax	2,605	2,605
Corporate income tax	781	781
Sales tax	1,996	1,996
Other taxes	<u>1,821</u>	<u>1,821</u>
Total tax revenue	7,203	7,203
Federal transfers	2,787	3,152
Other revenues	<u>3,659</u>	<u>3,692</u>
Total revenues	<u>13,649</u>	<u>14,047</u>
Expenditures		
Education	3,362	3,365
Health	6,176	6,248
Debt servicing	718	725
Other expenditures	<u>5,819</u>	<u>5,839</u>
Total expenditures	<u>16,075</u>	<u>16,177</u>

Notes: Saskatchewan's summary budget presentation includes government core operations, government service organizations (such as ministries, boards of education, and health regions), and government business enterprises (such as Crown corporations). "Other revenues" include non-renewable resource revenue of \$997 million for fiscal year 2020-21. Debt servicing is for general debt.

Sources: Saskatchewan, Ministry of Finance, 2020 Budget, June 15, 2020; and Budget Update 20-21, First Quarter Budget Update and Medium-Term Outlook, August 27, 2020.

\$9,000) can be claimed on the individual's 2022 tax return.²⁹ This measure received royal assent on December 10, 2020.

The government also announced that the defunct active families benefit will be reinstated as part of the 2021-22 budget and will be available retroactively to January 1, 2021.³⁰

29 Saskatchewan, "New Tax Credit Makes Home Renovations More Affordable," December 3, 2020 (www.saskatchewan.ca/government/news-and-media/2020/december/03/new-tax-credit-makes-home-renovations-more-affordable).

30 Saskatchewan, "Making Life More Affordable for Saskatchewan People in 2021," December 31, 2020 (www.saskatchewan.ca/government/news-and-media/2020/december/31/making-life-more-affordable-for-saskatchewan-people-in-2021).

3. Sales Tax

On March 18, 2020, when tabling 2020–21 estimates, the government announced a PST rebate for new home construction of up to 42 percent of the PST paid on a new house contract up to \$350,000, excluding the land, for new homes purchased after March 31, 2020 and before April 1, 2023.³¹

The 2020 budget indicated that measures would be implemented to ensure that non-resident businesses fairly collect PST on their Saskatchewan sales, but did not provide any additional information on these measures or when they would be effective.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

The 2020 budget introduced the Saskatchewan chemical fertilizer incentive, which provides a non-refundable, non-transferable 15 percent tax credit on capital expenditures valued at \$10 million or more for newly constructed or expanded eligible chemical fertilizer production facilities in Saskatchewan.³² The incentive was retroactively dated to accommodate projects that have already been initiated and is effective November 1, 2017. Applications for conditional approval for the incentive must be received before December 31, 2026 to be eligible. The 2020 budget also extends the manufacturing and processing exporter tax incentive by three years, to 2022.

The 2020 budget also introduced the oil infrastructure investment program, a SaskFirst new growth tax incentive to be administered by the Ministry of Energy and Resources. This program provides transferable royalty/freehold production tax credits for qualified projects at a rate of 20 percent of eligible program costs and is open to new or expanded pipelines. Applications are accepted from April 8, 2020 to March 31, 2025.³³

6. Real Estate Taxes

No changes were announced.

31 Saskatchewan, “2020–21 Estimates Provide Key Investments,” March 18, 2020 (www.saskatchewan.ca/government/news-and-media/2020/march/18/budget-2020).

32 Saskatchewan, “Saskatchewan Chemical Fertilizer Incentive Launched,” July 27, 2020 (www.saskatchewan.ca/government/news-and-media/2020/july/27/fertilizer-incentive-launched).

33 Saskatchewan, “Oil Infrastructure Investment Program (OIIP)” (www.saskatchewan.ca/business/agriculture-natural-resources-and-industry/oil-and-gas/oil-and-gas-incentives-crown-royalties-and-taxes/oil-infrastructure-investment-program).

7. Pensions

No changes were announced.

8. Other

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

MANITOBA (TABLE 15)

Tax Highlights

- Proposed new reduction in PST with the introduction of a provincial carbon tax that was deferred because of the COVID-19 crisis
- Extension of various business tax credits
- Elimination of probate fees

Tax Changes

1. Corporate Income Tax

The 2020 budget increased the exemption threshold for the health and post-secondary education tax levy from \$1.25 million to \$1.50 million of annual remuneration. In addition, the threshold below which employers pay a reduced rate on the levy is raised from \$2.5 million to \$3.0 million. Both changes are effective January 1, 2021.

The 2020 budget provided a Manitoba production company bonus of 8 percent on top of the existing 30 percent cost-of-production credit for principal photography under the film and video production tax credit, resulting in a total cost-of-production credit of up to 38 percent. This is effective for principal photography that begins after May 31, 2020 and is available for qualifying producers of eligible Manitoba productions and co-productions.

The 2020 budget also increased the existing child-care spaces limit from 208 spaces to 682 spaces for the purposes of the child-care centre development tax credit for eligible corporations. The maximum daily amount that can be charged is eliminated, allowing eligible corporations to partner with for-profit child-care centres and permitting non-profit child-care centres to establish parent fees to support their business. This change is effective March 20, 2020. All other aspects of the tax credit remain unchanged.

The 2020 budget extended several business tax credits. The manufacturing investment tax credit, which was scheduled to expire on December 31, 2020, is now extended indefinitely, with no fixed expiry date. The mineral exploration tax credit, which was scheduled to expire on December 31, 2020, was extended for three years, to December 31, 2023. The cultural industries printing tax credit, which was scheduled to expire on December 31, 2020, was extended by one year, to December 31,

TABLE 15 Projected Revenues and Expenditures, Manitoba, Fiscal Year 2020-21

	March 2020	December 2020
<i>millions of dollars</i>		
Total revenues	17,737	17,365
Total expenditures	(17,957)	(19,413)
In-year adjustments/lapse	nil	nil
Surplus/(deficit)	<u>(220)</u>	<u>(2,048)</u>
Revenue sources		
Personal income tax	3,982	3,726
Corporate income tax	639	498
Sales tax	2,021	1,977
Other taxes	1,615	1,277
Total tax revenue	8,257	7,478
Federal transfers	5,136	5,811
Other revenues	4,344	4,076
Total revenues	<u>17,737</u>	<u>17,365</u>
Expenditures		
Education	3,003	3,134
Health	6,819	7,460
Debt servicing	1,001	959
Other expenditures	7,134	7,860
Total expenditures	<u>17,957</u>	<u>19,413</u>

Notes: The summary budget's government reporting entity included core government, Crown corporations, government business entities, and public-sector organizations. The amount indicated as the health expenditure is for health, seniors, and active living expenditures. In-year adjustments/lapse may represent an increase in revenue and/or a decrease in expenditures. The 2020 budget notes that the 2019-20 budget has been restated to be consistent with the 2020-21 budget presentation. This appears to include a reclassification of the 2019-20 education expenditure, which has been restated as \$2,945 million (previously reported as \$4,560 million in the 2019-20 budget).

Sources: Manitoba, Department of Finance, 2020 Budget, March 19, 2020; and 2020/21 Mid-Year Report—Fiscal and Economic Update, December 17, 2020.

2021. The community enterprise development tax credit, which was scheduled to expire on December 31, 2020, was extended by one year, to December 31, 2021. The refundable portion of the manufacturing investment tax credit is reduced from 7 percent to 6 percent, to parallel the retail sales tax change effective for qualifying property acquired and available for use after June 30, 2020.

The 2020 budget eliminated the requirement for tax rebate discounters to be registered with the province of Manitoba, and the associated registration fees were eliminated. However, Manitoba discounters must still register with the Canada Revenue Agency, consistent with the practice in other provinces.

2. *Personal Income Tax*

Pursuant to the 2016 budget, the personal income tax brackets and basic personal amount were indexed to inflation starting in 2017. The 2020 budget confirmed that indexation will continue in 2020. The basic personal amount for 2020 is \$9,838. The 2020 budget also changed provisions of the primary caregiver tax credit to require renewal every three years.

3. *Sales Tax*

The 2020 budget provided for a 1 percentage point reduction in the PST, from 7 percent to 6 percent effective July 1, 2020, as a means of returning revenues collected by the new green levy, which was to come into effect on the same date. (See the excise taxes section below for details.) Accordingly, the PST rate charged on electricity used by manufacturing, mining, and oil well operators in Manitoba would also decrease from 1.4 percent to 1.2 percent effective July 1, 2020. The PST rate charged on mixed uses of electricity and natural gas used for home heating, heating and cooling of farm buildings, and operating farm grain dryers would decrease from 1.4 percent to 1.2 percent effective July 1, 2020. The PST rate on mobile, modular, and ready-to-move homes would decrease from 4.0 percent to 3.5 percent effective July 1, 2020. The prorated vehicle tax rates for commercial trucking would be adjusted for the lower general PST rate of 6 percent effective July 1, 2020. Furthermore, the preparation of personal income tax returns would be exempted from PST effective October 1, 2020. However, later in 2020, the government announced that the introduction of the green levy was deferred until further notice. Accordingly, the PST rate reductions set out above have also been deferred until further notice.³⁴

4. *Excise Taxes*

The 2020 budget introduced a green levy at a flat rate of \$25 per tonne of carbon dioxide equivalent emissions, effective July 1, 2020, which would apply to gas, liquid, and solid fuel products intended for combustion (referred to as fuels) and consumed in Manitoba. The green levy is 5.30 cents per litre for gasoline, 6.74 cents per litre for diesel, 4.74 cents per cubic metre for natural gas, and 3.87 cents per litre for propane. Various exemptions are provided for agricultural process emissions, marked fuels, and output-based pricing system entities. The 2020 budget also confirmed that PST will not apply to the green levy.

The 2020 budget also increased tobacco tax rates effective July 1, 2020. The following tobacco tax rates were changed: for cigarettes, from 30.0 cents per cigarette to 30.5 cents per cigarette; for fine-cut tobacco, from 45.5 cents per gram to

34 Manitoba, *Information Bulletin no. 120*, "Taxation Changes—2020 Budget," July 2020 (www.gov.mb.ca/finance/taxation/pubs/bulletins/2020budget.pdf).

46.0 cents per gram; for raw-leaf tobacco, from 27.5 cents per gram to 28.0 cents per gram; and for other tobacco products, from 29.0 cents per gram to 29.5 cents per gram.

However, later in 2020, the government announced that the introduction of the green levy and the tobacco tax increase that were scheduled to be effective on July 1, 2020 were deferred until further notice.³⁵

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

The 2020 budget introduced a made-in-Manitoba green levy with an associated PST reduction, which was supposed to take effect on July 1, 2020 to replace the federal backstop carbon tax. More information is provided in the excise taxes section. The proposed green levy is a flat rate of \$25 per tonne of carbon dioxide equivalent emissions. However, as the federal carbon pollution price increases through to 2022, a question remains as to whether the federal government will step in and implement a federal backstop carbon tax to top up Manitoba's green levy. The premier of Manitoba said that "our flat made-in-Manitoba Green Levy will return all of the money and more to Manitobans with the second-lowest PST in Canada."³⁶

The 2020 budget also eliminated probate fees payable on the value of a deceased individual's estate effective November 6, 2020 (the day on which the 2020 budget bill received royal assent).

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). Manitoba had intervenor status in the cases. The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional. Despite the court's ruling, Manitoba has indicated that it will move forward with its own legal challenge of the carbon-pricing regime, noting that its legal challenge is based on different grounds.

³⁵ Ibid.

³⁶ Manitoba, "Manitoba To Implement Flat \$25-Per-Tonne Green Levy, PST Will Be Reduced to Six Per Cent," *News Release*, March 5, 2020 (news.gov.mb.ca/news/index.html?item=46904).

ONTARIO (TABLE 16)**Tax Highlights**

- No new changes to corporate income tax or personal income tax rates
- Various tax measures targeted at small businesses
- New seniors' home safety tax credit introduced for individuals for 2021

Tax Changes**1. Corporate Income Tax**

On January 1, 2020, the small business corporate tax rate was reduced from 3.5 percent to 3.2 percent, as previously announced in the 2019 fall economic outlook and fiscal review.³⁷

On March 25, 2020, Ontario delivered a 2020 economic and fiscal update³⁸ that included several tax measures. The 2020 update retroactively raised the employer health tax (EHT) exemption for private-sector employers with total annual Ontario remuneration of less than \$5 million, from \$490,000 to \$1 million for 2020. The exemption will revert to \$490,000 on January 1, 2021. The 2020 update also introduced a regional opportunities investment tax credit, which provides Canadian-controlled private corporations (CCPCs) that make a qualifying investment in specified regions of Ontario with a 10 percent refundable tax credit. Qualifying investments are eligible expenditures for capital property included in class 1 and class 6 in the computation of capital cost allowance (CCA). The tax credit is available for eligible expenditures in excess of \$50,000 up to a limit of \$500,000 if the capital property becomes available for use on or after March 25, 2020.

The 2020 budget announced that the government would make the increase in the EHT exemption, initially announced in the 2020 fiscal update, a permanent change. The exemption will not revert to \$490,000 on January 1, 2021. As a result of the permanent increase, the government announced that the next scheduled adjustment to the EHT exemption for inflation would be moved to January 1, 2029. Furthermore, the government announced that the threshold payroll amount beyond which employers are required to pay EHT instalments would be doubled, from \$600,000 to \$1.2 million.

The government acknowledged that COVID-19 has disrupted production activity in the cultural industries. The 2020 budget proposes to temporarily extend some timelines and amend some requirements for the following cultural media tax credits: the Ontario film and television tax credit, the Ontario production services tax credit, the Ontario interactive digital media tax credit, and the Ontario book publishing tax credit.

37 Ontario, Ministry of Finance, 2019 Fall Economic Outlook and Fiscal Review, November 6, 2019.

38 Ontario, Ministry of Finance, March 2020 Economic and Fiscal Update, Ontario's Action Plan 2020: Responding to COVID-19, March 25, 2020.

TABLE 16 Projected Revenues and Expenditures, Ontario, Fiscal Year 2020-21

	March 2020	November 2020
<i>millions of dollars</i>		
Total revenues	156,266	151,074
Total expenditures	(174,276)	(187,042)
Reserve	2,500	2,500
Surplus/(deficit)	<u>(20,510)</u>	<u>(38,468)</u>
Revenue sources		
Personal income tax	37,316	36,901
Corporate income tax	15,170	9,941
Sales tax	29,078	24,879
Other taxes	26,625	25,741
Total tax revenue	108,189	97,462
Federal transfers	26,345	33,360
Other revenues	21,732	20,252
Total revenues	<u>156,266</u>	<u>151,074</u>
Expenditures		
Education	31,893	32,659
Health	67,844	64,646
Debt servicing	13,199	12,456
Other expenditures	61,340	77,281
Total expenditures	<u>174,276</u>	<u>187,042</u>

Notes: The figures include amounts for government business enterprises. Expenditures were shown by ministry. Health expenditures include expenditures from the Ministry of Health and the Ministry of Long-Term Care, which were reported separately for the first time in the projections for fiscal year 2020-21. Debt servicing is net of interest capitalized during construction of tangible capital assets of \$234 million for fiscal year 2020-21, as presented in the 2020 economic and fiscal update and the 2020 budget. Other expenditures presented in the 2020 budget include \$8,346 million of one-time COVID-19-related spending, which includes one-time COVID-19 health sector spending of \$3.1 billion and a COVID-19 health contingency fund of \$5.3 billion.

Sources: Ontario, Ministry of Finance, March 2020 Economic and Fiscal Update, Ontario's Action Plan 2020: Responding to COVID-19, March 25, 2020; and 2020 Budget, November 5, 2020.

The government also proposed to extend the reporting period for claiming the Ontario R & D tax credit to parallel the extension of the reporting deadlines for federal R & D claims. Corporations with taxation year-ends from September 13, 2018 to December 31, 2018 would have an additional six months to file their tax credit claim, and corporations with taxation year-ends from January 1, 2019 to June 29, 2019 would have until December 31, 2020 to file their claim.

2. Personal Income Tax

The 2020 budget contained only one change to Ontario's personal income tax system. The government introduced the seniors' home safety tax credit in the 2020

budget. This is a temporary refundable tax credit that would apply for the 2021 taxation year. The value of the tax credit is 25 percent of up to \$10,000 in eligible expenses for a principal residence in Ontario and must be shared by the people who share a home (for example, spouses and common-law partners). Eligible expenses generally include any expenses paid or payable in 2021 to the extent that they relate to renovations that improve safety and accessibility, or help a senior to be more functional or mobile at home. To qualify, the improvements must be made to the claimant's principal residence in Ontario or to a residence in Ontario that the claimant reasonably expects to become his or her principal residence within 24 months after the end of 2021.

The 2020 budget provided information about minor technical amendments to be made to the Taxation Act, 2007 that relate to personal income taxes. The adoption expenses tax credit can continue to be used in calculating the amount of tax payable by a spouse or common-law partner when determining the amount of tax credits that can be transferred to a taxpayer from the spouse or common-law partner. The low-income individuals and families tax credit, introduced in the 2019 budget, continues not to affect the calculation of the Ontario surtax. The community food program donation tax credit for farmers continues to be the last credit to apply in calculating an individual's Ontario income tax.

3. Sales Tax

No changes were announced.

4. Excise Taxes

In the 2020 budget, the government indicated that it would be freezing tax rates applying to beer until March 1, 2022 and proposed to retroactively cancel the increase in basic tax rates for wines legislated to occur on June 1, 2020. The government issued an order under the Financial Administration Act during the state of emergency (owing to COVID-19) that prevents the increase from being applied between June 1, 2020 and December 31, 2020.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

In the 2020 economic and fiscal update,³⁹ the government announced that the planned property tax reassessment for 2021 will be postponed. The 2020 update noted that the postponement provides an opportunity for the government to potentially reflect any advice received through the property assessment and taxation review that was being undertaken at the time of the update.

39 Ibid.

The 2020 budget announced that the government will lower business education tax rates across the province to 0.88 percent for both commercial and industrial properties beginning in 2021. Furthermore, the 2020 budget proposed an amendment, beginning in 2021, that would allow municipalities to adopt a new optional property subclass for small business properties, so that municipalities can target tax relief by reducing property taxes for small business owners. The 2020 budget also indicated that the government would consider matching these municipal property tax reductions by reducing the provincial property tax to provide further support to small businesses, but a formal commitment to this measure was not provided in the 2020 budget.

7. Pensions

The 2020 budget contained proposed amendments to the Pension Benefits Act to support the continued development of a target benefit pension plan framework and to reintroduce certain unproclaimed provisions of the Pension Benefits Act that were scheduled for automatic repeal in 2020.

8. Other

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

QUEBEC (TABLE 17)

Tax Highlights

- Introduction of a variety of tax credits and deductions for corporations
- Introduction of a new tax credit for caregivers to replace current caregiver credits

Tax Changes

1. Corporate Income Tax

As presented in the 2018 budget, effective January 1, 2020, the general corporate tax rate is reduced from 11.6 percent to 11.5 percent, and the net small business corporate tax rate is reduced from 6.0 percent to 5.0 percent. Furthermore, the additional deduction for small businesses in the primary and manufacturing sectors is reduced from 2.0 percent to 1.0 percent in 2020.

The 2020 budget introduced a wide variety of new tax credits for corporations and made minor changes to existing tax credits. A new tax credit for investments and innovation (“the C3i”) will be available to qualified corporations that acquire specified property (manufacturing or processing equipment, computer equipment, or certain management software packages) after March 10, 2020 and before January 1, 2025. The C3i is meant to promote investment in regions in Quebec where the

TABLE 17 Projected Revenues and Expenditures, Quebec, Fiscal Year 2020-21

	March 2020	November 2020
<i>millions of dollars</i>		
Total revenues	121,295	118,733
Total expenditures	(118,566)	(127,080)
Provision for economic risks and other support	nil	(4,000)
Stabilization reserve	nil	12,009
Surplus/(deficit)	<u>2,729</u>	<u>(338)</u>
Revenue sources		
Personal income tax	35,435	35,298
Corporate income tax	8,530	7,667
Sales tax	22,961	20,002
Other taxes	<u>5,555</u>	<u>7,538</u>
Total tax revenue	72,481	70,505
Federal transfers	25,692	30,296
Other revenues	<u>23,122</u>	<u>17,932</u>
Total revenues	<u>121,295</u>	<u>118,733</u>
Expenditures		
Education	25,734	26,083
Health	47,760	52,459
Debt servicing	8,266	7,573
Other expenditures	<u>36,806</u>	<u>40,965</u>
Total expenditures	<u>118,566</u>	<u>127,080</u>

Notes: The figures were presented on a consolidated basis, showing general fund plus consolidated entities. The figures shown for expenditures were presented by department, except for debt servicing. The surplus/(deficit) presented excludes deposits of dedicated revenues in the Generations Fund, a fund dedicated exclusively to repaying Quebec's debt.

Sources: Quebec, Finances Québec, 2020 Budget, Budget Plan, March 10, 2020; and Update on Québec's Economic and Financial Situation—Fall 2020, November 12, 2020.

economic vitality index is low. As a result, the rate of the C3i will range from 10 percent to 20 percent, depending on the region in Quebec where the investment is made. The refundability of the C3i depends on the total assets and gross income of the qualified corporation. The C3i is fully refundable for qualified corporations if their total assets or gross income does not exceed \$50 million and becomes completely non-refundable when either total assets or gross income is equal to or greater than \$100 million. For qualified corporations with total assets or gross income over \$50 million but not more than \$100 million, the C3i will be partially refundable, with the refundability percentage being reduced proportionately as total assets or gross income increases. The expenses eligible for the C3i cannot exceed a cumulative limit of \$100 million. The C3i replaces the former tax credit for investments in manufacturing and processing equipment in Quebec. However, since there is overlap in properties that may qualify for the C3i and the tax credit for investments, a qualified corporation can elect to claim the tax credit for investments

in respect of the expense if the corporation has never previously claimed the C3i on any specified properties.

To encourage the competitiveness of Quebec businesses and foster the retention of intellectual properties developed in Quebec, the 2020 budget introduced the incentive deduction for the commercialization of innovations in Quebec (IDCI) for any taxation year of a corporation beginning after December 31, 2020. The IDCI provides a deduction in calculating the taxable income of qualifying innovative corporations to reduce the effective provincial corporate tax rate on taxable income attributable to qualified intellectual property assets to a rate as low as 2 percent. The basic corporate income tax rate is currently 11.5 percent in Quebec, meaning that the IDCI provides a deduction of up to 9.5 percent of taxable income attributable to qualified intellectual property. A qualifying innovative corporation is a corporation (except a corporation exempt from tax, a Crown corporation, or a wholly controlled subsidiary of a Crown corporation) that has an establishment in Quebec and carries on a business in Quebec from which it derives income from the commercialization of a qualified intellectual property asset. A qualified intellectual property asset is property that resulted from R & D activities carried out in whole or in part in Quebec that produce inventions protected by patents, plant breeders' rights, or software protected by copyright.

The 2020 budget introduced the synergy capital tax credit to support the growth of innovative businesses. This non-refundable tax credit is available to any corporation (other than a financial institution, a corporation in the real estate sector, or a corporation whose activities consist mainly of granting loans or making investments) that subscribes for shares of the capital stock of a qualified corporation in the life sciences, manufacturing or processing, green technology, artificial intelligence, or information automation technology sectors. The tax credit is calculated at a rate of 30 percent of the investor's eligible investment (not exceeding \$750,000) for the year, resulting in a maximum non-refundable tax credit of up to \$225,000 annually. The qualified corporation that would like to issue shares of its capital stock to allow an investor to claim this tax credit must be a CCPC that meets certain conditions with respect to size, sector of activity, and scale of activities in Quebec, and must obtain an authorized placement certificate from Investissement Québec prior to the investment. The 2020 budget indicated that Investissement Québec will issue authorized placement certificates for up to \$30 million of investments annually. The funds obtained by the qualified corporation from the share subscription must be used to make investments related to the carrying on of the corporation's business. Qualified investors are subject to many conditions in respect of the investment, including a condition that the shares be retained by the investor for a minimum period of 60 months. This non-refundable tax credit may be carried back up to three taxation years or carried forward up to 20 taxation years, but cannot be applied to any taxation year that ended before January 1, 2021. Investissement Québec will begin accepting applications for the issuance of an authorized placement certificate filed after December 31, 2020; accordingly, the synergy capital tax credit will apply for share subscriptions that are eligible investments made after December 31, 2020.

To promote equal access to the labour market for persons with disabilities, the 2020 budget introduced a refundable tax credit for small and medium-sized enterprises that employ persons with a severe and prolonged mental or physical impairment. A qualified corporation is a corporation (other than a corporation exempt from tax, a Crown corporation, or a wholly controlled subsidiary of a Crown corporation) that has an establishment in Quebec, carries on business in Quebec, has paid-up capital of less than \$15 million, and has total remunerated hours in excess of 5,000 hours. The refundable tax credit will be equal to the amount of the qualified contributions paid by the corporation in respect of the employees with a severe and prolonged mental or physical impairment and will be available for any taxation year of a qualified corporation ending after December 31, 2019.

The 2020 budget extended the time limit for submitting an application for the initial qualification certificate for the tax holiday for large investment projects in the manufacturing, wholesale trade, warehousing, data processing, data hosting and related services, or development of digital platforms sectors that was announced in the 2013 budget. Prior to the 2020 budget, the application for an initial qualification certificate must have been made before the investment project was carried out and before December 31, 2020. To enable more investment projects to qualify for this tax holiday, the 2020 budget extended the deadline for the application of an initial qualification certificate to December 31, 2024, but the application must still be made before the large investment project is carried out.

The 2020 budget eliminated the exclusion threshold for R & D tax credits for qualified expenditures relating to a university research contract, an eligible research contract entered into with an eligible public research centre, a pre-competitive research project carried out in private partnership, or fees or dues paid to an eligible research consortium. For greater clarity, the elimination of the exclusion threshold does not apply to the R & D salary refundable tax credit, but for the purposes of calculating that tax credit, the rule for the splitting of the exclusion threshold among the various R & D credits will continue to apply as if the definition of reducible expenditures still applied to the other refundable R & D tax credits. This change applies to expenditures incurred by a taxpayer for a taxation year that begins after March 10, 2020.

The 2020 budget also proposed changes to a variety of tax credits for multimedia produced in Quebec. The 2020 budget allows for increased eligibility for the Quebec film or television production refundable tax credit. The conditions defining a film adapted from a foreign format in the case of a film whose primary market is the television market will now also apply to a film whose primary market is the online broadcasting market. Additionally, this credit's higher base rate for French-language films will also apply to French-language films whose primary market is online broadcasting. These changes will apply to a film or a television production for which an application for an advance ruling, or an application for a qualification certificate if no application for an advance ruling was previously filed, is filed with the Société de développement des entreprises culturelles (SODEC) after March 10, 2020.

The 2020 budget increased the refundable tax credit for sound recordings by increasing the limit on the percentage of production costs of the sound recording eligible for this tax credit. The limit of 50 percent of production costs of the sound recording, digital audiovisual recording, or clip eligible for the tax credit is increased to 65 percent for a qualified property for which an application for an advance ruling, or an application for a qualification certificate if no application for an advance ruling was previously filed, is filed with SODEC after March 10, 2020. A similar change was made to the refundable tax credit for the production of performances. The limit of 50 percent of production costs of the performance eligible for the tax credit is increased to 65 percent for any performance whose first eligibility period ends after March 10, 2020 and for which an application for an advance ruling, or an application for a qualification certificate if no application for an advance ruling was previously filed for that period, is filed with SODEC after March 10, 2020.

The 2020 budget also made changes to the definition of the level of activity required for a multimedia title to be recognized by Investissement Québec as an eligible multimedia title for the purposes of both the general component and the specialized component of the refundable tax credit for multimedia titles. A multimedia title may be considered to be controlled by software allowing interactivity if the conditions respecting the user's participation in the action of the title are met for all or substantially all of the action. This change will apply to an application for a certificate filed with Investissement Québec after March 10, 2020 for a taxation year that begins after March 10, 2020.

The 2020 budget narrowed the eligibility criteria for the tax credits for the development of e-business by eliminating “an activity involving the design or development of e-commerce solutions allowing a monetary transaction between the person on behalf of whom the design or development is carried out and that person's customers”⁴⁰ as an eligible activity for the purposes of the tax credits. Such an activity may be an eligible activity if it is incidental to an eligible activity relating to the development or integration of information systems or of technology infrastructures. This change applies to a taxation year of a corporation beginning after March 10, 2020.

The 2020 budget also changed the compensation tax for financial institutions. The changes exclude independent loan corporations, independent trust corporations, and independent corporations trading in securities from the calculation of compensation tax for financial institutions, and subject these entities to the compensation tax that is applicable to other persons. Furthermore, the maximum amount subject to the compensation tax for these corporations will be \$275 million. These changes will apply as of April 1, 2020.

The 2020 budget extended the income-averaging mechanism and the carry-over period for certified forest producers in respect of a private forest in Quebec.

40 Quebec, Finances Québec, 2020-2021 Québec Budget Summary, March 10, 2020, at 8-9.

The 2020 budget also eliminated three tax measures: the deduction for innovative manufacturing corporations is eliminated for a corporation whose taxation year begins after December 31, 2020; the refundable tax credit relating to information technology integration is eliminated for any application for a certificate submitted after March 10, 2020, in light of the C3i credit; and the tax-free reserve for Quebec shipowners is eliminated as of March 11, 2020. The minister of economy and innovation cannot accept an application for a qualification certificate for the tax-free reserve from a qualified shipowner submitted after March 10, 2020. A qualified shipowner that holds a valid qualification certificate that was previously issued by the minister will continue to be able to deduct the tax-free reserve for qualified shipowners if the shipowner continues to meet the conditions for the reserve.

On June 29, 2020, Finances Québec issued *Information Bulletin* 2020-9,⁴¹ which outlined changes to various fiscal measures. Because COVID-19 has forced some corporations to temporarily cease operating, this could have the effect of reducing or eliminating the small business deduction rate from which those corporations would otherwise have been able to benefit, since the total number of remunerated hours may not exceed 5,000 hours. The information bulletin identifies an amendment to tax legislation to provide for an ad hoc adjustment to the calculation of a corporation's remunerated hours for a given tax year that includes the period from March 15, 2020 to June 29, 2020. Temporary discretionary powers will also be granted to departments and agencies that are responsible for the administration of tax incentive measures to allow them to exceptionally issue a qualification certificate or sectoral document, even though the taxpayer does not meet a sectoral parameter that must be met if the taxpayer can demonstrate that its inability to meet the parameter is directly attributable to measures put in place as a result of COVID-19.

On November 6, 2020, Finances Québec issued *Information Bulletin* 2020-12,⁴² which outlined changes to various tax measures. Tax legislation will be amended so that the amount of financial assistance that SODEC grants in accordance with the economic relaunch plan would be considered an excluded amount for the application of the following tax credits for all amounts of assistance granted after March 31, 2020: the refundable tax credit for film dubbing, the refundable tax credit for the production of multimedia environments or events staged outside Quebec, and the refundable tax credit for book publishing.

Furthermore, for the application of the refundable tax credits and other tax incentive measures, the definition of "non-government assistance" currently excludes any amount that was (1) already included in the computation of the taxpayer's income for the year or for a preceding taxation year; (2) deducted in computing

41 Quebec, Finances Québec, *Information Bulletin* 2020-9, "Changes to Various Fiscal Measures," June 29, 2020 (www.finances.gouv.qc.ca/documents/Bulletins/en/BULEN_2020-9-a-b.pdf).

42 Quebec, Finances Québec, *Information Bulletin* 2020-12, "Changes to Various Tax Measures and Harmonization with Certain Federal Tax Measures," November 6, 2020 (www.finances.gouv.qc.ca/documents/Bulletins/en/BULEN_2020-12-a-b.pdf).

any balance of undeducted outlays, expenses, or other amounts for the year or for a preceding taxation year; or (3) an amount received in respect of a restrictive covenant and included in the computation of the income of a person related to the taxpayer. The government indicated this produces a result that does not conform to fiscal policy. Accordingly, a modification to the legislation will remove these exclusions from the definition of non-government assistance for any assistance granted after November 6, 2020.

Finally, the information bulletin indicates that Quebec tax legislation and regulations will be amended to incorporate and harmonize with amendments made to federal tax legislation and regulations with respect to the accelerated investment incentive and an enhanced CCA rate for zero-emission automotive vehicles and equipment that do not already benefit from a temporary enhanced CCA rate of 100 percent.

2. Personal Income Tax

The 2020 budget introduced a new refundable tax credit for caregivers, which replaces all four components of the tax credit for informal caregivers of persons of full age. The tax credit for caregivers comprises two components. The first component is universal basic tax assistance of \$1,250 (which requires co-residence with the individual receiving the care) and an additional maximum amount of \$1,250 (with no co-residence requirement, but subject to clawback). Both amounts require that the individual caregiver provides care to a person aged 18 or older who has a severe and prolonged impairment and needs assistance in carrying out a basic activity of daily living. The additional amount is reduced at a rate of 16 percent for every dollar of income over \$22,180 earned in the taxation year by the individual receiving the care (“the care receiver”). The second component of the tax credit for caregivers is universal tax assistance of \$1,250 for a caregiver who supports and co-resides with a relative aged 70 or older. The first component of the tax credit will be available to caregivers who provide assistance to any of the following eligible care receivers who have a severe or prolonged impairment and require assistance in carrying out a basic activity of daily living: a spouse over the age of 18 but under the age of 70; a family member over the age of 18, even if he or she is able to live alone; or a person over the age of 18 with no family relationship to the caregiver, provided that a health and social network professional certifies that the caregiver is genuinely involved with the eligible care receiver. For the second component, the eligible care receiver must be a direct ascendant of the caregiver or the caregiver’s spouse but cannot be the caregiver’s spouse. For the co-residence requirement, the caregiver must have resided with the care receiver for at least 365 consecutive days beginning in the year or the preceding year, including at least 183 days during the year for which the tax credit is claimed. If the care receiver dies, the 183-day requirement will be eliminated for the year of death. The new refundable tax credit for caregivers replaces the tax credit for informal caregivers of persons of full age as of January 1, 2020. Furthermore, the tax credit for respite of caregivers and the tax credit for volunteer respite services will be eliminated as of January 1, 2021. An overlap exists

in recognition of the fact that certain individuals may have incurred expenses or provided hours of volunteer services since the beginning of 2020; however, for the 2020 taxation year, an individual will not be able to claim, in respect of the same eligible care receiver, both the tax credit for caregivers and the tax credit for respite expenses or the tax credit for volunteer respite services.

The 2020 budget also announced a simplification of payment of the refundable solidarity tax credit for a surviving spouse. To facilitate the administration of the solidarity tax credit and to allow the surviving spouse to continue to receive the government assistance provided by this tax credit as soon as possible following the death of the spouse, the 2020 budget proposes to eliminate the requirement that a surviving spouse formally apply to Revenu Québec by filing schedule D in order to continue receiving the amounts of the solidarity tax credit to which the couple is entitled for the year of death. Instead, Revenu Québec will pay the surviving spouse the balance of the amounts of the solidarity tax credit determined for the couple via direct deposit when information concerning the spouse's death is transmitted to Revenu Québec. This simplification measure for the surviving spouse will apply in all situations where the death of the spouse claiming the solidarity tax credit occurs on or after July 1, 2020.

Information Bulletin 2020-9 indicates that changes will be made to the refundable tax credit for child-care expenses. This credit is available where child-care expenses are incurred to enable the taxpayer or an eligible spouse to perform the duties of an office or employment, carry on a business, carry on research, attend a qualified educational institution, or actively seek employment. Prior to the change, Revenu Québec's interpretation of "to attend a qualified educational institution" required a virtual presence at a fixed or interactive time, which excluded correspondence courses. Changes will be made to adapt the credit to distance learning and allow for courses offered by a qualified educational institution to be taken at a distance without the need for physical presence or, in the absence of such physical presence, virtual presence at a fixed or interactive time with the professor or the class. Physical presence will remain mandatory for courses offered by a secondary school for the purposes of qualification for the tax credit for child-care expenses. This amendment will apply to child-care expenses incurred after December 31, 2019. A similar change was proposed to the disability supports deduction for expenses incurred after December 31, 2019.

Information Bulletin 2020-12, discussed above, indicates that Quebec tax legislation will be amended to allow a deduction in the computation of a taxpayer's income for any reimbursement of COVID-19 benefits payable by the taxpayer no later than the balance-due date, to parallel changes made to the federal Income Tax Act.

Furthermore, the tax credit for holders of a taxi driver's permit will be reduced to 50 percent of the maximum amount that would have otherwise applied for 2021 and will be eliminated starting in the 2022 taxation year. Tax legislation will also be amended to change the conditions for a taxpayer to be entitled to the tax credit for holders of a taxi driver's permit in 2020 and 2021 as a result of the coming into force of the Act Respecting Remunerated Passenger Transportation by Automobile. The

tax credit for holders of a taxi owner's permit will be modified to allow a taxpayer who, as of October 9, 2020, held a taxi owner's permit in force to qualify for the tax credit for any taxation year starting after December 31, 2019.

3. Sales Tax

The 2020 budget reiterated Quebec's determination to see QST collected on movable corporeal property from abroad and indicates that Quebec will work with the federal government to implement harmonized rules for the collection of QST and GST/HST by foreign suppliers in 2021.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

The 2019 budget announced Quebec's intention to standardize the school tax system by establishing a single tax rate applicable to the entire province of Quebec over three years. The 2020 budget proposed an additional reduction in the single school tax rate. Effective July 1, 2020, the school tax rate will be 10.54 cents per \$100 of standardized property assessment.

7. Pensions

Bill 68, An Act Mainly To Allow the Establishment of Target Benefit Pension Plans, was introduced on October 7, 2020 and received royal assent on December 11, 2020. Bill 68 amends the Supplemental Pension Plans Act to allow for the establishment of target benefit pension plans by all employers in Quebec and establishes the requirements for target benefit pension plans. Prior to Bill 68, target benefit pension plans were allowed for employers in the pulp and paper industry. Bill 68 also requires established target benefit pension plans in the pulp and paper industry to amend their pension plan structure to comply with the requirements for target benefit pension plans in Bill 68 by December 31, 2023.

8. Other

The 2020 budget announced efforts to strengthen corporate transparency. Quebec will require businesses to declare information on beneficial owners to the Registraire des entreprises du Québec, make it possible to search the enterprise register using the name of a natural person, and prohibit the issuance of subscription warrants or stock options in bearer form.

The 2020 budget also introduced actions to fight tax evasion and abusive tax avoidance by introducing targeted initiatives in sectors where specific problems

have been observed. The most notable initiative is facilitating tax compliance in the residential renovation sector by simplifying tax compliance using innovative technological solutions developed by Revenu Québec. This initiative is expected to add revenue of \$160 million over five years. Furthermore, Revenu Québec acknowledges the development of new technologies in the financial sector, and the 2020 budget announced the creation of a group bringing together specialists from Revenu Québec, the Autorité des marchés financiers, the police forces, and Finances Québec to propose innovative solutions to better regulate the cryptocurrency sector.

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). Quebec had intervenor status in the cases. The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

NEW BRUNSWICK (TABLE 18)

Tax Highlights

- No changes to corporate or personal income tax rates
- Introduction of carbon tax on gasoline and motive fuels

Tax Changes

1. *Corporate Income Tax*

No changes were announced.

2. *Personal Income Tax*

No changes were announced.

3. *Sales Tax*

No changes were announced.

4. *Excise Taxes*

New Brunswick's carbon tax plan that was accepted by the federal government in 2019 went into effect in 2020. This carbon tax plan resulted in a price on carbon of 6.63 cents per litre of gasoline and 8.05 cents per litre of motive fuel (diesel) effective April 1, 2020.

The 2020 budget proposed a reduction in the provincial gasoline tax from 15.50 cents per litre to 10.87 cents per litre and a reduction in the motive fuel (diesel) tax from 21.50 cents per litre to 15.45 cents per litre. These changes would be effective April 1, 2020 and would result in an effective price on carbon of 2 cents per litre on gasoline and motive fuel (diesel) in 2020-21.

**TABLE 18 Projected Revenues and Expenditures, New Brunswick,
Fiscal Year 2020-21**

	March 2020	May 2020
<i>millions of dollars</i>		
Total revenues	10,278	9,987
Total expenditures	(10,186)	(10,286)
Contingency reserve	nil	nil
Surplus/(deficit)	<u>92</u>	<u>(299)</u>
Revenue sources		
Personal income tax	1,902	1,877
Corporate income tax	368	308
Sales tax	1,538	1,468
Other taxes	<u>1,136</u>	<u>1,087</u>
Total tax revenue	4,944	4,740
Federal transfers	3,705	3,745
Other revenues	<u>1,629</u>	<u>1,502</u>
Total revenues	<u>10,278</u>	<u>9,987</u>
Expenditures		
Education	1,352	1,351
Health	2,939	2,946
Debt servicing	631	650
Other expenditures	<u>5,264</u>	<u>5,339</u>
Total expenditures	<u>10,186</u>	<u>10,286</u>

Notes: Figures were shown on a main estimates basis. About \$324 million of federal transfers was provided in the form of conditional federal grants in the 2020 budget. Expenditure figures were shown by department. Education and health expenditures exclude special-purpose account and special operating agencies expenses.

Sources: New Brunswick, Department of Finance and Treasury Board, 2020 Budget, Budget Plan, March 10, 2020; and Fiscal and Economic Update, May 21, 2020.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

The 2020 budget proposed a reduction in the property tax rate for residential non-owner-occupied properties over a four-year period starting in the 2021 taxation year. The reduction would be phased in as a reduction of 14.04 cents per \$100 of assessment each year from 2021 to 2024. Once fully implemented by 2024, the tax rate on residential non-owner-occupied properties would be 56.17 cents per \$100 of assessment, representing a 50 percent reduction from the current property tax rate.

The 2020 budget also proposed a reduction in the property tax rate for non-residential properties starting in the 2021 taxation year. The reduction would be phased in as a reduction of 8.25 cents per \$100 of assessment each year from 2021

to 2024. Once fully implemented, by 2024 the tax rate on non-residential properties would be \$1.8560 per \$100 of assessment.

On May 27, 2020, the government announced that it would not proceed with the aforementioned property tax reductions in light of the financial impact of the COVID-19 pandemic.⁴³

On November 18, 2020, amendments were introduced to the Assessment Act that proposed to eliminate property tax beginning with the 2020 taxation year for the following local government transit systems: Saint John Transit, Codiac Transpo, and Fredericton Transit.⁴⁴

7. Pensions

No changes were announced.

8. Other

In 2019, Alberta, Ontario, and Saskatchewan appealed to the Supreme Court of Canada to rule on the constitutionality of the federal Greenhouse Gas Pollution Pricing Act (the carbon tax). New Brunswick had intervenor status in the cases. The Supreme Court completed hearings in September 2020, and in March 2021 it ruled that the carbon-pricing regime is constitutional.

NOVA SCOTIA (TABLE 19)

Tax Highlights

- Reduction of the general corporate and small business corporate tax rates
- Increases to tobacco tax and introduction of vaping products tax

Tax Changes

1. Corporate Income Tax

The 2020 budget announced a reduction of the general corporate income tax rate from 16 percent to 14 percent and a reduction of the small business corporate income tax rate from 3.0 percent to 2.5 percent. The reduced rates are effective April 1, 2020.

The 2020 budget also proposed an extension of two corporate income tax credits. The digital media tax credit and digital animation tax credit were set to expire on December 31, 2020, but the 2020 budget proposed that both tax credits be extended to December 31, 2025.

43 New Brunswick, Department of Finance and Treasury Board, "Proposed Property Tax Reductions Will Not Proceed Due to Impact of COVID-19," *News Release*, May 27, 2020 (www2.gnb.ca/content/gnb/en/departments/finance/news/news_release.2020.05.0305.html).

44 New Brunswick, Department of Finance and Treasury Board, "Property Taxes on Local Government Transit Facilities To Be Eliminated," *News Release*, November 18, 2020 (www2.gnb.ca/content/gnb/en/departments/finance/news/news_release.2020.11.0611.html).

TABLE 19 Projected Revenues and Expenditures, Nova Scotia, Fiscal Year 2020-21

	February 2020	December 2020
	<i>millions of dollars</i>	
Total revenues	11,597	11,410
Total expenditures	(11,616)	(12,324)
Reserve and consolidating adjustments	74	135
Surplus/(deficit)	<u>55</u>	<u>(779)</u>
Revenue sources		
Personal income tax	2,980	2,889
Corporate income tax	542	396
Sales tax	2,004	1,916
Other taxes	665	392
Total tax revenue	6,191	5,593
Federal transfers	3,851	4,273
Other revenues	1,555	1,544
Total revenues	<u>11,597</u>	<u>11,410</u>
Expenditures		
Education	1,479	1,583
Health	4,823	5,285
Debt servicing	758	743
Other expenditures	4,556	4,713
Total expenditures	<u>11,616</u>	<u>12,324</u>

Notes: Revenue source figures were for general revenue fund only with adjustments for consolidation. Expenditure figures were shown by department, general revenue fund. Education expenditures are for “education and early childhood development.”

Sources: Nova Scotia, Department of Finance and Treasury Board, 2020 Budget, Budget Plan, February 25, 2020; and Forecast Update, December 17, 2020.

2. Personal Income Tax

No changes were announced.

3. Sales Tax

No changes were announced.

4. Excise Taxes

The 2020 budget proposed increases in the tax rates for all tobacco products sold in Nova Scotia effective February 26, 2020. The tax rate increases from 27.52 cents per unit to 29.52 cents per unit for cigarettes and tobacco sticks; from 26.00 cents per gram to 40.00 cents per gram for fine-cut tobacco; and from 18.52 cents per gram to 40.00 cents per gram for all other tobacco products. The tax rate on cigars increases from 60 percent of the suggested retail selling price to 75 percent of the suggested retail selling price.

The 2020 budget also introduced a new vaping products tax effective September 15, 2020. All vaping substances, including those that do not contain nicotine, will

be subject to tax at a rate of 50.00 cents per millilitre. Vaping devices and their components will be subject to tax at a rate of 20 percent of the suggested retail selling price. All retailers, wholesalers, and manufacturers of vaping products must be licensed to sell their products in Nova Scotia effective July 1, 2020.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

No changes were announced.

PRINCE EDWARD ISLAND (TABLE 20)

Tax Highlights

- Small business tax rate reductions continue
- Basic personal tax credit continues to increase

Tax Changes

1. Corporate Income Tax

As previously announced in the 2019 budget, the small business corporate tax rate was decreased from 3.5 percent to 3.0 percent effective January 1, 2020. The 2020 budget proposed a further reduction in the small business corporate tax rate, from 3.0 percent to 2.0 percent, effective January 1, 2021.

2. Personal Income Tax

The 2020 budget proposed an increase in the basic personal amount, from \$10,000 to \$10,500 for the 2021 tax year. The 2020 budget also proposed an increase in the tax threshold for the low-income tax reduction, from \$18,000 to \$19,000 for the 2021 tax year.

The 2020 budget introduced a children's wellness tax credit effective January 1, 2021. This tax credit is a \$500 non-refundable tax credit for families with children under the age of 18 for the costs of eligible artistic, cultural, recreational, or developmental activities for the children.

3. Sales Tax

No changes were announced.

TABLE 20 Projected Revenues and Expenditures, Prince Edward Island, Fiscal Year 2020-21

	<i>millions of dollars</i>
Total revenues	2,293
Total expenditures	(2,416)
Supplementary appropriation	50
Surplus/(deficit)	<u>(173)</u>
Revenue sources	
Personal income tax	400
Corporate income tax	86
Sales tax	330
Other taxes	246
Total tax revenue	1,062
Federal transfers	1,007
Other revenues	224
Total revenues	<u>2,293</u>
Expenditures	
Education	409
Health	808
Debt servicing	128
Other expenditures	1,071
Total expenditures	<u>2,416</u>

Notes: Revenue and expenditure figures were consolidated. Expenditure figures were shown by department.

Source: Prince Edward Island, Department of Finance, 2020 Budget, Budget Plan, June 17, 2020.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

No changes were announced.

NEWFOUNDLAND AND LABRADOR (TABLE 21)**Tax Highlights**

- No changes to corporate or personal income tax rates
- New tax on vaping products and increased tax on tobacco and fuel

Tax Changes**1. Corporate Income Tax**

No changes were announced.

2. Personal Income Tax

No changes were announced.

3. Sales Tax

No changes were announced.

4. Excise Taxes

The 2020 budget proposed a new 20 percent tax on vaping products effective January 1, 2021. Tax on tobacco products also was increased, effective October 1, 2020, from 24.5 cents per cigarette to 29.5 cents per cigarette, and from 40 cents per gram to 50 cents per gram for fine-cut tobacco.

The 2020 budget also proposed changes to the gas tax in accordance with scheduled federal increases in the price on carbon. The 2020 budget proposed a reduction of the provincial portion of gas tax on gasoline by 2.0 cents per litre. As a result of the changes, effective October 1, 2020, the price of gasoline in the province would increase by 0.21 cents per litre and tax on diesel would increase by 2.68 cents per litre.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

No changes were announced.

TABLE 21 Projected Revenues and Expenditures, Newfoundland and Labrador, Fiscal Year 2020-21

	<i>millions of dollars</i>
Total revenues	7,129
Total expenditures	(8,967)
Oil revenue risk adjustment	nil
Surplus/(deficit)	<u>(1,838)</u>
Revenue sources	
Personal income tax	1,595
Corporate income tax	408
Sales tax	1,105
Other taxes	<u>625</u>
Total tax revenue	3,733
Federal transfers	1,482
Other revenues	<u>1,914</u>
Total revenues	<u>7,129</u>
Expenditures	
Education	1,539
Health	3,352
Debt servicing	1,073
Other expenditures	<u>3,003</u>
Total expenditures	<u>8,967</u>

Notes: The total revenue figure includes net income of government business enterprises and partnerships. Expenditures were reported by department, except for debt-related expenses. Health expenditure covers “health and community services.” Debt servicing included all “debt expenses.” Expenditures were a combination of current and capital account expenditures by department in the government reporting entity on a consolidated basis.

Source: Newfoundland and Labrador, Department of Finance, 2020 Budget, Budget Plan, September 30, 2020.

YUKON (TABLE 22)**Tax Highlights**

- Reduction of the small business corporate tax rate
- Increase to the basic personal amount for individuals

Tax Changes**1. Corporate Income Tax**

The 2020 budget proposed a reduction in the small business corporate tax rate from 2.0 percent to 0.0 percent effective January 1, 2021. The small business investment tax credit program would be expanded in 2020 to allow medium-sized businesses to apply, and the amount of money that a business can raise under the program would be increased. As a result of the changes, the program was renamed the business investment tax credit.

2. Personal Income Tax

The 2020 budget proposed that the basic personal amount would be increased to mirror changes made at the federal level. The increase would be phased in over four years.

3. Sales Tax

No changes were announced.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

To offset the reduction in revenue from the reduction of the small business corporate tax rate, the 2020 budget announced an increase in the insurance premium tax from 2.0 percent to 4.0 percent effective January 1, 2021.

TABLE 22 Projected Revenues and Expenditures, Yukon, Fiscal Year 2020-21

	<i>millions of dollars</i>
Total revenues	1,526
Total expenditures	(1,522)
Reserve	nil
Surplus/(deficit)	<u>4</u>
Revenue sources	
Personal income tax	80
Corporate income tax	14
Sales tax	na
Other taxes	<u>38</u>
Total tax revenue	132
Federal transfers	1,117
Other revenues	<u>277</u>
Total revenues	<u>1,526</u>
Expenditures	
Education	218
Health	461
Debt servicing	12
Other expenditures	<u>831</u>
Total expenditures	<u>1,522</u>

Notes: Expenditure figures for education and health were shown in consolidated and non-consolidated budgets by department. The health figure includes an amount for social services. Non-consolidated reporting was used to reflect the announced surplus/(deficit) figure; the consolidated surplus was reported as \$4 million. Consolidated reporting includes territorial corporations. The debt-servicing figure shown represents expenditures on loan programs. Debt servicing is prorated.

The Yukon government signed a devolution agreement with the federal government in 2003 to assume land and resource management responsibilities. Amendments to the resource revenue-sharing arrangement in 2012 ensured that more resource revenue generated in the Yukon would be available for use in the territory.

On October 1, 2020, the Yukon government issued supplementary estimates no. 1, which forecasts a deficit of \$32 million for fiscal year 2020-21.

Source: Yukon, Department of Finance, 2020 Budget, Budget Plan, March 5, 2020.

NORTHWEST TERRITORIES (TABLE 23)**Tax Highlights**

- No changes to corporate or personal income tax rates

Tax Changes**1. Corporate Income Tax**

No changes were announced.

2. Personal Income Tax

No changes were announced.

3. Sales Tax

No changes were announced.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

Property and education mill rates were adjusted for inflation effective April 1, 2020.

7. Pensions

No changes were announced.

8. Other

No changes were announced.

**TABLE 23 Projected Revenues and Expenditures, Northwest Territories,
Fiscal Year 2020-21**

	<i>millions of dollars</i>
Total revenues	2,186
Total expenditures	(1,896)
Infrastructure contribution, deferred maintenance, fund profit/loss	(87)
Surplus/(deficit)	<u>203</u>
Revenue sources	
Personal income tax	106
Corporate income tax	25
Sales tax	na
Other taxes	<u>146</u>
Total tax revenue	277
Federal transfers	1,785
Other revenues	<u>124</u>
Total revenues	<u>2,186</u>
Expenditures	
Education	340
Health	522
Debt servicing	21
Other expenditures	<u>1,013</u>
Total expenditures	<u>1,896</u>

Notes: Figures showed health and education expenditure by department; the education figure was a composite for the Department of Education, Culture, and Employment, and the health figure included social services. The stated surplus was on a non-consolidated basis.

On April 1, 2014, the Northwest Territories took responsibility for the management of its land, water, and non-renewable resources. The Northwest Territories started to receive resource revenues under devolution in 2014-15; half is offset against federal territorial formula financing grants, up to 25 percent of the balance will be shared with aboriginal governments, and 25 percent of the balance will be saved in the Heritage Fund. The Northwest Territories and the federal government signed a devolution agreement on March 11, 2013.

The debt-servicing amount is assumed to be expenditures classified as “interest” in the summary of expenditures.

A fiscal update address delivered by Finance Minister Caroline Wawzonek on October 16, 2020 indicated that the surplus for fiscal year 2020-21 is expected to decrease to \$60 million as a result of COVID-19.

Source: Northwest Territories, Department of Finance, 2020 Budget, Budget Plan, February 25, 2020.

NUNAVUT (TABLE 24)**Tax Highlights**

- No changes to corporate or personal income tax rates

Tax Changes**1. Corporate Income Tax**

No changes were announced.

2. Personal Income Tax

No changes were announced.

3. Sales Tax

No changes were announced.

4. Excise Taxes

No changes were announced.

5. Resource-Related Matters

No changes were announced.

6. Real Estate Taxes

No changes were announced.

7. Pensions

No changes were announced.

8. Other

No changes were announced.

TABLE 24 Projected Revenues and Expenditures, Nunavut, Fiscal Year 2020-21

	<i>millions of dollars</i>
Total revenues	2,348
Total expenditures	(2,328)
Supplementary requirements, revolving funds, and contingencies	(50)
Surplus/(deficit)	<u>(30)</u>
Revenue sources	
Personal income tax	31
Corporate income tax	21
Sales tax	na
Other taxes	93
Total tax revenue	145
Federal transfers	1,837
Other revenues	366
Total revenues	<u>2,348</u>
Expenditures	
Education	241
Health	496
Debt servicing	na
Other expenditures	1,591
Total expenditures	<u>2,328</u>

Notes: Main estimates were prepared on a non-consolidated basis. Surplus/(deficit) was shown on a main estimates basis and not the public account basis, which funds revenues and expenditures. Expenditure figures appeared to be shown by department and include both operations and maintenance expenditures and capital expenditures. The budget does not present debt-servicing costs separately in the main estimates, and an amount that represents those costs cannot be reasonably determined.

Nunavut is in the process of negotiating a devolution agreement with the federal government. The territory was officially established in 1999 and was formerly part of the Northwest Territories.

Source: Nunavut, Department of Finance, 2020 Budget, Budget Plan, February 19, 2020.

INTERNATIONAL TAX PLANNING

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SUBSECTION 15(2) AND PARTNERSHIPS IN THE FOREIGN AFFILIATE CONTEXT: INTERPRETIVE ARGUMENTS IN THE ABSENCE OF LEGISLATIVE AMENDMENTS

*David Bunn and Mark Dumalski***

The purpose of subsection 15(2) is to include in a shareholder's income amounts received from a corporation, either by the shareholder directly or by certain non-arm's-length persons and partnerships, in the guise of loans or other indebtedness. Specific exceptions exist for amounts owing by certain foreign affiliates, as well as for indebtedness between non-resident persons. Unfortunately, the broad language used in the relevant provisions can lead to anomalous results if those provisions are read and applied literally, without appropriate consideration being given to context and purpose. In particular, the manner in which partnerships have been incorporated into the shareholder loan rule can bring into question the potential application of subsection 15(2) in the foreign affiliate context. This article explores three examples of situations involving partnerships and foreign affiliates where a literal interpretation of the shareholder loan rule could lead to anomalous results. The article then outlines why it is reasonable to conclude, when considering the text, context, and purpose of subsection 15(2) and its related provisions, along with their legislative history, that the shareholder loan rule does not apply in the circumstances described in the examples.

KEYWORDS: PARTNERSHIPS ■ FOREIGN AFFILIATES ■ SHAREHOLDERS ■ LOANS ■ DEBT ■ STATUTORY INTERPRETATION

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CORPORATE TAX PLANNING

Co-Editors: Mark Brender,* Brian R. Carr,** Michael R. Smith,*** and Christopher J. Steeves****

STRATEGIES FOR TROUBLED TIMES, AGAIN

*Christopher J. Steeves**** and Kathryn Walker******

This article addresses income tax issues associated with the various strategies that corporations can employ in response to economic difficulties, focusing on debt-restructuring techniques and tax consequences for debtors. First, the article discusses the tax effects of the most fundamental debt-restructuring issues—interest deductibility and the deductibility of planning costs. Second, considering the out-of-court approaches to debt restructuring, the article examines the tax consequences that may arise where a debtor company and its creditors are able to agree on accommodations that will provide some financial relief for the debtor. Third, the article comments on the potential for the debt-parking rules to apply in the context of the assignment of debt by a creditor. Fourth, the article examines the tax implications of a debt-for-equity exchange, pursuant to which an outstanding debt is exchanged for shares in the debtor corporation. Fifth, the article presents the key tax issues that emerge where a debtor corporation sells assets as a way to mitigate debt pressure. Finally, the article considers tax questions relevant to the statutory (in-court) debt-restructuring options offered by corporate-law statutes, such as the Canada Business Corporations Act, and insolvency statutes, such as the Companies' Creditors Arrangement Act.

KEYWORDS: DEBT RESTRUCTURING ■ INTEREST DEDUCTION ■ DEBT FORGIVENESS ■ DEBT PARKING ■ DEBT FOR EQUITY EXCHANGE ■ ASSET SALE

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CURRENT TAX READING

Co-Editors: Robin Boadway, Kim Brooks, Jinyan Li, and Alan Macnaughton*

Jennifer Robson and Saul Schwartz, “Who Doesn’t File a Tax Return: A Portrait of Non-Filers” (2020) 46:3 *Canadian Public Policy* 323-39
(<https://doi.org/10.3138/cpp.2019-063>)

This article provides empirical data on the size of the non-filing population, the determinants of non-filing, and the value of social benefits forgone because of non-filing.

The situations of people who do not file personal tax returns vary, but these people may be said to fall into two categories. The first category includes people who still owe taxes after their taxes are withheld at source or are paid through instalments. Such non-filing could be an intentional act by these people, who seek to avoid being forced to pay the outstanding balance—in which case, tax evasion has occurred. (One reason to study non-filers is to identify a class of tax evaders.) The second category of non-filers includes those who owe no tax at all after their tax payments have been made. A large majority of these people are probably eligible to receive government benefits. A second reason for studying non-filers is to measure the effectiveness of social programs (for example, the Canada child benefit) at reaching people in need.

A main focus of this article is the size of the non-filing population. Although there are many hypotheses about what causes people not to file, aggregate data is not well suited to answering questions about individual motivation. Individual-level data on the direct and indirect costs of tax filing would be required to study this issue.

An approach to identifying non-filers that requires only publicly available data is to compare, on the basis of statistical data, the number of Canada’s population aged 15 and over with the number of tax returns filed. Using this approach, the authors produce a national non-filing rate of 9.3 percent for 2016.

A second approach to identifying non-filers is to examine data produced as a by-product of Statistics Canada’s survey work. Statistics Canada has an ongoing

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program that involves matching its survey respondents with their tax returns for the purpose of determining income amounts. Income data are obtained by gaining people's permission to access their tax return data rather than by asking them to identify these amounts themselves (either from memory or by consulting their own personal files). The data thus obtained are both more accurate and less burdensome for the respondents to provide. This is an effective approach: the vast majority of people (98 percent, according to one survey) agree to provide such access.¹ Thus, Statistics Canada runs an extensive matching program, and the group of people whom Statistics Canada has failed to match with a tax return can be considered to be non-filers. By this measure—according to the sample of approximately 24,000 people reached by Statistics Canada as part of the 2016 Survey of Consumer Finances (SFS)—13.7 percent of the population aged 15 or over are non-filers. However, given that the SFS is not completely representative of population subgroups, the better estimate is that 12.3 percent (2.4 million/19.5 million) of Canada's working-age population in 2016 were non-filers.

There appear to be two sources of error in this figure of 12.3 percent. First, the article notes that returns filed more than approximately one year late are not included in the matching. This exclusion would cause the figure to be on the high side, although previous research suggests that this inaccuracy may not be significant. Second, the data used for matching include name, address, date of birth, current age, labour force status, and a general estimate of total annual income as reported in the interview—but not social insurance number. Since failure to find a match does not mean that a match does not exist, this exclusion would seem to be a second reason for the 12.3 percent figure to be too high. The article's only comment in this regard, however, is that matching is subject to error that cannot be observed or reasonably estimated, and no direction for the error is suggested.

In addition to measuring the non-filing rate for the population as a whole, the authors also attempt to separate out the factors that contribute to non-filing. This is done through the estimation of two logistic regression models, one for women and one for men. (Non-filing rates are higher for men than for women—13.6 percent as opposed to 11.3 percent—and, as noted below, have different determinants.) In brief, the findings are that higher non-filing rates are associated with the following characteristics: Ontario residence; single status (for men only); having children 18 and over (for women only); and having self-employment as the main source of income (for men only).²

Finally, the article attempts to measure the value of government benefits lost to Canadians because of non-filing. The results are reported for families rather than for individual taxpayers; government benefits are generally paid according to family income. The authors disaggregate the results into six family types and into three types of government benefits—the goods and services tax/harmonized sales

1 See note 8 in the article.

2 Table 3.

tax (GST/HST) credit, the working income tax benefit,³ and federal and provincial child benefits. The value of the benefits forgone because of non-filing was highest for single parents and couples with children (averaging about \$3,000–\$4,000), while singles living alone and couples with no children had much smaller losses (averaging \$200–\$250).⁴ In terms of the cost to the federal and provincial fisc, this added up to \$1.7 billion for the 2017 benefit year.⁵

The study poses many questions for future research to address. In particular, how many people are non-filers for tax evasion purposes? The income reported on the survey could be suspect, in the case of such people, and thus the calculations of forgone government benefits would be incorrect. Also, if we assume, instead, that the income numbers are correct, why would so many people be missing out on such large amounts of government benefits? And are the study's single-year forgone benefit amounts consistent over time? In other words, are the same people missing out on these government benefits year after year?

A.M.

Florian Scheuer and Joel Slemrod, "Taxing Our Wealth,"

Journal of Economic Perspectives (forthcoming)

This is a succinct and accessible analysis of proposals for an annual wealth tax. A primary aim of such a tax is to shift the tax burden to the more affluent members of society. In this article, the notion that inequality of income and wealth has been rising over the past four decades is viewed as beyond dispute. Wealth, much more than income, is concentrated in a small group, so wealth is an attractive tax base for attacking inequality.

The authors begin by briefly discussing issues related to the base and rate of a wealth tax. First, according to standard models, a wealth tax at rate t is equivalent to a tax rate of t/r on capital income, where r is the interest rate. Thus, for an asset whose rate of return is 8 percent, a 4 percent wealth tax corresponds to an annual 50 percent tax on capital income. Thus, tax rates that might sound low in an income-tax or sales-tax context are effectively much higher when considered in a wealth tax context. Second, and finally, a wealth tax is not sensitive to the amount of income actually generated from that wealth; the wealth tax applies even if the rate of return on that wealth is zero or negative.

Next, the article turns to a description of existing and proposed wealth taxes. Much attention is paid to Switzerland. The Swiss wealth tax raises by far the most revenue as a share of total tax revenue, and it is comparable in that regard to wealth tax proposals made recently by US presidential candidates Elizabeth Warren and Bernie Sanders. Notable differences between the Swiss wealth tax and the proposed

3 The recasting of this as the Canada workers benefit occurred in 2019, after the year studied.

4 Table 4.

5 Table 5.

US tax are the exemption levels (US\$55,000 to US\$250,000, depending on the Swiss canton, as compared with \$50 million and \$32 million, respectively, for the Warren and Sanders plans) and the top marginal rates (0.1 percent to 1.1 percent, depending on the Swiss canton, as compared with 6 percent and 8 percent for the Warren and Sanders plans). Wealth taxes in other European countries are even more different from the US proposals. Thus, evidence about the effects of European wealth taxes may be of little use when it comes to evaluating current wealth tax proposals.

The article also compares wealth taxes with property taxes, estate and inheritances taxes, and capital gains taxes. A property tax applies to only one component of wealth, and that particular component amounts to less in the wealth of the richest people than it does in the wealth of upper-middle class people. The effective rate of tax on asset value varies widely, but it averages about 1.1 percent.

Regarding the possible evasion of a wealth tax, the authors note that studies of European wealth tax indicate high rates of evasion, but they also observe that evasion may be increasing in difficulty as a result of the Foreign Account Tax Compliance Act (FATCA) and the growth—which FATCA largely spawned—in the international exchange of information. Also, regarding comparisons between the wealth tax and the US estate tax, the high rates of avoidance and evasion for the latter may not extend to a wealth tax because the higher frequency of reporting (annually instead of just once) make it much harder to systematically conceal wealth.

The article also discusses normative questions, beginning with the Atkinson-Stiglitz result in respect of a wealth tax: any tax on capital income is undesirable, according to this theorem, because it is Pareto-inefficient. The authors describe this result as being useful as a conceptual baseline but not as a guide to policy action, because it holds true only for unrealistic assumptions. After developing new mathematical propositions based on more appropriate assumptions, the authors conclude that the modern theory of optimal taxation lends support, after all, to the imposition of such an annual wealth tax.

The article concludes by addressing issues that extend far beyond economic questions, into questions of political economy. Will the growing inequality of income and wealth lead to adverse political outcomes? At one extreme is a concern that excessive inequality may allow the rich to tilt the political system in their favour. At the other extreme is a concern that an increase in the concentration of wealth could lead to instability in the political system and, possibly, to revolution and radical redistribution. But is a wealth tax the appropriate tool for addressing these two concerns?

A.M.

Florian Scheuer and Joel Slemrod, “Taxation and the Superrich” (2020)

12 *Annual Review of Economics* 189-211. Also available as **Florian Scheuer and Joel Slemrod, *Taxation and the Superrich*, National Bureau of Economic Research Working Paper no. 26207** (Cambridge, MA: NBER, August 2019)

This paper surveys what is known about the taxation of the super-rich, with a focus on the United States. The minimum qualification for this group, commonly defined as “the Forbes 400,” is wealth of US\$2.1 billion. The article focuses on normative questions—that is, how this group should be taxed.

Realized capital gains form 60 percent of total adjusted gross income for the 400 Americans with the highest adjusted gross income.⁶ This statistic is important because much of the capital gains reported by this group may in fact be disguised compensation for labour—especially the sale of stock that was founded by the taxpayer or by a relative of the taxpayer (often called “founders’ stock”). An additional issue is the step-up in basis on death, which can cause a large amount of capital gains in the US tax system to escape tax forever—a non-problem in Canada, where we have a deemed disposition on death rather than a step-up in basis. Thus, the article concludes that, with different kinds of income being taxed at different rates and with the tax law in some cases allowing income not to be taxed at all, a big issue is the “plasticity” (that is, malleability) of the tax base for the super-rich.

Much of the paper is devoted to incorporating into the standard economic (Mirrlees) model of optimal taxation a richer modelling of labour markets, especially superstar effects (that is, when a few people with slightly superior skills reap disproportionate economic rewards). This modelling produces few policy conclusions, although it does produce a clear agenda for future research.

A.M.

Arun Advani, Emma Chamberlain, and Andy Summers, *A Wealth Tax for the UK, Final Report* (Wealth Tax Commission, 2020)

The Wealth Tax Commission published its final report, *A Wealth Tax for the UK*, which recommends the levy of a one-off wealth tax to raise revenues to address the financial pressure caused in the United Kingdom by the COVID-19 pandemic, and by inequality. The report has generated public debates, and its proposals were discussed at the House of Commons Treasury Committee’s inquiry into tax after coronavirus.⁷ It should be noted, however, that this so-called commission was not appointed by the government; it consisted of an independent group of academics and practitioners brought together by the London School of Economics and Political Science (LSE) and the University of Warwick. The authors of the report are

6 At 7.

7 See Hamant Verma, “Could a UK Wealth Tax Work? MPs Question Experts,” *Chartered Institute of Taxation*, November 25, 2020 (www.tax.org.uk/media-centre/blog/media-and-politics/could-uk-wealth-tax-work-mps-question-experts).

Arun Advani (assistant professor in economics at Warwick), Emma Chamberlain (a barrister), and Andy Summers (associate professor at LSE).

The report comprises six chapters, an appendix on the taxation of trusts and non-residents, and glossary terms. A foreword was penned by Lord Gus O'Donnell, cabinet secretary and head of the civil service (2005-2011) and former permanent secretary to HM Treasury. Chapters 1 to 3 provide an introduction and an overview of what a wealth tax is and why a wealth tax is needed. Chapter 4 proposes a one-off wealth tax and lays out the principles of such a tax (revenue, efficiency, fairness, avoidance, and alternatives); design issues (for example, who and what is taxed, how to value assets, and how to address the liquidity challenge of “wealth-rich and cash-poor” taxpayers); administrative matters; the design of thresholds and rates; and the delivery of the new tax. Chapter 5 considers the annual wealth tax in terms of principles, design features, and delivery. Chapter 6 offers conclusions and recommendations.

The report draws on research papers—written by a network of “world-leading experts on tax policy”—that represent, according to the report's three authors, “the largest repository of evidence on wealth taxes globally to date.”⁸ But the report's recommendations are the authors' own. The report avoids recommending the rates or thresholds that should apply under a wealth tax, which are considered to be “archetypal matters of political judgement and democratic deliberation.”⁹ It recommends a one-off wealth tax as opposed to an annual wealth tax, mainly because the former (1) can raise substantial revenue (£260 billion if all individual wealth above £500,000 is taxed at the flat rate of 5 percent or £80 billion revenue if the threshold is £2 million); (2) is better than the possible alternatives (for example, increasing the income tax rate by 9 percent or the value-added tax by 6 percent); and (3) does not distort behaviour and therefore would be economically efficient. The report suggests that the COVID-19 crisis would help increase public support for the one-off tax and that the new technological facilities and enhanced requirements with respect to the disclosure of offshore wealth would enable the administration of a wealth tax.

It is no secret that countries need to find ways of raising revenues to pay for the expensive COVID-19 relief programs and to finance the post-COVID-19 economic recovery. Also, the COVID-19 pandemic has highlighted wealth inequality as a social condition that needs to be addressed. Taxing wealth seems like a good idea. Argentina, for one, has just passed legislation to levy a one-off wealth tax.¹⁰

For tax policy makers and students of taxation, the report itself and the background papers are worth reading.

J.L.

8 At 6.

9 Ibid.

10 See Sebastian Boyd, “Argentina To Hit the Rich with Wealth Tax as Covid-19 Costs Rise,” *Bloomberg*, December 5, 2020 (www.bloomberg.com/news/articles/2020-12-05/argentina-to-hit-the-rich-with-wealth-tax-as-covid-19-costs-rise).

Ian Irvine and Miles Light, “The Tax Consequences of Legal Cannabis”(2020) 46:3 *Canadian Public Policy* 305-322

(https://doi.org/10.3138/cpp.2019-062)

This article simulates the effect of the legalization of cannabis within a demand model for alcohol, tobacco, cannabis (sourced legally or illegally), and other recreational goods. Market parameters, such as the various elasticities of demand, are obtained from previous research. The cannabis market is assumed to be in a condition of long-run equilibrium, so outlets are plentiful, prices are set by vendors, and consumers purchase according to their preferences. The legalization of cannabis is treated as having caused a large decrease in the legal-market price, from essentially infinity to the new price. This price is assumed to be 88 percent higher than the illegal-market price.¹¹ Legalization is assumed to have caused a 10 percent increase in the volume of cannabis consumed. Since many of the parameters of the model are subject to some uncertainty, a variety of outcomes are presented.

The key result of the model is that sales tax revenues and excise tax revenues from legal cannabis may be fully offset by reduced revenues from alcohol and tobacco. This is not all that surprising, perhaps, given that consumers' incomes do not rise with the legalization of goods: household budgets remain fixed, and thus the move to purchases of cannabis in the legal market necessarily implies a decreased consumption of other goods. Some of this decrease will be in the consumption of untaxed illegal cannabis, but much of it will be in the consumption of alcohol and tobacco, which generally have higher tax rates than legal cannabis. This difference in tax rates was a deliberate choice by governments seeking to reduce the size of the illegal cannabis market as much as possible.

A second result of the model is that new revenue will accrue from personal income tax and corporate income tax: it is assumed that people producing and selling cannabis in the illegal market do not pay tax but that income from legal-market cannabis activities is fully taxed. This is personal income tax for employees in the industry, and corporate income tax for cannabis businesses. With legalization, the result of the model is that two-thirds of sales now come from the legal market.

A.M.

Gretchen Lawrie and Yang Zhang, “KPMG Canada’s Isle of Man Offshore**Company Tax Strategy”** (2018) 4 *Journal of Case Research and Inquiry* 48-64

This is a case prepared for class discussion that summarizes the Isle of Man offshore company structure marketed by a Canadian accounting firm to some of its clients in the 2000s. The case also discusses the development and marketing of the structure, and the structure's consequences for some of the clients involved and for the accounting firm itself. Several original documents are cited. The case also provides introductory discussions of relevant provisions of Canadian tax law and US tax law;

11 Appendix A.

the case appears to be intended for classroom use by American students beginning their tax studies. An instructor's manual is available. Coverage of developments appears to end in mid-2016; the late-2016 decision in *Canada (National Revenue) v. KPMG LLP* is not discussed.¹²

A.M.

Adil Sayeed, "COVID-19 Blunts Alberta Challenge to Federal-Provincial Income Tax" (2020) 46:S3 *Canadian Public Policy* S300-6
(<https://doi.org/10.3138/cpp.2020-073>)

This article points out a little-known aspect of the present tax collection agreement (TCA) structure: when an economic downturn occurs, provinces receive a cash flow benefit. This benefit, according to the article, may be huge in 2020. In particular, the TCA system provides that federal instalment payments for 2020 personal income tax revenue were based on pre-COVID-19 forecasts of economic growth, even though personal income tax revenue for the 2020-21 fiscal year was at one point expected to be 14 percent lower than in the previous year.¹³

If that same percentage drop applied to the revenue of Alberta, the province would have been paid over \$1 billion more under the TCA system than the province's actual revenue would have merited. Furthermore, generous repayment terms built into the TCA provide that Alberta would not have to repay the excess until 2024-25, and no interest would be charged in the interim.¹⁴ Perhaps this provision of the TCA is reasonable; the article notes that the government of Canada can borrow funds at better rates than any province can.

Updated figures issued on November 30, 2020 (not available when the article was written) suggest that personal income tax revenue for 2020-21 dropped only 3.3 percent relative to the previous year, rather than the 14 percent projected in July 2020.¹⁵ Thus, the TCA system's benefit to provinces may turn out to be less significant than described.

Other portions of the article discuss Alberta's flirtation with pulling out of the TCA system. The article argues that, because of the pandemic, this is unlikely to happen for some time, given the cash flow benefit discussed above and the general

12 See 2016 FC 1322; Henry Shew and Jody Wong, "MNR v. KPMG: Professional Duty Overruled" (2017) 7:1 *Canadian Tax Focus* 7-8; and Daniel Bourgeois, Cheryl Gibson, and Martha MacDonald, "Current Cases," in *Report of Proceedings of the Sixty-Ninth Tax Conference*, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 1:1-22.

13 Canada, Department of Finance, *Economic and Fiscal Snapshot* (Ottawa: Department of Finance, July 8, 2020). This forecast is for federal revenue, which is probably a reasonable forecast for provincial revenues in the aggregate. Individual provinces could be higher or lower.

14 At \$303.

15 The drop is projected to be from \$167.6 billion to \$162.1 billion: see Canada, Department of Finance, Fall Economic Statement 2020, Supporting Canadians and Fighting Covid-19, November 30, 2020, at 127.

unwillingness of provinces to spend money on new projects not related to public health or economic recovery.¹⁶

A.M.

Ben Eisen and Milagros Palacios, *The Great Convergence: Measuring the Fiscal Capacity Gap Between “Have” and “Have-Not” Provinces* (Vancouver: Fraser Institute, December 2020) (www.fraserinstitute.org/sites/default/files/great-convergence-measuring-the-fiscal-capacity-gap.pdf)

Fiscal capacity—own-source revenues calculated on the assumption that tax rates are set at the national average—measures the ability of a province to generate revenue for financing expenditures. This report documents the fiscal capacity of each province from 2007-8 to 2020-21 (for the last two years, the figures are projected) and draws conclusions regarding provincial budgeting and the federal government’s equalization program. For this purpose, fiscal capacity includes 100 percent of resource revenues.¹⁷

It is well known that fiscal capacity varies dramatically across provinces, but it is less well known that the gap in fiscal capacity between richer and poorer Canadian provinces has shrunk dramatically in recent years—an event that the report calls “the great convergence.” The accompanying figure, taken from the report (reproduced by permission), demonstrates this convergence clearly.¹⁸

Furthermore, the rankings of provincial fiscal capacity have changed significantly. Alberta has had the highest fiscal capacity since at least 1967. In 2007-8, Alberta’s fiscal capacity was 93 percent greater than the other provinces’. For 2020-21, the report estimates that this gap between Alberta and the other provinces will have fallen to 4 percent.¹⁹ Alberta is estimated to have only a little more than half (55 percent) of the fiscal capacity per person (in 2020 dollars) that it had in 2007-8.²⁰ The fall in oil prices provides most of the explanation for this decline,

16 For further discussion of this TCA provision and the merits of Alberta pulling out of the TCA system, see H. Michael Dolson, “Should Alberta Collect Its Own Personal Income Tax?” (2020) 10:1 *Canadian Tax Focus* 7.

17 The authors inform me that for every year through 2018-19, the data are the fiscal capacity numbers drawn from the Finance Canada workbooks used in the calculation of equalization entitlements. For 2019-20 and 2020-21, the official numbers are not available and are estimated on the basis of data from provincial budgets and/or fiscal updates. For instance, resource fiscal capacities for 2019-20 and 2020-21 are forecasted by adjusting the last official number according to the percentage change in resource revenues presented on the budget and/or fiscal updates. Meanwhile, the non-resource fiscal capacity figures are estimated by adjusting each last official number according to the percentage change in actual non-resource revenues. Two exceptions to this procedure are described at 6-7.

18 At 3.

19 At 1.

20 At 5.

Per-Capita Fiscal Capacity (Non-Resource Revenues plus 100 Percent Resource Revenues), 2007-8 to 2020-21

Source: Ben Eisen and Milagros Palacios, *The Great Convergence: Measuring the Fiscal Capacity Gap Between “Have” and “Have-Not” Provinces* (Vancouver: Fraser Institute, December 2020), at 3, figure 1.

but the report shows that Alberta’s non-resource revenues have fallen, too, from 47 percent above Ontario’s revenues in 2014-15 to 3 percent below Ontario’s revenues in 2020.²¹

For Alberta, the budgeting implications are stark. When the province had a big advantage in fiscal capacity over the rest of Canada (almost double in 2007-8, as noted above), it was able to have both low tax rates (for example, no sales tax) and high per-capita spending (second in per capital program spending)²² without running large budget deficits (between 2010 and 2014, its largest deficit was 1 percent of gross domestic product).²³ The new situation was well summarized by Alberta’s finance minister in 2019: “We can no longer spend like we’re the rich kids on the block because, quite frankly, we’re not anymore.”²⁴ A detailed analysis of how to address this budgeting gap is said to be outside the scope of the report.

The accompanying figure shows that Alberta is the big loser in terms of fiscal capacity, while other provinces have either lost less than Alberta or have stayed

21 At 8.

22 At 6-7.

23 At 7.

24 At 8.

stable (this is currently the case, at any rate, before the effects of COVID on fiscal capacity are fully known). The report forecasts that in 2020-21 (the current budget year), Alberta will have given up its lead in fiscal capacity to British Columbia. Saskatchewan will be second, Alberta third, and Ontario fourth.²⁵ The lowest-ranking province will be New Brunswick, followed by Prince Edward Island and by Newfoundland and Labrador. This is a sharp fall for Newfoundland and Labrador, which had the second highest fiscal capacity in the country in 2010-11.²⁶

The report observes that budgeting in equalization-receiving provinces (currently Quebec, Manitoba, and the three maritime provinces) is especially complicated, in that forecasting own-source revenue is not enough; one also has to forecast changes in the equalization payments from the federal government. The report does not attempt to forecast the amounts of these payments. Instead, it makes a number of observations about the complexity of such forecasts over the next few years. In particular, payments to existing recipients could fall with the arrival of new equalization recipients—and the report suggests that Alberta and Ontario are candidates for such payments. The report makes a plausible case that this unwelcome possibility is more or less in keeping with current trends.

A.M.

Sherra Profit, *Reaching Out: Improving the Canada Revenue Agency's Community Volunteer Income Tax Program* (Ottawa: Office of the Taxpayers' Ombudsman, June 2020), 50 pages

The Canada Revenue Agency's (CRA's) Community Volunteer Income Tax Program (CVITP), operated through partner organizations across the country, helps individuals with modest income and a simple tax situation comply with their tax-filing obligations and access the benefits and credits to which they are entitled. In the 2018-19 program year, about 835,200 returns (3 percent of all returns in Canada) were filed under the program.²⁷ In Quebec, the CVITP program is operated in conjunction with Revenu Québec, and volunteers prepare both federal and provincial returns. This comprehensive and thoughtful report is the result of a study requested by the minister of national revenue in connection with an increase in the CVITP's funding in the 2018 budget. The ombudsman reports on a number of obstacles that prevent the CVITP from reaching its full potential and makes numerous recommendations for improvement, only a few of which are discussed here.

The CRA's role in the CVITP program is mainly to train volunteers, provide software, and provide assistance to CVITP volunteers (such as a dedicated phone

25 At 5.

26 At 10.

27 The numerator is from page 6. The denominator of 30,346,932, for the total number of 2019 returns, is from Canada Revenue Agency, "Individual Income Tax Return Statistics for the 2020 Tax-Filing Season" (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/individual-income-tax-return-statistics.html).

number). The partner organizations do the rest, including allocating paid staff to the program (not all “volunteers” are donating their time). CRA employees do not prepare returns. The CRA does not provide or direct funding to partner organizations, so they must raise funds on their own. The ombudsman recommends that the CVITP provide program funding for partner organizations to pay their employees, noting that “[t]he CRA cannot promote the CVITP as its program and tax credit for the program’s successes, while distancing itself to mitigate liability risks, and not assuming some responsibility for the cost of operating the clinics.”²⁸ Although the CRA informed the ombudsman’s office that such direct funding would require that a “grants and contributions” program be in place, the report notes that one was in place until 2011 and suggests that the CRA review and reconsider its decision not to have such a program.

The CVITP’s definition of a “modest income” is \$35,000 for a single individual, \$45,000 for a couple, and \$50,000 for a couple with two children. The CVITP considers a simple tax situation to include interest income under \$1,000, employment income, pensions, support payments, scholarships, and benefits from employment insurance, disability, and social assistance.²⁹ Among the items that would disqualify a return from the program are self-employment income, employment expenses (presumably paragraph 8(1)(f) salespersons’ expenses), and capital gains or losses.³⁰ However, CVITP organizations and volunteers have the ability to complete returns outside these guidelines.³¹ The report recommends that these restrictions on access be reduced.

The report devotes considerable space to the difficulties of accessing services—problems caused by barriers in the CRA’s authentication and authorization processes. This problem is not limited to the CVITP. The report notes: “We repeatedly hear about difficulties individuals face passing the CRA’s authentication questions to validate their identity when contacting the CRA for information. These difficulties especially arise with the more vulnerable segments of the population, including those using the CVITP.”³² People facing these problems include “housing-insecure” people who move frequently and do not inform the CRA; newcomers to Canada who face language barriers in telephone communication; and people whose record-keeping practices do not allow them to provide the CRA phone agent with an

28 At 24.

29 At 7.

30 Since the report was published in May 2020, a limited exception for self-employment income has been added: income reported in box 48 of the T4A that is under \$1,000 where no expenses are claimed: Canada Revenue Agency, “About Free Tax Clinics,” under the heading “Eligibility Criteria” (www.canada.ca/en/revenue-agency/services/tax/individuals/community-volunteer-income-tax-program/lend-a-hand-individuals/about.html).

31 At 7. The website is stricter about the types of income, noting that training is not provided for these other types of income, and volunteers should not prepare returns that contain such items: see “About Free Tax Clinics,” *supra* note 30, under the heading “Eligibility Criteria.”

32 At 14.

amount on a particular line of a past return. The CRA's response to this concern is that "[w]hen deciding what constitutes a valid consent [for release of information], the CRA is not engaging in a service oriented risk/benefit balancing act. Rather, it is bound by law to take necessary measures not to commit a criminal offence."³³ The CRA has a point, but does that mean that there is no answer to the problem? The report does not go so far as to advocate a change in the law, perhaps because such a recommendation is outside the scope of an ombudsman report, but this is something that needs to be considered.

A.M.

Eduardo Baistrocchi, "The International Tax Regime and Global Power Shifts," *Virginia Tax Review* (forthcoming) (<http://dx.doi.org/10.2139/ssrn.3744992>)

This article claims that the centre of world economic power has been shifting over the past 100 years—from the United Kingdom to the United States in the 1930s, and from the United States to China in the early 21st century—and that this power shift is correlated with the evolution of the international tax regime. The author offers historical empirical evidence to support these claims. Regarding this shift's normative implications for a solution to the emerging problems of taxing the global digital economy, the article states that a multilateral rule-based resolution is unlikely to emerge because, among other reasons, no jurisdiction or group of jurisdictions has emerged so far that has influence in global international tax policy comparable with US influence. In other words, while the hegemonic influence of the United States is declining, a new hegemon has not yet emerged:

The hegemon's role in the international tax sphere is usually to provide some underlying purpose and coherence, which the U.S. has done from 1933 until 2015 through, for example, its support for the ALP [arm's-length principle]. The hegemon, which is normally the major capital exporter, is really pursuing the interests of the hegemon's capital, and it uses the ideas and the sense of purpose, to generate consent for its hegemony.³⁴

J.L.

Shafik Hebous, *Global Firms, National Corporate Taxes: An Evolution of Incompatibility*, IMF Working Paper no. WP/20/178 (Washington, DC: International Monetary Fund, September 2020)

This paper—by reviewing and synthesizing the literature on international trade, public finance, and firm market power—seeks to explain why the international corporate tax framework ("the tax framework") is increasingly difficult to apply to

³³ At 16.

³⁴ At 51.

global firms. It notes, first, that the difficulty is not distinctively new: multinational enterprises (MNEs) existed at the tax framework's inception, 100 years ago. But the "global" nature of enterprises today exacerbates the weaknesses of the tax framework, which was created with an "international" company in mind. The residence versus source distinction (including the "physical presence" requirement in the source country) and the transfer-pricing rules are increasingly incompatible with the business reality of global firms today. For example, the paper states that "the typical global firm of today produces in and for the global market, which incapacitates the notion that production and business can be easily separated by national boundaries."³⁵ Also, as the author says, "[t]he owners of the global firm are all over the globe, and so are its customers."³⁶

This paper's contribution to the debates about reforming the tax framework is that it summarizes succinctly, through charts and figures, the incompatibility between the structure of the tax framework and the structure of global firms. It concludes that MNEs have evolved while the tax framework has not been able to, and arguably cannot, "get up to speed."³⁷

J.L.

Craig Elliffe, "International Tax Frameworks: Assessing the 2020s Compromise from the Perspective of Taxing the Digital Economy in the Great Lockdown" (2020) 74:9 *Bulletin for International Taxation* 532-49

This article uses the unprecedented global economic recession triggered by the COVID-19 pandemic as a backdrop for assessing the proposals by the Group of Twenty/Organisation for Economic Co-operation and Development (G20/OECD) base erosion and profit shifting (BEPS) Inclusive Framework to reallocate taxing rights on automatic digital services (ADS) and consumer-facing businesses (the so-called pillar 1 proposal) and to impose a global minimum corporate tax on MNEs (the so-called pillar 2 proposal). The author characterizes these proposals as the "2020s compromise," aimed at addressing seven problems with the "1920s compromise" that was created after the First World War as the foundation of the existing international tax framework. Among the seven problems identified by the author are the vanishing ability to tax business profits that arise from the exploitation of intangibles, especially marketing intangibles and data generated by users; the failure of transfer pricing to deal with the effects of integration and synergies of MNEs; and tax competition among states. In the author's view, the 2020s compromise represents "the most far-reaching international tax reforms for 100 years"³⁸ and involves

35 At 5.

36 At 22.

37 Ibid.

38 At 548.

issues that are “highly contentious, politically and intellectually.”³⁹ Overall, the proposed solution “is a very positive step on the journey to a new international tax consensus that is much-needed for the 2020s and beyond.”⁴⁰ The author hopes that if the “significant worldwide deficits”⁴¹ arising from the First World War helped forge the 1920s compromise, the fiscal challenges created by the great lockdown caused by COVID-19 might help forge the 2020s compromise.

J.L.

Mindy Herzfeld, “Are Pillars 1 and 2 Compatible with Sovereignty and Democracy?” (2020) 169:10 *Tax Notes* 1557-62

The OECD/G20 BEPS Inclusive Framework published, on October 12, 2020, reports on the pillar 1 and pillar 2 blueprints. Pillar 1 proposes to allocate new taxing rights to market jurisdictions in respect of automated digital services and consumer-facing businesses. Pillar 2 proposes anti-avoidance measures to ensure a minimum corporate tax on an MNE group’s profit. The Inclusive Framework invited the public to submit comments on various technical issues by December 14, 2020.⁴² The stated aim is to bring the process to a successful conclusion by mid-2021 through a resolution of the remaining technical issues, many of which require a still non-existent political consensus, and through the development, as needed, of model draft legislation, guidelines, international rules, and processes.

Herzfeld comments on the legitimacy of the project and the implications for sovereignty and democracy. Drawing on Dani Rodrik’s⁴³ theories regarding the political trilemma of the world economy—in particular, the notion that “it’s impossible to simultaneously pursue democracy, national sovereignty, and economic hyperglobalization”⁴⁴—Herzfeld argues that the push for uniform tax rules in pillar 1 and pillar 2 puts pressure on democracy and sovereignty. She identifies some key areas in pillar 1 (such as the determination of the tax base) that would involve “the OECD usurping the role of elected lawmakers who answer directly to their citizens.”⁴⁵ Herzfeld recognizes the need for more multilateral coordination on international tax rules to address the challenges of taxing digital economic and

39 At 549.

40 At 534.

41 At 549.

42 See Organisation for Economic Co-operation and Development, “OECD/G20 Inclusive Framework on BEPS Invites Public Input on the Reports on Pillar One and Pillar Two Blueprints” (www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm).

43 Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: Norton, 2011).

44 At 1557.

45 At 1559.

profit shifting by MNEs, but she argues that the pillar 1 measures “appear to go too far in requiring countries to give away their sovereignty, which inevitably involves losses in their democratic processes.”⁴⁶ She suggests a more cautious and principled approach instead.

J.L.

Michael Abramowicz and Andrew Blair-Stanek, “Contractual Tax Reform”

(2020) 61:6 *William & Mary Law Review* 1537-1605

This article makes a provocative proposal—namely, to privatize tax reform through contracts. The proposal contemplates two levels of contracting: (1) a private, profit-motivated intermediary would contract with the participating taxpayers about the amount of tax to be paid according to alternative tax regimes that might better accommodate taxpayers’ tax preferences; (2) the intermediary would contract with the government about the total amount of tax that participating taxpayers would otherwise pay. Under this proposal, the government would receive the same amount of tax revenue that it would otherwise collect directly from taxpayers, and it would stipulate which tax policies—for example, tax expenditures to promote certain social and economic objectives—could not be altered in the contract between the intermediary and participating taxpayers. Participating taxpayers would “profit” from this arrangement through “trading” tax preferences with one another. For example, some taxpayers might receive lower tax rates in exchange for forgoing deductions that cause the taxpayer to engage in socially wasteful behaviour. The assumption is that the proposal would reduce deadweight loss and improve efficiency because the intermediaries would design alternative tax regimes and decide which taxpayers to invite on the basis of better information generated by artificial intelligence (AI) about taxpayers.

The authors offer the following example to show that the proposal will benefit all taxpayers without reducing government tax revenues:

[A] private intermediary called “Taxes, Inc.” hires tax experts and AI experts to collaborate. The firm identifies one million candidate taxpayers to invite to opt into an alternative tax regime. Taxes, Inc. would send these taxpayers an invitation to opt in, along with disclosures about the upsides and downsides of the alternative regime. Suppose that 100,000 of the invitees agree to participate and are deemed suitable candidates after further voluntary disclosures to Taxes Inc. A randomly selected subset of these opting-in taxpayers (say, 10 percent, meaning 10,000 taxpayers) would be assigned at random to the control group. But the other 90,000 taxpayers would be bound by the alternative tax regime; the alternative tax regime would be a contract between them and Taxes Inc. If the 90,000 taxpayers—the “treatment group”—paid more than 9.0 times the taxes paid by the control group, then Taxes, Inc. would receive the excess (or some fraction thereof) as profits. But if the treatment group paid less than

46 At 1562.

9.0 times the taxes paid by the control group, Taxes Inc. would have to reimburse the government the difference (or the same fraction thereof).⁴⁷

The proposed outsourcing of tax reform to private intermediaries may sound too radical to some, because it goes against the fundamental principles that taxation is governed by the rule of law and that the same law applies to all taxpayers. In reality, however, some taxpayers are already able, through advance pricing arrangements or the settlement of tax disputes, to “negotiate” with the tax administration about their tax liabilities. Under the pillar 1 blueprint proposed by the Inclusive Framework, large MNEs will have greater opportunities to contractually determine their tax liability in various countries, and a third party or mechanism will function as a kind of intermediary. Thus, the proposed contractual tax reform idea, although it is targeted at the US domestic context, may help us to understand the direction of international tax reform.

J.L.

Anthony Ting, “Intangibles and the Transfer Pricing Reconstruction Rules: A Case Study of Amazon” [2020] no. 3 *British Tax Review* 302-34

In transfer-pricing analysis, unique, hard-to-value, and foot-loose intangibles—that is, intellectual property (IP)—defy the fundamental assumption of the arm’s-length principle embedded in the comparable transactional pricing methods. The migration of IP from a country in which the IP was created, often with generous tax subsidies, to a low-tax jurisdiction to which royalties or returns on the IP are paid presents a significant challenge to the tax administration of the former jurisdiction. It is this challenge that lies at the heart of the US Tax Court decision in *Amazon.com Inc. & Subsidiaries v. CIR*.⁴⁸ In this case, Amazon argued that the value of the IP that it transferred to Luxembourg was US\$255 million, while the Internal Revenue Services (IRS) argued for a value of US\$3.5 billion. The court determined that the arm’s-length valuation should be US\$799 million.

In this article, the author analyzes the *Amazon* case to show the shortcomings of the traditional transfer-pricing methods and uses it as a case study to discuss and evaluate the Australian reconstruction rules that were introduced in 2003. The analysis is relevant to the understanding of paragraphs 247(2)(b) and (d) of the Canadian Income Tax Act,⁴⁹ which empower the minister of national revenue to recharacterize taxpayers’ transactions and which were considered in the *Cameco Corp* case.⁵⁰

47 At 1543-44.

48 148 TC no.8 (2017) (<https://casetext.com/case/amazoncom-inc-v-commr-2>).

49 RSC 1985, c. 1 (5th Supp.), as amended.

50 *Canada v. Cameco Corporation*, 2020 FCA 112; aff’g 2018 TCC 195.

The author explains that the reconstruction or recharacterization rules are a response to a major structural flaw in the current transfer-pricing rules on the freedom of contract of associated corporations. Under the structure in the *Amazon* case, Amazon US transferred its IP to a wholly owned subsidiary in Luxembourg pursuant to several agreements. These agreements included (1) a license agreement to permit the subsidiary to use the IP related to Amazon's website technology; (2) an assignment agreement that granted the subsidiary the rights to use marketing intangibles (for example, trademarks, trade names, website contents, and domain names related to the European business); and (3) a cost-sharing agreement, under which the subsidiary would make an annual cost-sharing payment toward the costs of the ongoing IP development. The amount of buy-in payment under the license agreement and assignment agreement was the key issue before the court. At the time of the agreement, the value of the IP was difficult to determine: Amazon's own operational staff could not produce financial projections for more than 18 months ahead owing to the rapidly changing digital world, and Amazon asked its tax department to come up with the projections.⁵¹ Amazon's valuation was accepted by the court, in principle. Accordingly, the *Amazon* case shows the importance of having "reconstruction rules" whereby an intragroup contractual price does not have the fundamental economic attributes of arrangements between unrelated parties.

The article then discusses a spectrum of alternatives for disregarding the actual transaction, including (1) adjusting the price of an actual transaction on the basis of hypothetical contractual terms and (2) substituting a different transaction for actual transactions. It explains that the domestic transfer-pricing law of some countries may not allow the actual transaction to be disregarded. In the *Amazon* case, for example, the court rejected the IRS's argument that the taxpayer would not have entered into a similar transaction with an independent party.⁵² The article then reproduces the explicit permission for disregarding actual transactions in the 2017 version of the OECD transfer-pricing guidelines:

The transaction as accurately delineated may be disregarded, and if appropriate, replaced by an alternative transaction, where the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction. It is also a relevant pointer to consider whether the MNE group as a whole is left worse off on a pre-tax basis since this may be an indicator that the transaction . . . lacks the commercial rationality of arrangements between unrelated parties.⁵³

51 At 308.

52 This seems to be the approach taken in the *Cameco* case.

53 Organisation for Economic Co-operation and Development, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, July 2017), at paragraph 1.122 (<https://dx.doi.org/10.1787/tpg-2017-en>).

In other words, a consideration of the “commercial rationality of arrangements between unrelated parties” involves answering three main questions: (1) Is the price acceptable to both parties? (2) Are there realistically available options for each party? (3) Is the MNE group in a worse pre-tax position? The use of ex post evidence on valuing hard-to-value intangibles was also permitted.

The article then discusses Australia’s statutory reconstruction rules, which empower the Australian Tax Office (ATO) to reconstruct an actual transaction in three situations:

1. when the form of the actual commercial or financial relations is inconsistent with the substance of those relations (Rule 1);
2. when independent entities in comparable circumstances would have entered into different commercial or financial relations (Rule 2); and
- when independent entities in comparable circumstances would not have entered into any commercial or financial relations (Rule 3).⁵⁴

For Canadian readers, rule 2 might be more relevant. The article describes the following example, used by the ATO to illustrate the application of rule 2:

[A]n Australian manufacturer sells goods to a foreign controlled distributor which assumes all the manufacturing warranty risk in return for a fee equal to 1 per cent of gross sales. However, evidence shows that, among other things, the distributor does not have “the financial capacity to bear the warranty risk nor any ability to control or mitigate it.” Rule 2 would apply to remove the warranty clauses from the intra-group contract.⁵⁵

Can the transactions in the *Amazon* case be reconstructed under these rules? Probably so. There is evidence to suggest that for Amazon US, the best of the realistic and available options is not to transfer its IP to a third party, and that the transactions may not be commercially rational. The article concludes that the Australian reconstruction rules provide a direct path for the ATO and the courts to disregard an intra-group transaction and are largely in alignment with the OECD transfer-pricing guidelines.

J.L.

Glen Loutzenhiser and Rita de la Feria, *Dynamics of Taxation: Essays in Honour of Judith Freedman* (Oxford, UK: Hart Publishing, 2020), 384 pages

This is a collection of essays in honour of Judith Freedman. The essays examine areas of tax scholarship in which the honouree has made significant contributions: issues in (1) the taxation of small and medium enterprises and individuals, (2) tax avoidance, (3) tax administration, and (4) taxpayers’ rights and procedures.

⁵⁴ At 327.

⁵⁵ At 329.

John Avery Jones wrote the foreword for the collection; Philip Baker a tribute (“Judith Freedman as a Colleague 1982-2020”); and Heather Self the afterword (“Professor Judith Freedman: A Short Appreciation from Women in Tax”). David Duff wrote an essay on the taxation of small business, which was previously reviewed in this feature.⁵⁶ Other essays include

- “Geoffrey and Elspeth Howe and the Path Towards Independent Taxation of Husbands and Wives: 1968-1980,” by Glen Loutzenhiser;
- “Does an Inheritance Tax Have a Future? Practical Options to Consider,” by Emma Chamberlain;
- “Should the Suggestion That Ownership Is a ‘Myth’ Have Any Implications for the Structure of Tax Law?” by Edwin Simpson;
- “Dependent Contractors in Tax and Employment Law,” by Hugh Collins;
- “Tackling Tax Avoidance: The Use and Growth of Statutory ‘Avoidance’ Language,” by Malcolm Gammie;
- “EU General Anti-(Tax) Avoidance Mechanisms,” by Rita de la Feria;
- “The Concept of Abuse of Law in European Taxation: A Methodological and Constitutional Perspective,” by Wolfgang Schön;
- “Fiscal Jurisdiction and Multinational Groups. A Perspective from ‘Political Right,’” by John Snape;
- “Reflections on the Allowance for Corporate Equity After Three Decades,” by Michael P. Devereux and John Vella;
- “The Changing Patterns of EU Direct Tax Integration,” by Anzhela Cédelle;
- “The Origins, Development and Future of Zero-Rating in the UK,” by Geoffrey Morse;
- “Drawing the Boundaries of HMRC’s Discretion,” by Stephen Daly;
- “Trends in Tax Administration,” by Michael Walpole; and
- “True and Fair View and Tax Accounting,” by Andrés Báez Moreno.

J.L.

Organisation for Economic Co-operation and Development,

Taxation and Philanthropy (Paris: OECD, 2020)

(<https://doi.org/10.1787/df434a77-en>)

This report provides a comprehensive review of the tax treatment accorded to philanthropic entities and philanthropic giving in 40 OECD member and participating countries. It draws on national responses to a questionnaire on taxation and philanthropy by national delegates to Working Party no. 2 on Tax Policy Analysis and Tax Statistics of the Committee on Fiscal Affairs of the OECD. It is part of a collaboration between the OECD and the Geneva Centre for Philanthropy.

⁵⁶ “Current Tax Reading” (2020) 68:3 *Canadian Tax Journal* 909-29, at 917-18.

According to the report, most countries have tax preferences for philanthropic entities (typically in the form of tax exemptions) and for philanthropic giving by individuals or corporations (typically in the form of tax deductions or tax credits). These tax measures have not been updated, however, to reflect significant changes, such as (1) the growth of the philanthropic sector; (2) the significant new reliance, by many large philanthropic entities, on self-generated income, including business and investment income; (3) the new prevalence of large philanthropic entities, which gives large donors greater influence on the use of taxpayer funds; and (4) the increasingly global nature of many policy challenges (for example, the COVID-19 pandemic and climate change), which raises questions about the tax treatment of cross-border giving. Countries are urged to ensure that the design of their tax preferences for philanthropic giving is consistent with their underlying policy goals. For example, countries should reassess the merits of exempting from taxation a philanthropic entity's commercial income and consider how such income is taxed in domestic and cross-border contexts.

Canada is not singled out as a country where tax reform is urgent, but the policy recommendations seem pertinent to Canada. It is perhaps time for Canada to review the tax exemption of registered charities and the preferential tax treatment given to donors, with a view to assessing whether the billions of dollars in tax expenditures are achieving the desired policy objectives.

J.L.