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The Faculty of the University of Waterloo Master of Taxation (MTax) program congratulates the Class of 2020. You have achieved much and we celebrate your success. We wish you all the best in your careers.

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www.ctf.ca/www.fcf-ctf.ca
The Canadian Tax Foundation, an independent, not-for-profit research and educational organization, is seeking proposals for books in the areas of taxation and public finance.

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

- result in a book on a single topic of interest in the area of taxation or public finance;
- be undertaken by an experienced researcher who has expertise in an area of taxation or public finance; and
- be carried out within a time frame that is reasonable, given the nature of the project.

Projects selected by the Foundation may qualify for its full or partial financial support of the research and for its underwriting of the publication costs. The Foundation retains the absolute right at its sole discretion to choose whether to support a given proposal or to publish a project.

Interested parties should send a brief written outline of a proposal, for initial consideration by the Foundation, to:

Heather Evans  
Executive Director and Chief Executive Officer  
Canadian Tax Foundation / Fondation canadienne de fiscalité  
145 Wellington Street West, Suite 1400  
Toronto, Ontario M5J 1H8  
hevans@ctf.ca

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

Hugh Woolley  
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks  
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité
APPEL DE PROPOSITIONS DE LIVRES

La Fondation canadienne de fiscalité (FCF) / Canadian Tax Foundation, un organisme sans but lucratif indépendant de recherche et à caractère éducatif, souhaite recevoir des propositions de livres dans les domaines de la fiscalité et des finances publiques.

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 :

■ mèneront à la rédaction d’un livresur un sujet unique d’intérêt en fiscalité ou en finances publiques;
■ seront dirigés par un chercheur chevronné ayant une expertise dans un domaine de la fiscalité ou des finances publiques;
■ seront effectués dans un délai raisonnable, compte tenu de la nature du projet.

Les projets qui seront sélectionnés par la FCF pourront être partiellement ou totalement admissibles à une aide financière pour la recherche et les frais de publication. La FCF se réserve le droit absolu, et à sa seule discrétion, d’appuyer une proposition particulière ou de publier un projet.

Toute personne intéressée doit faire parvenir un bref sommaire de la proposition pour examen initial par la FCF à :

Heather Evans
Directrice exécutive et chef de la direction
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8
hevans@ctf.ca

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 :

Hugh Woolley
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité
Recent and Upcoming Events*  
Activités récentes et à venir*

We are pleased to announce The Foundation Conferences: Building Your Tax Expertise—a unique collection of four virtual events that will be delivered in the fall of 2020 and will cater to all tax professionals.

Nous sommes heureux d’annoncer Les conférences de la Fondation : Bâtir votre expertise fiscale — une collection unique de quatre événements virtuels qui seront offerts à l’automne 2020 et qui répondront aux besoins de tous les fiscalistes.

YOUNG PRACTITIONER FOCUS / FOCUS SUR LES JEUNES FISCALISTES
September 9, 2020

THE DEFINITIVE GUIDE TO OWNER-MANAGER TAXATION / 
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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.

Articles may be written in English or French and should present an original analysis of the topic. Submitted work, or any substantial part or version thereof, must not have been previously published, either in print or online, and it must not be submitted or scheduled for publication elsewhere. The journal welcomes shorter submissions (from 4,000 to 8,000 words) focused on specific topics as well as longer submissions (to a maximum of 20,000 words) that analyze issues in depth.

Submitted articles are subject to a double-blind peer review; authors' identities are not known to reviewers, and reviewers' identities are not known to authors. (Non-peer-reviewed contributions may appear elsewhere in the journal.) Final decisions on publication of articles are made by the editors, Alan Macnaughton, Daniel Sandler, and Kevin Milligan, on the advice of reviewers. Many reviewers are drawn from the editorial board (listed on the inside front cover of this journal), although ad hoc reviewers are also consulted. Submissions may be (1) accepted outright; (2) accepted if recommended revisions are made; (3) revised by the authors, as requested by the editors on the advice of reviewers, and resubmitted for further review; or (4) rejected with reasons. The time from submission to the first editorial decision is usually two months or less.

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.

The full text of many articles that have appeared in the Canadian Tax Journal since 1991 can be found on the Canadian Tax Foundation's website: www.ctf.ca. Additionally, the journal in its entirety appears in the Canadian Tax Foundation's TaxFind, which is updated regularly.

The Canadian Tax Journal is indexed in EconLit, ABI Inform, LegalTrac, Index to Canadian Legal Literature, CCH Canadian’s Canadian Income Tax Research Index, Carswell’s Income Tax References, Accounting and Law Index, Current Law Index, Canadian Index, Canadian Periodicals Index, Index to Canadian Legal Periodical Literature, Index to Legal Periodicals and Books, and PAIS International in Print.
La *Revue fiscale canadienne* publie des recherches et des commentaires éclairés sur la fiscalité et les finances publiques, particulièrement pertinents pour le Canada. À cette fin, la revue invite les personnes intéressées à soumettre des articles en vue d’une éventuelle publication en tant qu’articles revus par des pairs, et elle accueille tout particulièrement les travaux qui contribuent à l’analyse, à la conception et à la mise en œuvre des politiques fiscales.

Les articles peuvent être rédigés en anglais ou en français et doivent présenter une analyse originale du sujet. Les articles soumis, ou toute partie substantielle ou version des articles, ne doivent pas avoir été publiés antérieurement en format papier ou électronique, et ne doivent pas être soumis ou prévus pour publication ailleurs. Vous pouvez soumettre pour publication, dans la revue fiscale, des articles plus courts (4 000 à 8 000 mots) sur des sujets particuliers ainsi que des articles plus longs (maximum de 20 000 mots) analysant des sujets en profondeur.

Les articles soumis sont sujets à une double revue à l’aveugle par des pairs; l’identité des auteurs n’est pas connue des réviseurs et celle des réviseurs n’est pas connue des auteurs (certains articles non soumis à cette révision par des pairs peuvent paraître ailleurs dans la revue.) La décision finale de publier ou non un article est celle des rédacteurs en chef Alan Macnaughton, Daniel Sandler et Kevin Milligan, à la recommandation des réviseurs. Bien que certains réviseurs *ad hoc* soient aussi consultés, la majorité des réviseurs sont choisis parmi les membres du Comité de rédaction (énumérés à l’endos de la page couverture de la revue). Les articles soumis peuvent être 1) acceptés d’emblée; 2) acceptés après modifications; 3) modifiés par les auteurs tel que demandé par les rédacteurs en chef sur l’avis des réviseurs, et resoumis à une nouvelle révision; ou 4) rejetés avec raisons. Le temps écoulé entre la soumission d’un article et la première décision éditoriale est habituellement de deux mois ou moins.

Les aspirants contributeurs doivent soumettre un exemplaire de l’article proposé au service éditorial. Il est préférable que la soumission se fasse par courriel, avec une pièce jointe en Word. Les demandes de renseignements par courriel sont les bienvenues. Elles doivent être adressées à CTFeditorial@ctf.ca. Les contributeurs doivent soumettre l’ensemble de leurs sources, un précis détaillé de leurs articles (entre 200 et 400 mots), et jusqu’à six mots clés aux fins d’indexation.

On peut trouver le texte intégral de nombreux articles publiés dans la *Revue fiscale canadienne* depuis 1991 sur le site Internet de la Fondation : www.fcf-ctf.ca. De plus, la revue dans son entier se trouve dans *TaxFind*, qui est mis à jour régulièrement.

La *Revue fiscale canadienne* est indexée sous EconLit, ABI Inform, LegalTrac, Index to Canadian Legal Literature, Canadian Income Tax Research Index de CCH Canadian, Income Tax References de Carswell, Accounting and Law Index, Current Law Index, Canadian Index, Canadian Periodicals Index, Index to Canadian Legal Periodical Literature, Index to Legal Periodicals and Books, et PAIS International in Print.
**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.

Members find the Foundation to be a valuable resource both for the scope and depth of the tax information it provides and for its services, which support their everyday work in the taxation field.

Government policy makers and administrators have long respected the Foundation for its objectivity, its focus on current tax issues, its concern for improvement of the Canadian tax system, and its significant contribution to tax and fiscal policy.

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Membership in the Foundation is open to all who are interested in its work. Membership fees are $399.00 a year, except that special member rates apply as follows: (a) $199.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) $199.00 for persons on full-time teaching staff of colleges, universities, or other educational institutions; (c) $40.00 for students in full-time attendance at a recognized educational institution; and (d) $171.00 for persons who have reached the age of 65 and are no longer actively working in tax. Memberships are for a period of 12 months dating from the receipt of application with the appropriate payment.

Applications for membership are available from the membership administrator for the Canadian Tax Foundation: facsimile: 416-599-9283; Internet: www.ctf.ca; e-mail: ctfmembership@ctf.ca.
Fondation canadienne de fiscalité

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.

Les décideurs et administrateurs gouvernementaux respectent depuis longtemps l’objectivité de la FCF, son attention aux questions fiscales de l’heure, sa préoccupation envers l’amélioration du système fiscal canadien et son importante contribution au développement des politiques fiscales.

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Il est possible de se procurer les demandes d’adhésion auprès de l’administratrice responsable de l’adhésion à la FCF : télécopieur : 514-939-7353; Internet : www.fcf-ctf.ca; courriel : adminmtl@ctf.ca.
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The Foundation's publications comprise a range of forms and delivery formats. A number of the regularly issued publications are distributed without charge to Foundation members: the Canadian Tax Journal (4 issues), Perspectives on Tax Law & Policy (4 issues, delivered electronically), Tax for the Owner-Manager (4 issues, delivered electronically), Canadian Tax Focus (4 issues, delivered electronically), and the annual conference report. Monographs and books may be purchased on the Foundation’s website at www.ctf.ca.

Canadian Tax Journal — issued quarterly to members via www.ctf.ca (Non-Members $75 per copy, $343.75 per year).

Newsletters

Perspectives on Tax Law & Policy — issued quarterly to members via www.ctf.ca.
Tax for the Owner-Manager — issued quarterly to members via www.ctf.ca.
Canadian Tax Focus — issued quarterly; available to members and non-members via www.ctf.ca.

Conference Reports — Reports of the proceedings of annual tax conferences (Members $40; Non-Members $350).

— 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)

2018. Tax Treaties After the BEPS Project: A Tribute to Jacques Sasseville, Brian J. Arnold, ed. (Members $60; Non-Members $90)

2018. Reforming the Corporate Tax in a Changing World, School of Public Policy of the University of Calgary (Members $30; Non-Members $50)

2017. Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act, Jinyan Li, J. Scott Wilkie, and Larry F. Chapman, eds. (Members $60; Non-Members $90)

2016. Reform of the Personal Income Tax in Canada, School of Public Policy of the University of Calgary (Members $35; Non-Members $50)

2016. Canadian Taxation of Trusts, Elie S. Roth, Tim Youdan, Chris Anderson, and Kim Brown (Members $150; Non-Members $200; Students $50)

2016. User Fees in Canada: A Municipal Design and Implementation Guide, Catherine Althaus and Lindsay M. Tedds ($40 each)


2015. Effective Writing for Tax Professionals, Kate Hawkins and Thomas E. McDonnell, QC (Members $35; Non-Members $40)

2014. After Twenty Years: The Future of the Goods and Services Tax, School of Public Policy of the University of Calgary (Members $25; Non-Members $35)
2013. *Essays on Tax Treaties: A Tribute to David A. Ward*, Guglielmo Maisto, Angelo Nikolakakis, and John M. Ulmer, eds. ($100 each)

2012. *Tax Policy in Canada*, Heather Kerr, Ken McKenzie, and Jack Mintz, eds. (Members $75; Non-Members $100; Students $50)


2011. *International Financial Reporting Standards: Their Adoption in Canada*, Jason Doucet, Andrée Lavigne, Caroline Nadeau, Jocelyn Patenaude, and Dave Santerre (Members $30; Non-Members $40)


2010. *Taxation of Private Corporations and Their Shareholders*, 4th edition (Members $75; Non-Members $100; Students $25)

**TAX PROFESSIONAL SERIES** (Please specify title and author when ordering.)


2003. *International Taxation in the Age of Electronic Commerce: A Comparative Study*, Jinyan Li. Co-published with International Fiscal Association (Canadian Branch) (Members $95; Non-Members $145; Students $45)


**CANADIAN TAX PAPER SERIES** (Please specify publication number when ordering.)


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Les publications de la Fondation canadienne de fiscalité

Les publications de la Fondation existent sous différentes formes et elles sont disponibles de diverses façons. Certaines de ces publications régulières sont distribuées gratuitement aux membres de la Fondation : la Revue fiscale canadienne (4 numéros), Perspectives en fiscalité et en politique fiscale (4 numéros, offerts électroniquement), Actualités fiscales pour les propriétaires exploitants (4 numéros, offerts électroniquement), Canadian Tax Focus (4 numéros, offerts électroniquement) et le Rapport de la conférence annuelle. Les livres et monographies peuvent être achetés sur le site Web de la Fondation www.fcf-ctf.ca.

Revue Fiscale Canadienne — parution trimestrielle aux membres sur www.fcf-ctf.ca
(Non-membres 75 $ par numéro, 343,75 $ par année).

Bulletins
Perspectives en fiscalité et en politique fiscal — parution trimestrielle disponible aux membres sur www.fcf-ctf.ca.
Actualités fiscales pour les propriétaires exploitants — parution trimestrielle disponible aux membres sur www.fcf-ctf.ca.
Canadian Tax Focus — parution trimestrielle disponible aux membres et non-membres sur www.fcf-ctf.ca.

Rapports des Conférences — comptes rendus des conférences annuelles sur la fiscalité (Membres 40 $; Non-membres 95 $). Dernière édition : 2018 (Membres 40 $; Non-membres 195 $).
— Tax Dispute Resolution, Compliance, and Administration in Canada: Proceedings of the June 2012 Conference (Membres 30 $; Non-membres 195 $)
— Collections contenant les travaux présentés aux conférences régionales sur la fiscalité, soit British Columbia, Prairie Provinces, Ontario et Atlantic Provinces, sont disponibles en format USB (Membres 445 $; Non-membres 495 $).


Monographies
2020. Taxation of Private Corporations and Their Shareholders, 5e édition, Rachel Gervais, John Sorensen, David Stevens et Dave Walsh, éds. (Membres et Non-membres 170 $; Étudiants 70 $)
2019. Funding the Canadian City, Enid Slack, Lisa Philipps, Lindsay M. Tedds et Heather L. Evans, éds. ($40 chacun)
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2018. Reforming the Corporate Tax in a Changing World, l’École de politique publique de l’Université de Calgary (Membres 30 $; Non-membres 50 $)
2017. Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act, Jinyan Li, J. Scott Wilkie et Larry F. Chapman, éds. (Membres et Non-membres 60 $; Étudiants 90 $)
2016. Reform of the Personal Income Tax in Canada, l’École de politique publique de l’Université de Calgary (Membres 35 $; Non-membres 50 $)
2016. Canadian Taxation of Trusts, Elie S. Roth, Tim Youdan, Chris Anderson et Kim Brown (Membres 150 $; Non-membres 200 $; Étudiants 50 $)

2015. *Effective Writing for Tax Professionals*, Kate Hawkins and Thomas E. McDonnell, QC (Members $35; Non-members $40)


2013. *Essays on Tax Treaties: A Tribute to David A. Ward*, Guglielmo Maisto, Angelo Nikolakakis and John M. Ulmer, eds. (100 $ each)

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Taxpayer Non-Compliance with Input Tax Credit Rules: Data and Policy Options for Canada

Cody Kessler*

PRÉCIS
Les crédits de taxe sur les intrants (CTI) sont un mécanisme qui permet aux entreprises de récupérer la taxe sur les produits et services (TPS) et la taxe de vente harmonisée (TVH) payées sur les dépenses liées à leurs activités commerciales. De nombreuses entreprises présentent leurs demandes de CTI en conformité avec les règles, mais ce n’est de toute évidence pas le cas de toutes les entreprises. Dans le système canadien, le demandeur doit conserver les documents à l’appui de sa demande qui pourront être vérifiés pour déceler toute surestimation du droit aux CTI. En l’absence de vérification, les entreprises ne sont généralement pas tenues de fournir aux autorités fiscales les détails de leurs opérations.

Cet article s’appuie sur une étude de la jurisprudence relative à l’article 169 de la Loi sur la taxe d’accise sur une période de cinq ans, de 2014 à 2019. L’article 169 contient les principes généraux et les règles relatives à la demande de CTI. L’étude met en évidence diverses raisons de non-conformité au régime des CTI au Canada, tant intentionnelles qu’involontaires. Plusieurs thèmes sont récurrents : la prédominance des pratiques frauduleuses dans certains secteurs, la lourdeur des exigences relatives à la documentation et à la vérification, et la mauvaise compréhension par les contribuables des règles de demande des CTI, en raison des critères juridiques ambigus ou autrement compliqués. En particulier, les règles de fond concernant ce qui constitue une « activité commerciale » aux fins de la demande de CTI sont souvent mal appliquées ou mal comprises par les demandeurs. Les relations de mandataire non divulguées posent également des problèmes lorsqu’elles entraînent l’inscription du mauvais nom sur les documents présentés à l’appui d’une demande de CTI. Ces problèmes mettent en évidence certaines failles dans la mise en œuvre des règles du régime de la TPS/TVH au Canada.

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En réaction à des cas de fraude présumée, les autorités fiscales canadiennes ont imposé aux fournisseurs des exigences de vérification de plus en plus lourdes, qui doivent être satisfaites pour pouvoir demander un CTI, en particulier lorsque le fournisseur n’a pas versé la taxe applicable. Cela contribue au lourd fardeau d’observation des contribuables. Des changements qui réduiraient les problèmes liés aux relations de mandataire non divulguées ont été proposés, mais il reste encore des problèmes à régler relativement aux exigences de documentation et d’autres règles de fond s’appliquant à la demande des CTI.

L’article se termine par un examen des options de réforme proposées ou adoptées dans d’autres juridictions ayant une taxe à la valeur ajoutée. Il aborde également une mesure d’observation mise en œuvre au Québec (l’attestation de Revenu Québec), qui pourrait être appliquée dans d’autres provinces. Des recommandations particulières sont faites pour l’adoption de la facturation électronique et l’augmentation des exigences de déclaration pour s’attaquer à certaines des raisons de l’inobservation au Canada. Un certain nombre de pays ont entrepris de mettre en œuvre des exigences de déclaration périodique ou en temps quasi réel. Ces mesures sont prometteuses et font penser que le Canada pourrait également choisir cette voie.

**ABSTRACT**

Input tax credits (ITCs) are a mechanism for businesses to recover the goods and services tax (GST)/harmonized sales tax (HST) paid on expenses related to their commercial activities. While many businesses claim ITCs in accordance with the rules, instances of non-compliance are apparent. Canada uses an invoice credit system that relies on the claimant’s retention of documentation that can be checked to detect any overstatement of ITC entitlement. Absent an audit, businesses are generally not required to provide tax authorities with details of their transactions.

This article draws on a study of case law relating to section 169 of the Excise Tax Act over the five-year period 2014-2019. Section 169 contains the general principles and rules for claiming ITCs. The study highlights various reasons for non-compliance with the ITC system in Canada, both intentional and unintentional. There are several recurring themes: the prevalence of fraudulent practices in certain industries, burdensome documentation and verification requirements, and taxpayers’ misunderstanding of the rules for claiming ITCs, owing to ambiguous or otherwise complicated legal tests. In particular, the substantive rules concerning what constitutes a “commercial activity” for the purposes of claiming ITCs are often misapplied or misunderstood by claimants. Undisclosed agency relationships also cause problems where they result in the wrong name appearing on the documentation supporting an ITC claim. These issues point to certain flaws in the implementation of the rules under the GST/HST regime in Canada.

In response to instances of suspected fraud, Canadian tax authorities have been results-driven in implementing increasingly onerous supplier verification requirements that must be met before an ITC is claimed, particularly where the supplier did not remit the applicable tax. This contributes to a high compliance burden for taxpayers. Some proposals have been made for changes that would mitigate the issues associated with undisclosed agency relationships, but there are still problems with the documentation requirements and other substantive rules for claiming ITCs that need to be addressed.

The article concludes with a review of reform options proposed or adopted in other jurisdictions with a value-added tax. It also discusses a compliance measure implemented in Quebec (the attestation de Revenu Québec), which could be applied in
other provinces. Specific recommendations are made for the adoption of e-invoicing and increased reporting requirements to address some of the reasons for non-compliance in Canada. A number of countries have moved toward implementing periodic or near-real-time reporting requirements. These measures show promise and suggest that Canada could move in that direction as well.

**KEYWORDS:** GOODS AND SERVICES TAX (GST) ■ HARMONIZED SALES TAX (HST) ■ INPUT TAX CREDIT (ITC) ■ COMPLIANCE ■ POLICY ■ REFORMS

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NON-COMPLIANCE WITH CANADA’S INPUT TAX CREDIT SYSTEM

Input tax credits (ITCs) are a mechanism for businesses to recover the goods and services tax (GST)/harmonized sales tax (HST) paid on expenses related to their commercial activities. Canada uses an invoice credit system that requires an ITC claimant to retain documentation that can be checked to detect any overstatement of ITC entitlement. Absent an audit, businesses are generally not required to provide tax authorities with details of their transactions. One Canadian parliamentarian has described this system as an “order form for a government cheque.”¹

In 2003, the Standing Committee on Public Accounts noted that substantial revenues were being lost through fraud related to the GST.² These losses were mostly associated with businesses making false claims for ITCs and receiving refund payments above their entitlement. The Canada Revenue Agency (CRA) attributed the overstatement of registrants’ ITC entitlement to misunderstanding of the tax rules, clerical errors, or deliberate fraudulent activity.³

This article is based on a study of ITC case law over a five-year period (2014-2019), which sought to identify and explore key administrative and compliance issues relating to Canada’s ITC system. The study reveals a variety of reasons for non-compliance with the system, both intentional and unintentional. It shows that the documentation requirements to be met in order to claim ITCs impose a disproportionate compliance burden on smaller businesses, and that various forms of fraud are prevalent in a number of industries. The substantive rules concerning what constitutes a commercial activity for the purposes of claiming ITCs are also misapplied or misunderstood by registrants. These forms of non-compliance result in businesses overstating their entitlement to ITCs and overpayments of net tax refunds.

Canadian tax authorities have responded to instances of suspected fraud by increasing the number of audits and by trying to impose onerous supplier verification requirements on ITC claimants, particularly where the supplier fails to remit the collected GST/HST. Increased audit activity is often self-defeating unless the benefits gained from taxpayer reassessments offset the administrative burden of carrying out the audits. The tax authorities have not addressed the other reasons for non-compliance.

For the 2002 taxation year, the CRA received 2.6 million GST/HST refund claims from small and medium-sized businesses, on which it paid out refunds totalling

¹ Canada, House of Commons, Debates, November 20, 2002, at 1656 (Bill Casey).
$29.8 billion.\footnote{Ibid., at paragraph 5.41.} Only 41,600 (or 1.6 percent) of those claims were audited, but the CRA still found approximately $247 million in claims that overstated the registrant’s entitlement to a GST/HST refund.\footnote{Ibid. This figure refers to audit adjustments and does not reflect adjustments that were reversed on appeal.} The CRA did not estimate the potential overstatement in the remaining 98.4 percent of claims that were not audited. In 2014, the CRA completed 70,421 GST/HST audits with a total additional fiscal impact of more than $2.2 billion.\footnote{Canada Revenue Agency, \textit{Annual Report to Parliament 2014–2015} (Ottawa: CRA, 2015), at 57. “Fiscal impact” refers to tax assessed, tax refunds reduced, interest and penalties, and present value of future tax assessable arising from compliance actions.} Again, there was no estimate of the potential revenue cost of overstated ITC claims among those that were not audited. More recently, however, the CRA has begun to calculate the extent of the broader GST/HST “tax gap.”\footnote{The CRA defines the tax gap as “the difference between the taxes that would be paid if all obligations were fully met . . . and the tax actually paid and collected”: Canada Revenue Agency, \textit{Tax Gap in Canada: A Conceptual Study} (Ottawa: CRA, June 2016), at 7.}

Beginning in 2017, the CRA estimated the tax gap for the 2014 taxation year relating solely to the GST to be $2.9 billion, or 7.1 percent of the corresponding revenues, with the combined GST/HST tax gap estimated to be $4.9 billion.\footnote{Canada Revenue Agency, “Estimating and Analyzing the Tax Gap Related to the Goods and Services Tax/Harmonized Sales Tax” (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-CRA/tax-canada-a-conceptual-study/estimating-analyzing.html). The analysis was conducted for the 15-year period from 2000 to 2014 to account for changes in Canadian tax policy.} The tax gap measures non-compliance and is the result of a number of factors: deliberate choices not to pay tax; taxpayers making claims above their entitlement for refunds; the underground economy; mistakes; ignorance of filing, reporting, and payment obligations; and an inability to comply. Between 2011 and 2015, the CRA reported that the total average value of ITCs claimed was approximately $206 billion each year.\footnote{Canada Revenue Agency, “GST/HST Statistics Tables (2012 to 2016 Calendar Years),” table 3 (www.canada.ca/en/revenue-agency/programs/about-canada-revenue-agency-CRA/income-statistics-gst-hst-statistics/gst-hst-statistics/gst-hst-statistics-tables-2012-2016-calender-years.html).} While the amount specific to ITCs remains unknown, considerable tax revenue is at stake through the misuse of ITC claims, whether fraudulent or not.

The GST is a form of value-added tax (VAT), which is a type of tax that has been susceptible to fraud and evasion in many jurisdictions.\footnote{See, for example, Michael Keen and Stephen Smith, “VAT Fraud and Evasion: What Do We Know and What Can Be Done?” (2006) 59:4 \textit{National Tax Journal} 861-87 (http://dx.doi.org/10.17310/ntj.2006.4.07).} While all VAT schemes are to some extent unique, many have similar components, such as an invoice credit and refund mechanism (like the system adopted in Canada). A comparison of Canada’s
ITC system with the VAT in other jurisdictions highlights weaknesses in the invoice credit system itself as well as options for reform.

This article first sets out the conceptual and legislative background of the ITC system in Canada. It then describes the methodology for the study of ITC case law on which the article is based and reports the results of the study. As noted above, the study focused on the case law for the period 2014-2019. Those cases revealed a number of problems inherent in Canada’s GST/HST scheme, particularly with respect to the imposition of a duty of verification on claimants for ITCs. Aggressive audits in response to alleged or actual fraud, and concerns about registrants’ understanding of and ability to comply with the requirements for claiming ITCs, were also recurring themes. The article concludes with an analysis of reform options that have been proposed or implemented in other VAT jurisdictions.

This article adds to the existing scholarship on the ITC system in two ways: first, to my knowledge, it is the only study of Canadian ITC case law to date;11 and second, it looks to other VAT jurisdictions as a potential source of reform options that could be adopted in Canada. Drawing on case law and international scholarship, the article highlights the reasons for non-compliance in Canada’s ITC system and makes some moderate recommendations for reform.

BACKGROUND ON THE GST AND HST

Canada’s federal government imposes a 5 percent GST on taxable supplies of goods and services. In provinces where HST applies (“participating provinces”), the tax rate includes an additional component reflecting the applicable provincial retail sales tax rate. The GST is considered to be a VAT because it is imposed on the value added to a good or service at each stage of production and distribution.12 The GST/HST is also a consumption sales tax, meaning that the tax is charged on the exchange or sale of goods and services, and is imposed on the party purchasing the good or service. Although the incidence of the tax (the burden of payment) is borne by the purchaser, the obligation to collect and remit the collected tax falls on the seller.

Conceptual Underpinnings of the GST/HST

In broad terms, as an instrument of fiscal policy, general consumption taxes on goods and services have certain advantages over personal and corporate income taxes because they tend not to change taxpayers’ behaviour. The conceptual underpinnings

11 Prior studies have examined certain aspects of GST/HST evasion and the associated increase in administrative and compliance burdens in Canada. See, for example, Bahro A. Behran and Glenn P. Jenkins, “The High Costs of Controlling GST and VAT Evasion” (2005) 53:3 Canadian Tax Journal 720-36. My study represents a new approach, analyzing these issues through a review of the case law.

of the GST/HST also represent an attempt to make the tax system fairer, more pro-
gressive, and more advantageous to businesses.

A GST/HST rate increase has been shown not to significantly change Canadian
consumption patterns. The tax is unavoidable for consumers in that it applies to
a vast range of goods and services. Specific consumption taxes on goods such as
tobacco and alcohol (sometimes referred to as sin taxes) may also be viewed as un-
avoidable, but the reason is that the demand for these goods is inelastic.

The Invoice Credit Method

A key element of Canada’s GST is the use of an invoice credit mechanism. Each
supplier of a good or service charges the tax at the rate specified for each supply
and provides documentation to the purchaser showing the amount of tax charged,
generally in the form of an invoice or receipt. The purchaser can credit that input
tax against the output tax that it charges on its sales, remit the balance to the tax
authorities, and receive a refund for any excess ITCs. The invoice credit method
continues throughout the supply chain until the final sale. On the final sale, the
applicable GST/HST is collected, and the consumer cannot claim a corresponding
ITC for the amount of tax paid.

The invoice credit method is designed to discourage fraud, in that the invoices
provided by the suppliers can be checked to detect any overstatement of ITC en-
titlement, by connecting the tax credit claimed on the purchaser’s inputs to the tax
actually paid by the purchaser. This is partly why the documentation requirements
for entitlement to ITCs are strictly enforced in Canada.

Canada’s invoice credit method is also described as self-enforcing: suppliers are,
in theory, unable to evade tax on sales because purchasers will want evidence that
the tax has been paid so that they can claim ITCs. This rationale applies to sales to
registrants that can claim ITCs. On final sales to consumers where a claim for
ITCs is not available, this rationale is likely inapplicable.

ITCs are critical to the functioning of the GST in Canada because they prevent
cascading tax, or “tax on tax.” Cascading tax occurs when something is taxed at each
stage of production and the price includes the tax charged at the previous stage,
with the final consumer bearing the burden of the multiple taxes. This makes the
GST a better alternative than its predecessor, the manufacturer’s sales tax (MST).
Because the MST failed to prevent cascading tax, it raised business costs and thereby
hindered the ability of Canada’s domestic exporters to compete in world markets.

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13 See Ergete Ferede and Bev Dahlby, “The Costliest Tax of All: Raising Revenue Through
Corporate Tax Hikes Can Be Counter-Productive for the Provinces” (2016) 9:11 SPP Research
Papers [University of Calgary School of Public Policy] 1-27.

14 Behran and Jenkins, supra note 11, at 721.

The conceptual underpinnings of the GST are reinforced by the provisions of the Excise Tax Act (ETA)\(^{16}\) outlining its operation. Several of these provisions set out the requirements that must be met in order for the claimant to be entitled to ITCs.

**Legislative Scheme of the GST/HST**

Canada’s GST regime is relatively complex, with many exemptions and “special cases.”\(^{17}\) A registrant that purchases goods or services that are consumed, used, or supplied in the course of a commercial activity (a taxable supply) may recover the GST/HST paid or payable by claiming ITCs. Every recipient of a taxable supply made in Canada is liable to pay the GST.\(^{18}\)

A “recipient” of a supply of goods or a service is the person who is liable to pay the consideration in the transaction.\(^{19}\) A “supply” occurs when a good or service is provided in any manner, including by “sale, transfer, barter, exchange license, rental, lease, gift or disposition.”\(^{20}\) As indicated above, a “taxable supply” is a supply made in the course of a commercial activity.\(^{21}\)

The ETA requires every “person”\(^{22}\) who makes a taxable supply in the course of a commercial activity to be registered for the GST/HST unless the person is a small supplier, makes a supply of real property outside the normal course of business, or is a non-resident that does not carry on business in Canada.\(^{23}\)

GST/HST is imposed on most supplies of goods and services that are either made or deemed to be made in Canada. No GST/HST is imposed on two categories of supplies, referred to as “exempt” or “zero-rated.” The main distinction between zero-rated supplies and exempt supplies relates to the availability of ITCs. No GST/HST is charged or collected on zero-rated or exempt supplies, but a person is entitled to recover the GST/HST incurred to make zero-rated supplies through a claim for ITCs. No ITCs are available in respect of exempt supplies.

Once registered, a registrant will complete and file a GST/HST return\(^{24}\) to claim ITCs in respect of tax paid on eligible inputs. The return is filed monthly, quarterly,

\(^{16}\) RSC 1985, c. E-15, as amended. Unless otherwise stated, statutory references in this article are to the ETA.

\(^{17}\) See, for example, sections 171-194.

\(^{18}\) Subsection 165(1).

\(^{19}\) Subsection 123(1), the definition of “recipient.”

\(^{20}\) Subsection 123(1), the definition of “supply.”

\(^{21}\) Subsection 123(1), the definition of “taxable supply.”

\(^{22}\) As defined in subsection 2(1), “person” means an individual, partnership, corporation, trust, estate, or a body that is a society, union, club, association, commission, or other organization of any kind whatever.

\(^{23}\) Subsection 240(1).

\(^{24}\) Canada Customs and Revenue Agency form GST-62, “Goods and Services Tax/Harmonized Sales Tax (GST/HST) Return (Non-Personalized).”
or annually, depending on the registrant’s GST/HST filing period. Basically, to claim ITCs, the registrant calculates the GST/HST collected or collectible on total sales for the period and subtracts the GST/HST paid on inputs. If the GST/HST paid exceeds the GST/HST collected or collectible, the registrant claims a refund of the difference; otherwise, the registrant must remit any balance of tax owing. In the absence of an audit, businesses are not required to submit documentation to support their ITC claim to the tax authority.

The general rule for claiming ITCs is contained in section 169. In essence, where a person acquires property or a service and that person is a registrant, the registrant can claim an ITC to the extent that it acquired or imported the property or service for consumption, use, or supply in the course of its commercial activities. A claimant must apportion its inputs between commercial and non-commercial uses. Additionally, a claim for an ITC must be reasonable.25

**The Quebec Sales Tax (QST)**

Effective in 2011, Quebec harmonized its sales tax (QST) with the GST but retained its separate legislation.26 For the most part, the QST provisions parallel the GST provisions in the ETA.

Revenu Québec (RQ) administers both the QST and the GST in Quebec; however, appeals relating to RQ assessments of GST are made to the federal courts (in the first instance, the Tax Court of Canada), while appeals relating to assessments of QST are made to Quebec’s provincial courts. Commonly, the parties agree to proceed initially with the Tax Court appeal and leave the Quebec appeal on hold, although an appellant can decide to proceed with both concurrently. An appeal of a Tax Court decision is heard before the Federal Court of Appeal, while an appeal of a Court of Quebec decision is heard before the Quebec Court of Appeal.

Once a decision has been rendered by either court, on an issue related to the GST or the QST as the case may be, an appeal to the other court on the same facts and issues with respect to the other tax will be dismissed as an abuse of process or on the basis of the doctrine of judicial comity.27 For example, in *Construction SYL Tremblay inc.*,28 the Quebec Court of Appeal refused to hear a QST appeal dealing with an issue that had been resolved in the Tax Court with respect to the GST, basing its decision on the doctrine of abuse of process.

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25 Section 170.

26 See Department of Finance, Memorandum of Agreement Regarding Sales Tax Harmonization with a View to Concluding a Canada-Quebec Comprehensive Integrated Tax Coordination Agreement, signed on September 29, 2011. See also Jung Ah Kwon, Michael Tsao, and Simon Thang, “QST Harmonization” (2011) 1:3 *Canadian Tax Focus* 9.


Small Suppliers—Voluntary Registration for the GST

For the purposes of Canada’s GST, a small supplier is a person with business revenues in the prior year below a specified minimum threshold of $30,000, or $50,000 if the person is a public service body.\(^29\)

Small suppliers are not required to register for the GST but may do so voluntarily. The rationale for this policy is that the administrative and compliance costs of mandatory registration would be too burdensome for many small suppliers. The forgone tax revenue is also perceived as being low.\(^30\)

Voluntary registration for the GST may provide some benefits for small suppliers, although it means taking on filing and remittance obligations. Compliance with the GST/HST reporting and remittance requirements has been one of the top irritants for small businesses.\(^31\) A study of the VAT in the United Kingdom found that small suppliers were more likely to register voluntarily where they (1) purchased a high proportion of their inputs from VAT-registered suppliers; and/or (2) sold mostly to VAT-registered customers; and/or (3) operated in a competitive industry.\(^32\)

In the Canadian context, a study by Satterthwaite surveyed 100 small suppliers based in Ontario to determine why a small-business owner might choose to register for the GST.\(^33\) Satterthwaite found that voluntary registration likely stems from a business’s relationships with customers that are themselves registered for the GST rather than from the potential monetary incentives created by the availability of ITCs.\(^34\)

As discussed below, my study of the ITC case law indicates that 31 percent of all cases heard under the informal procedure (which was more likely to be used by smaller businesses) involved insufficient documentation to support an ITC claim. Small businesses may lack the resources to maintain proper record-keeping practices and follow up with suppliers where inadequate information to support an ITC claim was

\(^{29}\) Subsection 148(1).


\(^{32}\) Li Liu, Ben Lockwood, Miguel Almunia, and Eddy H.F. Tam, VAT Notches, Voluntary Registration, and Bunching: Theory and UK Evidence, International Monetary Fund Working Paper no. 19/205 (Washington, DC: IMF, September 2019), at 38. The United Kingdom has a VAT registration threshold of £85,000 (approximately Cdn$144,000). The rationale for item (1) in the text above is that when input costs are significant, registration allows the business to offset those costs by claiming ITCs. The rationale for (2) is that if most customers are VAT-registered, the burden of an increase in VAT can be passed on in the form of higher prices because the ability to claim ITCs allows the customer to recover the cost of the increase.

\(^{33}\) Satterthwaite, supra note 30.

\(^{34}\) Ibid., at 804. Satterthwaite suggests, ibid., at 772, that “[t]he potential payoffs to expanding the business’s customer base or making it more attractive to future customers by registering voluntarily were sufficiently compelling to justify shouldering the added compliance burden.”
provided. Any difficulty in complying with the documentation requirements is compounded by the reverse onus in ITC cases, which allows the Crown to assume that the registrant lacks the required documentation and is not entitled to the claimed ITCs unless the registrant proves otherwise.

**METHODODOLOGY FOR THIS STUDY**

This article reviews a study of case law relating to ITCs over the five-year period 2014-2019—specifically, cases that cited section 169, which sets out the general principles and rules for claiming and calculating ITCs. The study is restricted to cases in which the entitlement to ITCs was the main issue. Trial and appellate decisions are treated as one case.

With respect to cases in which the underlying matter arose in Quebec, many of the decisions are available in both French and English. Where both English and French versions are available, the French version has been excluded to avoid double-counting.

On the basis of the study criteria, a total of 59 cases were included. In reviewing these cases, the goal was to identify and analyze the themes and issues as they relate to the Canadian ITC system and to similar concerns arising in other VAT jurisdictions.

**RESEARCH FINDINGS**

The study identified four main themes within the set of cases selected for review. As will be seen, some of these themes are representative of intricacies within Canada’s legislation and others are representative of issues faced by all VAT-collecting jurisdictions. The four main themes are:

1. entitlement or agency;
2. commercial activities, reasonable expectation of profit (REOP), and apportionment;
3. inadequate documentation; and
4. alleged or actual fraud cases.

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35 The cases were identified by a search of the Taxnet Pro, Tax Court of Canada, Federal Court of Appeal, and CanLII databases for all decisions that cited section 169 or any of subsections 169(1) through (5), and that were released between January 1, 2014 and December 31, 2019. A focus on section 169 precludes cases involving the CRA’s attempts to collect GST/HST that was not remitted. Those cases do not deal explicitly with ITC issues. Several cases discussed later in the article involved situations where the supplier failed to remit collected tax and the tax authority denied the claim for ITCs in an attempt to recoup its loss. These cases were included in the study because they dealt with issues for ITC claimants.

36 The reviewed cases are available at https://www.ctf.ca/CTFWEB/Documents/CTJ%202020/Issue%203/Kessler%20Non-Compliance%20with%20ITC%20Rules%20Data%20Spreadsheet.xlsx.
These themes exemplify the various reasons for non-compliance with the ITC rules in Canada, whether intentional or not. The inadequate documentation and commercial activities cases often involved unintentional non-compliance; that is, the ITC claimant either misunderstood or misapplied the rules. The themes also highlight the substantive rules whose interpretation and application often lead to disputes, suggesting that taxpayers find those rules ambiguous or otherwise difficult to comply with.

This study does not claim to be representative of all instances of non-compliance with the Canadian ITC rules; some types of non-compliance may be more or less common in the sample of cases reviewed in this study, compared to all GST/HST returns filed in Canada. Rather, this study seeks to understand the underlying actions of taxpayers and the reasons for non-compliance with the ITC rules. Further research using different research tools, such as randomized control trials and a top-down approach, should be considered to determine the full extent of the problem.

The entitlement or agency cases dealt with the question of who was entitled to claim the ITCs in question and whether those claims were reasonable. Generally, the cases considered whether the claimant or an agent of the claimant acquired the supply and whether GST/HST was payable or paid by the claimant in question.

The commercial activities, REOP, and apportionment cases all relate to the application of the definition of “commercial activity” in the ETA.37 (For simplicity, in the discussion that follows, this subset of cases may be referred to collectively under the label “commercial activities.”) To claim an ITC, the registrant must have acquired a property or service for consumption, use, or supply in the course of its commercial activity.38 The amount of the claim is generally based on the extent of the use of the property or service for such purpose. The ETA provides simplification rules to make this determination easier.39 As well, the definition of “commercial activity” requires an individual, a personal trust, or a partnership (all of the members of which are individuals) acquiring the supply to have a “reasonable expectation of profit.”40 The apportionment cases were included within this theme because they dealt, in essence, with what percentage of the registrant’s supplies were taxable supplies, which—as noted above—are defined as supplies made in the course of a commercial activity.

The inadequate documentation cases dealt with situations in which ITCs were denied owing to the registrant’s failure to provide supporting documentation as required by the ETA and the GST/HST regulations.41

37 The definition of “commercial activity” is found in subsection 123(1).
38 Subsection 169(1).
39 Sections 141 and 199.
40 Subsection 123(1), paragraphs (a) and (b) of the definition of “commercial activity.”
41 Input Tax Credit Information (GST/HST) Regulations, SOR/91-45, as amended (herein referred to as “the GST/HST regulations”).
In the alleged or actual fraud cases, the courts addressed allegations by the tax authorities that the taxpayer in question engaged in a fraudulent scheme to claim ITCs.

Of the 59 cases reviewed,

- 15 (25 percent) fell within the entitlement or agency theme;
- 21 (36 percent) fell within the commercial activities theme;
- 14 (24 percent) fell within the inadequate documentation theme; and
- 9 (15 percent) fell within the alleged or actual fraud theme.

This distribution by theme is illustrated in figure 1.

Among the 59 cases surveyed, 36 (61 percent) were heard under the informal procedure, and 23 (39 percent) were heard under the general procedure (figure 2). For GST/HST issues to be heard under the informal procedure, the person must elect into the procedure and the total amount in dispute must be less than $50,000. The informal procedure has less formal rules of evidence and procedure compared to the rules for the general procedure, and is intended to make the process more streamlined for self-represented litigants. The litigants in 17 (47 percent) of the 36 informal procedure cases were self-represented. None of the cases heard under the general procedure in this study involved self-represented litigants.

As shown in table 1, of the 36 informal procedure cases, 11 dealt with the claimant having inadequate documentation. Fifteen cases involved the tax authority’s allegation that the claimant’s supplies were not acquired for consumption, use, or supply in a commercial activity or that the claimant had no REOP. Eight cases dealt with issues of entitlement or agency, and only 2 involved allegations of fraud.

Among the 23 general procedure cases, the distribution by theme was more even, with 6 dealing with whether the claimant was engaged in a commercial activity and 7 dealing with issues of entitlement or agency. There was also an uptick in the number of alleged or actual fraud cases: 7 were heard under the general procedure, suggesting that instances of suspected fraud generally involved sums above $50,000. Only 3 cases dealt with inadequate documentation, suggesting that entities with amounts in dispute over $50,000 likely understood the documentation requirements or had better record-keeping practices than the litigants using the informal procedure. The disparate impact of the documentation requirements is discussed in a later section of this article.

Table 2 shows the amount of ITCs at issue under each hearing procedure. In total, approximately $38.2 million in ITCs was at issue in the 59 cases in the study sample. For the 23 general procedure cases, the total amount at issue was $37.6 million, or an average of $1.6 million per case. In contrast, in the 36 informal procedure cases, $0.061 million was at issue, or an average of $0.017 million per case. The general procedure cases accounted for 98 percent of the overall amount at issue.

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42 Tax Court of Canada Act, RSC 1985, c. T-2, as amended, section 18.3001(c).
Within the specific themes, the total dollar amounts at issue are wide-ranging. As shown in figure 3, the 15 entitlement or agency cases involved approximately $7.1 million, or 18 percent of the total ITCs at issue. The 21 commercial activities cases involved approximately $29.1 million, or 76 percent of the total ITCs at issue. Large amounts were evidently at stake in the apportionment cases and cases dealing with the commercial activities of public or quasi-public bodies.\textsuperscript{43} Stewardship Ontario,\textsuperscript{44} the case with the largest amount of ITCs at issue, dealt with the question of whether a non-profit organization that acted under a statutory arrangement to recycle goods used the goods and services in the course of its commercial activities.

\textsuperscript{43} For example, in Sun Life Assurance Company of Canada v. The Queen, 2015 TCC 37, an insurance business claimed ITCs of approximately $1.28 million. In British Columbia Ferry Services Inc v. The Queen, 2014 TCC 305, the issue was apportionment between ferry services that are exempt under the ETA, schedule V, part VIII, section 1, and other taxable sales on board the ferries, such as retail sales; approximately $4.05 million in ITCs was at issue.

\textsuperscript{44} Stewardship Ontario v. The Queen, 2018 TCC 59.
The Tax Court allowed some $17.96 million in claimed ITCs in that case. If Stewardship Ontario is removed from the data above, the total dollar amount at issue in the general procedure cases is approximately $19.6 million and the average dollar amount at issue in those cases is $0.891 million.

The 9 alleged or actual fraud cases involved only $1.7 million, or 5 percent of the total amount of ITCs at issue. The amount that the Canadian government was actually defrauded of during the study period could be significantly higher, owing to instances of non-compliance that went undetected, were in the process of being audited, or had not yet been resolved by the courts. In addition, as stated above, the study was limited to cases that cited section 169. Instances of ITC fraud also exist in cases that cite other provisions of the ETA, especially the administration and enforcement provisions.\(^45\)

The documentation cases dealt with the smallest amounts. The 14 documentation cases involved ITCs totalling about $0.29 million, or 0.75 percent of the total for all cases. Twenty-four percent of the total number of cases and 31 percent of the cases heard under the informal procedure involved issues with documentation. These findings suggest that the documentation requirements for claiming ITCs impose a disproportionate burden on smaller businesses.

Many of the cases dealt with numerous themes. Notably, documentation is generally at issue in an ITC case because of its status as a mandatory requirement. The

\(^{45}\) See, for example, Cherniak v. The Queen, 2015 TCC 53, a director’s liability case under subsection 323(1), involving an alleged “carousel scheme” and some $6 million in fraudulent ITC claims. (Carousel schemes are discussed in a later section of this article.)
survey of cases by theme that follows provides further insight into the recurring problems within the ITC system.

**Entitlement or Agency Cases**

For taxable supplies over $150, which require the highest level of documentation to claim an ITC, the documentation must include

1. the name of the recipient, the recipient’s agent, or the name that the recipient does business under; and
2. the name of the supplier, the supplier’s intermediary, or the name that the supplier does business under.

Where this information is missing, the claim for ITCs will be denied. Similarly, ITCs have been denied where the name on the supporting documentation is not that of the party that actually received or made the supply. As discussed below, in cases involving a duty of verification, a purchaser must show both that the name on the invoice belongs to a supplier or the supplier’s intermediary and, if applicable, that the intermediary was acting on behalf of the supplier. In the subset of cases involving entitlement and agency, the court was asked to determine whether the party claiming the ITCs was acting as the agent of the party that acquired the supply, whether the ITC claimant was the party that acquired the supply, or whether the GST/HST was payable or paid by the claimant. Some cases also involved provisions of the ETA other than section 169 that restricted the claimant’s entitlement to ITCs.

**The Agency Test (the iPhone Exportation Cases)**

For the purposes of the ETA, a principal is entitled to claim ITCs in respect of supplies purchased by its agents on its behalf.\(^{46}\) Following the decision in *Merchant*...
\textit{Law Group},\textsuperscript{47} and in light of the CRA's policy statement P-182R,\textsuperscript{48} checklist tests are used to determine whether an agency relationship exists. The existence of an agency relationship generally requires that

1. both the principal and the agent consent to the relationship;
2. the principal grants authority to the agent allowing the agent to affect the principal's legal position; and
3. the principal controls the agent's actions.\textsuperscript{49}

Conflicting decisions have been reached in cases where ITCs were claimed by companies whose alleged agents purchased Apple iPhones for resale on the grey market.\textsuperscript{50} Apple Inc. has rules that apply when new products are released, to protect against such practices. Two cases involved companies enlisting the owners' friends, family, and acquaintances to make individual purchases of the most recent model of the iPhone through various retail stores in Canada. This was done to circumvent Apple's resale rules. The phones were then resold in an overseas market where the new model had not been released. In both cases, the company exported the phones but did not collect GST/HST on the sales because exported goods are zero-rated (taxable at 0 percent). However, under the ETA, generally a business can claim ITCs in respect of a supply of such goods.

In \textit{2253787 Ontario},\textsuperscript{51} a case heard under the informal procedure, the Tax Court of Canada found the contract of sale to be void, on the basis that Apple's rules prohibited bulk purchases for resale or export, limiting purchases by any individual to a maximum of two per day at any retail store. The agents could not affect the principal's legal position in that case, but the court should have considered that tax still applied to the transactions that actually took place, regardless of whether those transactions were illegal or violated the parties' contractual obligations.\textsuperscript{52} In the court's


\textsuperscript{49} See \textit{Club Intrawest v. The Queen}, 2016 TCC 149, at paragraph 78 (citing \textit{Royal Securities Corp Ltd. v. Montreal Trust Co}, 1966 CanLII 173 (ON SC), at paragraph 55); rev’d 2017 FCA 151.

\textsuperscript{50} The “grey market” refers to the trade of a product through channels that are not authorized by the original manufacturer. A grey market is created when multinational corporations sell their products into markets that are perceived to be lucrative and proprietary in advance of selling those products into markets that are perceived to “cutthroat” and less proprietary. See \textit{2253787 Ontario Inc. v. The Queen}, 2014 TCC 121, at paragraphs 1 and 2.

\textsuperscript{51} Ibid.

\textsuperscript{52} See, for example, \textit{Brizzi v. The Queen}, 2007 TCC 226 (dealing with illegal income, forfeiture, and loss deductibility); \textit{Canada (National Revenue) v. Sifto Canada Corp.}, 2014 FCA 140 (addressing the issues of legality, morality, and taxation); and \textit{Demers v. The Queen}, 2014 TCC 368 (involving the taxability of funds from a Ponzi scheme).
view, the non-disclosure of the alleged agency arrangement meant that it did not exist, despite case law establishing the opposite.\textsuperscript{53} The claim for ITCs was denied.

In \textit{Lohas Farm},\textsuperscript{54} a case heard under the general procedure, the Tax Court found that the rules merely stated that Apple could refuse or cancel a person’s order if it suspected that the purchases were made for resale. Accordingly, the contract in that case was voidable, but not void. The court therefore held that the agents could affect the principal’s legal position, even though Apple did not know that they were Lohas’s authorized agents. The claimant in \textit{Lohas} also benefited from much stronger supporting documentation, compared to the claimant in \textit{2253787 Ontario}.

Some remedies have been proposed to deal with agency issues. In cases where no agency relationship is found, the Tax Court has held that the alleged agent holds collected GST in bare trust for its principal, entitling the principal to ITCs.\textsuperscript{55} As discussed below, Quebec has also introduced requirements to disclose nominee agreements.

\textbf{Mandatory Disclosure of Nominee Agreements in Quebec}

Quebec has introduced new measures requiring the mandatory disclosure of nominee or agency agreements to address tax authorities’ concerns around the use of “prête-noms,” or nominees, in transactions.\textsuperscript{56} Under these new measures, there is a prescribed form that must be filed whenever an agent consents to act on behalf of an undisclosed principal under a nominee agreement, thereby giving the appearance that the agent is acting in its own name.

The form is required to be filed with RQ no later than 90 days after the date on which the nominee agreement was concluded, or by September 16, 2019 if the agreement was concluded prior to May 17, 2019 and the tax consequences of the transaction to which the agreement relates continue after that date. The parties to the agreement, a description of the transaction or series of transactions to which the agreement relates, and the identity of any person or entity for which the transactions have tax consequences must be disclosed.

Parties to a nominee agreement who fail to file the prescribed form within the specified time are jointly liable for a penalty of $1,000 and an additional penalty of $100 per day, up to a maximum of $5,000, beginning on the second day of the omission. Non-disclosure of the agency agreement results in the suspension of the normal reassessment period for the taxation years in which the taxpayers fail to comply with the disclosure obligations.

\textsuperscript{53} \textit{Lussier v. The Queen}, 2000 CanLII 517 (TCC).

\textsuperscript{54} See \textit{Lohas Farm}, supra note 46.

\textsuperscript{55} See, for example, \textit{Edmonton (Town) v. The Queen}, 2015 TCC 172.

Undisclosed agency relationships are of particular concern where the tax authority denies a claim for ITCs because the name of the “true supplier” (the person that actually provided the goods or services) is not on the supporting documentation. As discussed below, the case law requires that the supplier named on the invoice actually supplied the goods or services in order for an ITC claim to be accepted. If an intermediary is used, the purchaser may have to show that the intermediary was acting on behalf of the supplier, a requirement that is easier to satisfy in Quebec as a result of the mandatory disclosure of nominee agreements.

Commercial Activity, REOP, and Apportionment Cases
The commercial activities subset of cases dealt with whether the goods or services for which ITCs were claimed (the taxable supplies) were consumed, used, or supplied in the course of the claimant’s commercial activities; whether a REOP existed; or whether the taxable and non-taxable supplies were apportioned properly. These cases involved taxpayers claiming ITC amounts above their entitlement owing to a misapplication of the rules.

Misunderstanding of What Constitutes Commercial Activities
As discussed above, to claim an ITC in respect of a supply, a person must have acquired the supply for consumption, use, or supply in the course of its commercial activity. The ETA defines “commercial activity” to mean a business carried on by a person, or an adventure or concern of the person in the nature of trade, other than one carried on without a reasonable expectation of profit by an individual, a personal trust, or a partnership (all of the members of which are individuals). A supply of real property also constitutes a commercial activity.

In 9124-0515 Québec, ITCs claimed for the tax paid on the purchase of a Winnebago were denied because the vehicle was not used in a commercial activity. The Tax Court was skeptical of the alleged commercial use of the Winnebago, noting that at least 70 percent of its use was personal. That use included a 4-week personal trip and a 9-week family trip across Canada. The Winnebago was also parked in Florida for 10 weeks so that the family of the director of the company could use it during the winter. The court denied the claimed ITCs.

In Gutbucket, a business claimed ITCs for the utility expenses on two condominiums where rare books were stored. The company’s sole shareholder, a lawyer, had his claim for ITCs denied. In the absence of evidence of an intent to sell the books, the Tax Court held that the storage of the books was not a “business” as defined in subsection 123(1) of the ETA and therefore was not a commercial activity, although the shareholder insisted that he planned to sell the books eventually.

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57 Subsection 169(1).
58 Subsection 123(1), the definition of “commercial activity.”
59 9124-0515 Québec Inc. v. The Queen, 2016 TCC 208.
60 Gutbucket Inc. v. The Queen, 2015 TCC 156.
Gutbucket is also an example of a self-represented litigant who was unable to provide a credible defence of his position because he did not fully understand the ITC scheme. The appellant did not provide any documentation to support his claim that the properties were used for commercial activities and stated in his notice of appeal that the CRA “was not entitled to this information.”61 Clearly, the appellant was unaware of the requirements for claiming an ITC. Moreover, he admitted to the court that he was unfamiliar with tax litigation, even though he was a practising lawyer.62

Gutbucket shows that, in the broad context of GST/HST appeals, even litigants with a legal education may have difficulties navigating the intricacies of the scheme of the ETA when they represent themselves before the Tax Court, including those who elect to use the informal procedure. This is concerning, given that when the informal procedure was introduced in 1991, the intention was to provide better access to justice for self-represented taxpayers.63

A study by Gallant published in 2005 reported that 32 percent of all appeals filed in the Tax Court of Canada in 2004 involved self-represented litigants.64 My study indicates that 17 (47 percent) of the cases heard under the informal procedure, representing 29 percent of the 59 cases included in the study, involved self-represented litigants. Of the 17 cases involving self-represented litigants, 15 (88 percent) related to either inadequate documentation or the commercial activities of the ITC claimant. Only 1 (6 percent) of the 17 self-represented litigants in this study was successful.

For the purposes of this study, a litigant was successful if more than one-half of the ITC claim at issue was allowed. Given that small businesses are more likely to choose to defend their claim under the informal procedure, this low success rate suggests that some small businesses find it difficult to comply with the documentation requirements or to determine whether they are engaged in a commercial activity. In the income tax context, Campbell has noted that there is a “cost trap” that likely constitutes a significant disincentive to the pursuit of income tax appeals beyond the stage of filing an objection to a CRA assessment.65 According to Campbell, few taxpayers in informal procedure appeals are represented by lawyers; as a result, their opportunity for a fully effective review may be diminished, and an additional burden may be placed on judges if they find it necessary to assist those appellants in presenting their case.66

The cases discussed above suggest that at least some taxpayers lack a clear understanding of the GST/HST scheme, including what constitutes a commercial activity.

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61 Ibid., at paragraph 7.
62 Ibid., at paragraph 9.
64 Ibid., at 336.
66 Ibid., at 455.
Other taxpayers may be better informed and may intentionally file claims above their entitlement in the hope that they will not be audited. In the cases reviewed, ITCs were also consistently denied where the CRA suspected that the business did not have a REOP, as discussed below.

**The Application of a REOP Test Following the Stewart Decision**

As discussed above, the definition of “commercial activity” in subsection 123(1) of the ETA explicitly requires certain individuals, a personal trust, or a partnership, all of the members of which are individuals, to have a “reasonable expectation of profit.” The application of a REOP test in the context of the Income Tax Act (ITA)67 was partially overturned by the Supreme Court of Canada in the *Stewart* case.68 That decision is relevant to the application of the test in the GST/HST context.

The Supreme Court in *Stewart* held that there is no statutory foundation for the application of a REOP test under the ITA where the nature of the activity undertaken by the taxpayer is clearly commercial. The REOP test is still applicable where the facts suggest that the taxpayer’s venture is a hobby or personal pursuit. Specifically, in such cases, the existence of a REOP is one factor to be considered in determining whether the venture was undertaken in a sufficiently commercial manner to qualify as a business.

In *Stewart*, the Supreme Court constrained the use of the REOP test in the income tax context because, in the court’s view, it had been applied too broadly—both to distinguish between commercial and personal activities, and to retrospectively challenge the business judgment of taxpayers, in order to deny losses incurred in legitimate but unsuccessful commercial ventures.69 That approach resulted in uncertainty and unfairness in the application of the test.

Following *Stewart*, in income tax cases an expense is still deductible in computing the income of a taxpayer from a business or property if it was incurred for the purpose of gaining or producing income from the business or property and is not otherwise statute-barred.70 Although the statutory REOP test remains, the concerns expressed in *Stewart* are reflected in the GST/HST cases applying a similar test.

The REOP issue arises in the GST/HST context when a registrant’s ITC claims consistently exceed the amount of tax collected, meaning that the registrant is purchasing more than it is selling and likely reporting losses each year.71 The resulting net tax refund is often denied on the ground that the individual had no REOP and

67 RSC 1985, c. 1 (5th Supp.), as amended.
69 Ibid., at paragraphs 2 to 4.
70 See ITA subsections 18(1) and 20(1).
71 This rationale does not apply to a business that supplies zero-rated goods since such a business will always be in a refund position.
thus no commercial activity. The CRA considers various factors in determining whether a REOP exists, including the following:72

- the profitability of the business in past years;
- the length of time over which a profit could reasonably be expected;
- the extent of the activity of the business, compared to businesses of a similar nature and size in the same locality;
- the claimant’s education, experience, and training; and
- whether the person has a business plan or has conducted market research.

In *Living Friends Tree Farm*,73 the Tax Court dealt with whether a partnership whose tree-farming business plans had been affected by ongoing litigation had a REOP. In 2009, the appellants purchased 160 acres of land and began construction of a barn and a house. Tradespeople were hired, but serious deficiencies were discovered in the course of an inspection, which resulted in the appellants suing the contractors. The construction was not completed until 2014, and no sales from the tree-farming business were reported in the intervening years. The CRA denied the claim for ITCs during the startup period in 2009 because it appeared that the business plans had been postponed and there was no REOP.

The Tax Court accepted that the initial startup phase of a tree farm would be longer than that of other commercial enterprises because of the length of time that it would take for the trees to reach maturity. However, the court was critical of the lack of clear steps in establishing a future business plan for the tree farm.

As Sherman has noted in his editorial comment on the case,74 the court used after-the-fact evidence about the business to deny the claims for 2009. In effect, the court determined whether the business had a REOP in 2009 on the basis of what happened in subsequent years. As discussed above, in rejecting a REOP test for income tax purposes in *Stewart*, the Supreme Court found the test to be unfair because it seemed to encourage a retrospective assessment of the business judgment of taxpayers in order to deny losses incurred in bona fide but unsuccessful commercial ventures.75 The same issues with respect to the application of a REOP test are clearly evident in both the income tax and the GST/HST contexts.

**Apportionment Cases**

GST/HST is imposed on almost all supplies of property and services that are either made or deemed to be made in Canada except exempt or zero-rated supplies. As

72 Canada Revenue Agency, *GST/HST Audit and Examination Manual 2016-01*, chapter 44, at section 44.1.4 (available on Taxnet Pro).
74 See David Sherman’s editorial comment on *Living Friends Tree Farm* case (available on Taxnet Pro).
75 *Stewart*, supra note 68, at paragraph 4.
noted above, the main distinction between zero-rated supplies and exempt supplies relates to the availability of ITCs.

Zero-rated supplies are taxable at a rate of 0 percent, and generally the supplier is entitled to recover the GST/HST incurred to make those supplies through a claim for ITCs. Zero-rating reduces the price of a good because tax is not added to it. Essential goods, such as groceries and prescription drugs, are typically zero-rated to ensure access to them by persons at all income levels.

Exempt supplies (which include financial, educational, child-care, and healthcare services) are exempt from GST/HST; therefore, a seller of such services cannot claim ITCs in respect of supplies purchased and used in carrying on the business. Goods or services are exempted from a VAT when it is hard to define the value added by the service, or for policy reasons. Similar to zero-rated goods, exempt services, such as education, health care, and child care, serve a public good. Exemption from GST/HST means that they can be priced lower and remain accessible, although some writers have argued that financial services should be taxable, similar to models adopted by other countries.\(^\text{76}\)

Businesses (other than financial institutions) that provide a mix of taxable and exempt supplies must use the allocation rules in subsection 141.01(5) to determine the appropriate amount of ITCs to claim. The method chosen by the taxpayer must be a fair and reasonable way of determining which inputs were used in making taxable or exempt supplies.

For ITC apportionment purposes, where a combination of supplies (taxable, exempt, and/or zero-rated) is made, the claimant must determine whether the supplies are part of a “single supply.” As the Tax Court explained in Hurd Dentistry,\(^\text{77}\) the single supply doctrine asks whether the alleged separate supply is an integral part of the overall supply, such that it cannot be separated and still retain value. If the components of the supply are so interconnected that they cannot realistically be separated, they will be considered to be integral to a single whole rather than separate parts.\(^\text{78}\)

In Hurd Dentistry and other allocation cases reviewed in this study, the single supply doctrine was used to determine that orthodontists provide only exempt services, not zero-rated orthodontic appliances, such as braces. The orthodontic appliances and adjustment services were determined not to be useful items on their own, since neither service alone could provide the required corrective treatment. Both the appliance and the adjustment services had to be combined in order

\(^{76}\) See, for example, Pierre-Pascal Gendron, “Policy Forum: Canada’s GST and Financial Services—Where Are We Now and Where Could We Be?” (2016) 64:2 Canadian Tax Journal 401-16. Gendron suggests, ibid., at 415, that Canada should adopt the South African model, which taxes all fee-based financial services and all property and casualty insurance, and exempts only margin-based services and term insurance.

\(^{77}\) Dr. Brian Hurd Dentistry Professional Corporation v. The Queen, 2017 TCC 142.

\(^{78}\) Ibid., at paragraphs 16 and 17.
to benefit the patient; therefore, they constituted a single supply of “orthodontic treatment.”79 The single supply of orthodontic treatment was determined to be an exempt supply.

Other surveyed cases dealt simply with whether the apportionment method chosen by the taxpayer was “reasonable.” Several of these apportionment cases involved disputed amounts in the millions of dollars, with both sides using complex apportionment methods.80 Where the CRA has lost in previous cases, one response has been to ask the Department of Finance to introduce legislation that provides more consistent, and possibly more favourable, outcomes. For example, legislation was created to provide a consistent apportionment method for financial institutions.81

The commercial activities cases represent a multitude of considerations that taxpayers must bear in mind prior to making a claim for ITCs. The strictly enforced documentation requirements are another consideration for ITC claimants.

Inadequate Documentation Cases

The documentation requirements to claim an ITC are mandatory, must be met before a claim for ITCs can be made,82 and are strictly enforced.83 Notwithstanding that the documentation has to be obtained before a claim for ITCs can be made, the documents do not have to be submitted to the tax authority unless the business is audited.

While some claimants simply lack the required documentation, issues also arise where the name on the invoice or the GST/HST registration number does not match the supplier. These discrepancies can occur where an undisclosed agent or intermediary acts for the supplier.

Before filing a return in which an ITC is claimed, a registrant must obtain sufficient information to enable the amount of the ITC to be determined.84 The information to be included is prescribed in the GST/HST regulations. For supplies over $150, which require the highest level of documentation, the requirements include the following:85

- the name of the supplier or the supplier’s intermediary;
- the date of the invoice or, where no invoice is issued, the date on which tax was paid or payable;

79 Ibid., at paragraph 21.
80 See, for example, University of Calgary v. The Queen, 2015 TCC 321; and Sun Life Assurance, supra note 43.
81 See Jobs and Economic Growth Act, SC 2010, c. 12, under “Input Tax Credit Allocation Methods (GST/HST) Regulations.”
82 Davis v. The Queen, 2004 TCC 662.
83 Systematix Technology Consultants Inc. v. The Queen, 2006 TCC 277, at paragraph 10.
84 Subsection 169(4).
85 GST/HST regulations, supra note 41, section 3(c).
the total amount paid or payable;
- the supplier’s or the intermediary’s GST/HST registration number;
- terms of payment;
- a brief description of each property or service sufficient to identify it;
- the name or trading name of the recipient of the supply or the recipient’s agent; and
- an indication of the status of each supply where the invoice includes both taxable and exempt supplies.

The required information does not have to be in the form of an invoice, nor does it have to be contained in a single document.[^1] If the information is contained in different documents, the ITCs will be allowed provided that the amounts reported can be reconciled with the claimed amount.[^2]

Some documentation cases involved the failure of the registrant to collect the required information. In *George*,[^3] the registrant operated a buffet restaurant and provided no documentation to support the claimed ITCs on her first tax return. This was likely because she did not keep proper records or did not believe that she had to. Before trial, she was able to adduce some invoices, and the CRA conceded the ITCs to the extent that the invoices supported them. Otherwise, claims for ITCs are generally denied where there is missing information.

In *Tan*,[^4] the registrant provided documentation that did not include the suppliers’ GST registration numbers. The registrant argued that the CRA knew the registration numbers and should have looked for them to fix the problem. The Tax Court rejected that argument and denied the ITC claim, noting that although the CRA is the entity that issues and records GST registration numbers, it is not responsible for tracking down the numbers of a registrant’s suppliers if the registrant fails to provide them.[^5] The court held this was too onerous a burden for those charged with administering the ETA.[^6]

In *THD Inc.*,[^7] a trucking company provided documentation that included invalid GST registration numbers for the company’s suppliers. When the CRA initially denied the ITC claim, the company requested and obtained new invoices, which also contained invalid registration numbers, and the ITCs were denied again. The Tax Court noted that before giving the CRA’s auditor and the court the new series of invoices, the appellant should have checked the GST/HST registry to ensure that the numbers

[^1]: *McDavid v. The Queen*, 2014 TCC 112, at paragraph 27.
[^2]: Ibid., at paragraphs 33-36.
[^4]: *Tan v. The Queen*, 2015 TCC 121.
[^5]: Ibid., at paragraph 20.
[^6]: Ibid.
[^7]: *THD Inc. v. The Queen*, 2018 TCC 147.
were valid.\textsuperscript{93} (The CRA provides a free GST/HST registry search service to assist in the verification of registration numbers.)\textsuperscript{94} This imposed a “duty of verification” on the claimant—a duty that was first asserted in \textit{Salaison Lévesque},\textsuperscript{95} discussed below.

Arguably, any duty to verify a supplier’s information that is imposed on a taxpayer should be constrained. Such a duty is overly burdensome if it extends beyond verifying the supplier’s GST/HST registration number. A requirement to verify the identity of a supplier to ensure that the name on the invoice is the name of the entity that provided the service in question appears to go too far, unless a comparatively easy verification system or clear verification guidelines are implemented.

Attempts by the tax authority to require an ITC claimant to ensure that a supplier is remitting the applicable tax also go too far, and essentially ask the taxpayer to perform the tax authority’s job. The case law has largely concluded that taxpayers are not required to monitor their suppliers, despite repeated attempts by tax authorities to impose various supplier verification requirements.

In \textit{Salaison Lévesque},\textsuperscript{96} a company with operations in Quebec had contracted with temporary help agencies to provide it with personnel to work in its meat processing plants during peak times. Four of these agencies disappeared without remitting the GST and QST that they had collected from Salaison. Before paying any agency, Salaison checked to make sure that the agency was registered under the GST/QST number shown. In denying Salaison’s claim for ITCs, RQ argued that the company had not taken adequate steps to verify the legitimacy of the suppliers prior to making a claim for ITCs. The verification steps that RQ proposed included the following:\textsuperscript{97}

- going to the supplier’s head office to see if there were actual commercial activities;
- paying attention to the handwriting on the invoices to try to detect differences between invoices from the same business;
- verifying that the invoices from the same business followed a numerical sequence;
- verifying whether the business had vehicles registered with the applicable vehicle registry;
- asking all of the agencies’ employees who came to work for the company to provide identification and their social insurance numbers; and
- obtaining compliance letters to ensure that the hours worked by the agencies’ employees were reported.

\textsuperscript{93} Ibid., at paragraph 58.
\textsuperscript{94} Canada Revenue Agency, “Confirming a GST/HST Account Number” (www.canada.ca/en/revenue-agency/services/e-services/e-services-businesses/confirming-a-gst-hst-account-number.html#h1).
\textsuperscript{95} \textit{Salaison Lévesque}, infra note 96.
\textsuperscript{96} \textit{Salaison Lévesque Inc v. The Queen}, 2014 TCC 36; aff’d in part 2014 FCA 296.
\textsuperscript{97} Ibid. (TCC), at paragraph 72.
The Tax Court found that, in trying to impose the above verification steps, RQ would like Salaison to do the tax authority’s own work.98 RQ’s limited resources were apparently a consideration for the tax authority: one of the auditors who had acted on the Salaison file testified that “businesses that deal with employment agencies have more resources and powers than [RQ] to ensure that agencies are complying with the [ETA] and its Regulations.”99 With respect, the auditor’s position does not seem realistic.

The Tax Court ultimately held that the proposed verification requirements were too burdensome, but did accept that taxpayers should at least verify that the GST/HST numbers of their suppliers are valid by searching the GST/HST or QST registry.100 The ITCs were allowed in this case, confirming that taxpayers should not be required to police their suppliers’ GST/HST/QST remittances.

Following Salaison Lévesque, in Papier Reiss101 the Tax Court summarized the following principles regarding the duty of verification:

- The name of the true supplier or its intermediary, or the name under which the true supplier or intermediary does business, must appear on the supporting documentation submitted in respect of the ITC claim.102
- Registrants must have valid GST/HST registration numbers for their suppliers.103
- Registrants should implement appropriate risk management procedures; a registrant’s payment of GST “in good faith” is irrelevant.104

The court then expanded the requirements of the duty of verification to include105

- verification of the supplier’s tax registration online through the GST/HST or QST registry;
- an inquiry to the applicable provincial or federal government business registry; and
- verification of the supplier’s identity.

The court did not detail how a business should verify a supplier’s identity; however, it appears to have adopted RQ’s requirements that a purchaser should contact the

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98 Ibid., at paragraph 73.
99 Ibid.
100 Ibid., at paragraphs 89-92.
102 Ibid., at paragraph 189, citing Kosma-Kare Canada inc. v. Canada, 2014 FCA 225, at paragraph 7.
104 Papier Reiss, supra note 101, at paragraph 193, citing Comtronic Computer Inc. v. The Queen, 2010 TCC 55, at paragraph 29.
105 Papier Reiss, supra note 101, at paragraph 218.
applicable business registry to determine the business status of the supplier and to confirm the names of the supplier’s directors and officers. The business would then presumably cross-check the directors’ identity as provided by the applicable business registry against the names of the directors of the entity that the business had engaged to provide the goods or services.

The Quebec Court of Appeal has also stated in obiter that a registrant has a duty of verification that arises implicitly from the strict ITC eligibility requirements. None of the so-called requirements set out by RQ and by the Tax Court in Papier Reiss are explicitly stated in the ETA, the GST/HST regulations, or the equivalent Quebec legislation.

The high-water mark for documentation requirements may be found in Pro-Poseurs, in which ITCs claimed by a drywall installation company were denied. The Tax Court held that an invoice for construction services must state precisely where and when the work was done, including the specific floor or office in a building with multiple floors, and what kind of work was done.

Ironically, RQ has also denied the ITCs of prudent businesses that undertook steps to verify their suppliers. In SNF LP, the claimant was engaged in the business of recycling metals that it purchased from various sellers. SNF LP verified the GST registration numbers of all its suppliers and obtained photo identification, addresses, and telephone numbers to ensure that the suppliers were who they said they were. RQ denied the ITC claim on the basis that the suppliers in question did not have the resources to make the actual supplies and that the names of the suppliers on the invoices were not the names of the true suppliers, but were prête-noms (undisclosed agents) for the actual suppliers. RQ took issue with 12 out of the hundreds of suppliers that SNF LP transacted with, arguing that several of those suppliers did not have a scrapyard, trucks, or a sufficient number of employees to make the supplies. RQ took the position that a prête-nom was not an “intermediary” as defined in regulation 2 of the GST/HST regulations. Accordingly, in RQ’s view, the requirements to claim an ITC were not met because the name of the supplier or the supplier’s intermediary did not appear on the supporting documentation. Although SNF LP requested RQ’s help in identifying false suppliers and offered to remit the GST and QST directly to RQ, RQ did not take SNF LP up on this offer—likely because there is no legislative authority for a purchaser to remit tax payable directly to the tax agency rather than to the supplier.

In SNF LP, the Tax Court was firm in stating that a business with “hundreds, if not thousands, of suppliers” should not be expected “to make exhaustive inquiries

106 Ibid., at paragraph 28. RQ argued that the appellant should have attempted these measures.
108 Les Pro-Poseurs Inc. v. The Queen, 2011 TCC 113; aff’d 2012 FCA 200.
109 Ibid. (TCC), at paragraph 47. The Federal Court of Appeal did not address this point.
110 SNF LP v. The Queen, 2016 TCC 12.
of each potential supplier.” The court also noted that any obligation to verify the information provided by suppliers has no statutory basis in the ETA or elsewhere. Moreover, neither the ETA nor the GST/HST regulations set out the procedure to be followed in verifying suppliers’ information, although the court did suggest that a registrant is not required to make inquiries each time it makes a purchase. Rather, in the court’s view, a business should make inquiries prior to making its first purchase from a supplier. The court did state that a registrant must make inquiries when it suspects that its supplier is engaged in illegal, dishonest, disreputable, or corrupt business practices. A failure to make such inquiries means that the registrant purchases supplies at its own risk and may have its claim for ITCs denied. This suggests that if a registrant has actual or persuasive evidence of disreputable practices on the part of its supplier, the registrant must make reasonable inquiries to ensure that the supplier named on the supporting documentation (or the supplier’s intermediary) actually provided the supply. Otherwise, the claimed ITCs will be denied. With respect, the court’s statement on this point goes too far, particularly in circumstances where genuine goods or services are exchanged, and enforcing such a requirement would have far-reaching implications. Ultimately, the claim for ITCs in SNF LP was allowed because the business had taken “reasonable precautions” in verifying its suppliers.

The duty of verification is an attempt by the tax authorities to indirectly ease their own administrative burden by having registrants ensure that their suppliers remit the applicable tax. As discussed further below, fraud is a real and recurring issue, but increasing the taxpayer’s compliance burden has the potential to harm businesses, particularly smaller enterprises, and is an inappropriate response. Rather than requiring purchasers to verify their suppliers, the tax authorities should more stringently scrutinize applicants for GST registration.

The case law has constrained a duty of verification to requiring the use of GST/HST registry searches and requiring that purchasers ensure that the invoices submitted to them by their suppliers actually originate from those who supply the services. Where the supplier uses an intermediary, the ITC claimant may need to show that the alleged intermediary acted on behalf of the supplier. In some cases, where the name on the supporting documentation does not appear to be that of the true supplier and the ITC claims are denied, the tax authorities allege that the registrant and the supplier are engaged in a fraudulent “invoice-of-convenience” scheme to manufacture ITCs. (Such schemes are discussed in the next section.)

Supplier verification can be important in refuting allegations of fraud by the tax authorities. One response has been Quebec’s creation of the attestation de Revenu Québec (also discussed below). The attestation verifies that businesses in certain

111 Ibid., at paragraph 82.
112 Ibid., at paragraph 78.
113 Ibid.
114 Ibid., at paragraph 81.
industries are compliant with Quebec’s tax laws, thereby signalling to other businesses that they are less likely to be fraudulent suppliers.

**Alleged or Actual Fraud Cases**

The issue of GST fraud in Canada has been recognized since the inception of the GST in 1991. As early as 1993, there was evidence of an increase in the underground economy and the purposeful evasion of the GST.\(^{115}\)

The invoice credit method for ITC claims can result in unfairness to purchasers that have paid GST/HST in good faith, since it leaves the purchaser to bear the risk of any fraud committed by a supplier. As evidenced by the duty-of-verification cases, Canadian businesses are effectively required to adopt risk management procedures in order to verify each of their suppliers or take the chance of having their ITC claims denied. These enhanced verification norms inherently place a greater burden on businesses with many suppliers.

In response to media accounts of GST fraud, two reports were commissioned by the auditor general of Canada to review the CRA’s capacity to detect and deter GST errors, fraud, and abuse. The first report, completed in 1999, concluded that the CRA’s post-payment audits consume too many staff hours and that audit performance could be improved by “better selection of registrants for audit.”\(^{116}\) The followup report in 2001 noted that “satisfactory” progress had been made in these areas.\(^{117}\)

Two common forms of GST/HST fraud are situations where a registrant overstates the amount of GST/HST that it paid in an attempt to receive a larger refund, or where a supplier fails to remit the collected tax.

Tax authorities have been increasingly results-driven in trying to recover unremitted amounts by denying ITC claims. RQ has been particularly aggressive in denying ITCs and, as discussed further below, has been reprimanded in this regard by the Quebec ombudsman. Enforcement activities should not make the tax regime more difficult to administer, or shift the burden for compliance from dishonest to honest taxpayers. The danger is that overzealous enforcement will create an unfair tax system.

Certain types of fraud also exploit differing tax rates or the zero-rating of certain supplies. For example, goods purchased in provinces where HST applies (at rates ranging from 13 percent to 15 percent) may be resold in provinces where only GST

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applies (at the rate of 5 percent). A fraudulent claimant could create false invoices and make a claim for ITCs based on the difference in the tax rates, thereby increasing the amount claimed by 8 percent to 10 percent. The business would also be in a refund position, and may be able to sustain the scheme for some time before being audited. Similarly, as discussed earlier in this article, no tax is collectible on zero-rated supplies, but a business making such supplies can still claim ITCs. Zero-rated export sales and the sale of refined gold have been abused in this manner.

A recent news story may best exemplify the extent of fraudulent claims for ITCs. In 2019, four members of a Nova Scotia family who owned multiple businesses were charged with 10 counts of fraud. They were accused of filing fraudulent GST/HST returns claiming ITCs that totalled more than $3.6 million, including one claim for $117,850 purportedly for services provided by a company named Vandalee Industries (an apparent play on the name of a fictional company featured in an episode of the Seinfeld television series).118

A missing trader is simply a supplier that does not remit the collected GST/HST. This type of fraud can be particularly troubling for the tax authorities because they may lose the value of the GST/HST twice—first when the tax is not remitted, and a second time if a claim for ITCs is paid out. The innocent parties in these situations (the recipients of the goods or services) often have their claimed ITCs denied as the tax authority tries to recoup some of its loss.119 RQ has been particularly aggressive in this regard, notably in its attempt to impose more stringent duty-of-verification requirements in support of ITC claims.

In cases where a supplier does not remit the collected GST/HST, Canadian tax authorities often assert that the ITC claimant is participating in an invoice-of-convenience or invoice-of-accommodation scheme. This type of scheme involves an arrangement between a purchaser and a supplier whereby the supplier issues invoices to evidence a fictitious supply in order to manufacture ITCs. In effect, the supplier “accommodates” the purchaser’s demand for ITCs. Where an audit shows


119 See Salaison Lévesque, supra note 96; Kosma-Kare, supra note 102; Pépinière A. Massé Inc. v. The Queen, 2014 TCC 271; SNF LP, supra note 110; and Syscomax Inc. v. The Queen, 2014 TCC 202.

120 Pro-Poseurs, supra note 108 (FCA), at paragraph 3.
that no actual goods or services were supplied, the ITCs will be denied because the claimant did not “acquire” property or a service as required under subsection 169(1).

As the duty-of-verification cases make clear, the tax authority may allege that the person issuing the invoice is not the “true supplier,” but rather is an accommodation party. The case law now requires the purchaser to verify the supplier’s GST/HST/QST registration number and to confirm that the supplier named on the invoice was the entity that supplied the goods or services at issue. If an intermediary is used, the purchaser must show that the intermediary acted for the supplier.

Quebec encounters alleged invoice-of-convenience schemes primarily in relation to contractors in the construction industry and employment agencies. In Syscomax, ITCs claimed on payments to construction subcontractors purported to have been supplied by a company called TFX were denied because there was no evidence that anyone from TFX had worked on the site. The documentation examined in this case included the records of Quebec government inspections. The owner of TFX had also been convicted of providing false invoices to other companies. While the Tax Court upheld the denial of the ITCs, it found no evidence that Syscomax had participated in an accommodation invoice scheme as alleged by RQ.

In the employment agency context, ITCs are denied where there are suspicious circumstances in the arrangements, suggesting that no services were actually provided. These circumstances include the calculation of billings by the recipient of the services rather than the agency, and a reported hourly rate that was too low for the agency to have been able to pay the employees the legal minimum wage and still cover operating expenses.

In some situations, the invoice shows a valid GST/HST registration number, which the purchaser has verified using the GST/HST registry, but the tax authority argues that the number on the invoice is not the registration number of the true supplier. These situations are particularly troubling because they may involve ITC claimants that are innocent and not acting in concert with the supplier, but that nevertheless have their ITC claims denied.

In cases where actual goods or services are supplied but the invoices show the name and GST/HST registration number of an entity that does not appear to have the resources to provide the goods or services, that entity may be an intermediary of the true supplier under the GST/HST regulations. ITCs may be allowed if the invoices show the intermediary’s name and GST/HST registration number. However, if actual goods or services are supplied but the supplier provides a false GST/HST registration number, the ITC claim will be denied because the true supplier’s name and registration number are not shown on the documentation, as required by the GST/HST regulations.

121 Syscomax, supra note 119.
122 Ibid., at paragraphs 1 and 23-28.
123 See Pépinière, supra note 119; Kosma-Kare, supra note 102; and Salaison Lévesque, supra note 96.
124 Salaison Lévesque, supra note 96 (TCC), at paragraph 44.
125 Ibid.
As discussed earlier, in *Salaison Lévesque*, RQ denied ITCs on payments to four employment agencies that had disappeared without remitting their GST and QST. ITCs were allowed for payments to other agencies that did remit the applicable taxes. RQ was results-driven in this approach. When it was unable to get the tax remittances from the agencies, it tried to get the tax from Salaison.

RQ’s attempt to expand the duty of verification in respect of suppliers’ information aimed in part to ensure that delinquent suppliers would remit the collected tax. In 2014, the Quebec ombudsman spoke out against this approach, noting that “[b]y requiring businesses to check whether subcontractors have fulfilled their tax obligations, Revenu Québec imposes a task that is not prescribed by law and that is practically impossible for businesses that subcontract to carry out.”126

The Quebec ombudsman has also been critical of RQ’s auditing methods in these situations, noting that audit officials assume from the outset that the business is guilty and refuse to take into account documents or explanations that the business in question provides.127 These practices violate several basic taxpayer rights as well as principles of procedural fairness, and preclude a complete defence.128 The remittance of tax collected by the supplier should not be a prerequisite to an ITC claim, especially where the claimant is innocent of the fraud and actual goods or services are provided.

In 2010, the Quebec government introduced a new measure to combat fraudulent activities in certain industries. The attestation de Revenu Québec certifies that a person or business met the following conditions on the date of its application for the attestation:129

- It had filed the returns and reports required under Quebec tax laws.
- It did not have any overdue account with Quebec’s minister of revenue in respect of a tax law or, if it did, it had reached and abided by a payment agreement, or the collection of its debts had been legally suspended.

An attestation de Revenu Québec is valid from the time of issue until the end of the third month following the month in which it is issued. A business can sign up for automatic renewal of the attestation if the business holds at least one valid attestation at the time the request is made. However, a person applying to use the automatic renewal service on behalf of a business must have a general power of attorney with respect to the business. Presumably, each automatic renewal is vetted by the tax authorities to ensure that the business has remained compliant.

127 Ibid.
128 Ibid., at 30.
An attestation de Revenu Québec is required before a person or business can bid on or enter into certain construction contracts, public contracts, and contracts or arrangements with temporary help agencies and placement services. Where a supplier has applied for and received an attestation, a potential purchaser is reassured, to some degree, that the supplier is compliant with the tax laws and is less likely to engage in fraudulent practices.

While the attestation is currently limited to the construction and temporary help industries, it could be extended to other problem areas. For example, in the scrap metal industry, invoices of convenience are being used in situations where there is no actual transfer of goods between a supplier and a purchaser.130

**Gold Scams**

Canada has had to deal with a particular form of GST/HST fraud in the gold-trading industry.131 Scrap gold is subject to sales taxes, while pure gold is zero-rated as a precious metal.132 Dealers buy scrap gold, refine it, sell the pure gold, and claim ITCs for the tax paid to their suppliers. This creates an opportunity for unscrupulous parties to take advantage of the zero-rating of precious metals by creating fake invoices to evidence transactions where scrap gold is purchased, refined, and sold, but where no gold actually changes hands. The zero-rating of the supply means that the party making the ITC claim is almost always in a refund position, and the scheme may go undetected for some time. Alternatively, the supplier of the scrap gold may collect the tax, sell the pure gold, and then not remit the collected taxes.

In 2011, RQ initiated a series of searches and seizures of companies in the Montreal area, alleging that companies in the gold-refining and -trading industry engaged in tax fraud on transactions worth $1.8 billion.133 Approximately 125 companies were allegedly complicit in the scheme, which defrauded the Canadian government of an estimated $350 million.134 One of Quebec’s most prominent gold-trading companies, Métaux Kitco, was reassessed for $85 million in ITCs and $227 million in QST input tax refunds.135 Ultimately, the company negotiated an

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130 For similar examples, see Papier Reiss, supra note 101; and SNF LP, supra note 110.

131 See CC Gold Inc. v. The Queen, 2018 TCC 155 (full trial pending); National Money Mart Company v. 24 Gold Group Ltd., 2018 ONCA 812; TricomCanada Inc. v. The Queen, 2016 TCC 8; and Métaux Kitco inc. (Arrangement relatif à), 2016 QCCS 444.

132 See subsection 123(1), the definition of “precious metal.”


134 Ibid.

135 See Métaux Kitco, supra note 131, at paragraph 14.
agreement with the CRA and RQ allowing it to settle the tax debt with a payment of $81.7 million.\textsuperscript{136}

In another case, TricomCanada (“Tricom”) bought $20 million worth of gold during an eight-month period in 2012.\textsuperscript{137} Companies participating at earlier stages of the sales chain had disappeared without remitting GST and QST. Despite evidence that the gold purchases were real, the minister of national revenue alleged that Tricom had knowingly, or acting with wilful blindness, participated in a false-invoicing scheme. In the Tax Court’s view, two of the suppliers were suspect, because they were run by people living on welfare, and evidence suggested that Tricom actually knew what was going on both up and down the supply chain. The court found that the invoices were used to mask the identity of Tricom’s true suppliers and did not disclose the names of the suppliers as required under subsection 169(4). Accordingly, the court denied ITC\textsuperscript{s} totalling $995,000, along with $2 million of QST input tax refunds. The court’s decision is consistent with the duty of verification imposed in \textit{Salaison Lévesque} and subsequent cases. Businesses in the gold-trading industry should be wary: future cases may involve innocent parties that have been duped in a complex scheme or that do not fully understand the potential consequences of their activities.

\textbf{Carousel Schemes}

A carousel scheme involves false commercial transactions and a lengthy paper trail intended to convince government agencies that a business is eligible for large tax refunds on export sales. The fraudster creates fictitious sales and transfers to accomplice companies. The goods continue to be sold through a series of controlled companies, each liable to pay the GST, before the goods are finally exported as sales of zero-rated supplies. The companies in the chain disappear without remitting the GST, and the final supplier claims a refund. This process can be repeated many times, resulting in the goods circulating in the same fashion as a carousel.\textsuperscript{138}

Media reports in 2017 revealed a carousel scheme based in the United Kingdom that involved filing claims for ITCs in Canada.\textsuperscript{139} Eleven individuals in the United


\textsuperscript{137} TricomCanada, supra note 131.

\textsuperscript{138} In the European Union, “intracommunity transactions” (that is, transactions between businesses in different EU member countries) are zero-rated. In that context, an example might involve, say, company A located in France, which sells goods to company B, located in Germany. No VAT is charged because the transaction is zero-rated. Company B sells to company C, which is also located in Germany. Company B does not remit the VAT charged on the transaction. Company C then sells the goods back to company A, allowing company C to claim a VAT refund on zero-rated exports.

Kingdom set up 84 corporations in Canada and overseas. Those corporations then created long paper trails to give the appearance of a series of international transactions involving the trade of telecommunications time and electronic equipment. The scheme aimed to defraud the Canadian government of some $52 million but obtained only $4.7 million in ITCs before the CRA caught on.

Carousel schemes are rare in Canada; however, in the European Union, it is estimated that carousel schemes and missing-trader fraud could account for €40 billion to €60 billion of annual VAT revenue loss and that 2 percent of organized crime groups could be behind 80 percent of the fraud. These figures might even be understated. Carousel and other VAT fraud schemes are increasingly using intangible property, such as carbon credits, making such schemes harder to detect.

The European Union has spent considerable resources trying to limit the perpetration of VAT fraud by organized crime groups, reflecting concerns that the stolen funds are often used to finance illegal activities such as human trafficking and terrorism. Canada has encountered such VAT fraud on a much smaller scale. Lessons from countries with greater experience in addressing the problem can inform how Canada might respond to prevent it from becoming a larger issue.

OPPORTUNITIES FOR TAX REFORM

Opportunities to address non-compliance in the ITC system in Canada are numerous, but wholesale reform of the GST/HST will not be considered here, owing in part to the amount of revenue that the tax provides ($38.2 billion, or 11.5 percent of all federal revenues, in the 2018-19 taxation year).

For two recent cases, see Cherniak, supra note 45, and Iris Technologies Inc. v. Canada (National Revenue), 2020 FC 532 (involving an alleged carousel scheme that sought a refund of $62.3 million).


compared to an increase in corporate income tax rates.\textsuperscript{146} Any increase in the GST/HST rate may increase the potential revenue loss from non-compliance.

Worldwide, 169 countries currently impose a VAT, including 35 of the 36 member countries of the Organisation for Economic Co-operation and Development (OECD).\textsuperscript{147} Among OECD member countries, VATs raise, on average, approximately one-fifth of total tax revenues.\textsuperscript{148} Other VAT jurisdictions are arguably more proactive than Canada in confronting VAT fraud because their tax mix means that more revenue is at stake. According to the OECD, on average, VATs account for 30.7 percent of the total tax revenues of the Group of Seven countries (excluding the United States), compared to 13.4 percent in Canada.\textsuperscript{149} The International Monetary Fund (IMF) has encouraged Canada to change its tax mix and to specifically consider increasing its reliance on the GST.\textsuperscript{150} Recommendations to change Canada’s tax mix rely on foreign evidence, and one Canadian study has suggested that the alleged gains that may accrue from changing the tax mix are “overstated, controvertible, or non-existent.”\textsuperscript{151} A shift of the tax mix toward the GST/HST would also result in uncertain gains in tax compliance and no savings in tax administration.\textsuperscript{152} However, taking into account the impact of the COVID-19 pandemic, increasing the GST rate (even temporarily) may be viewed as an option to decrease the federal debt incurred in responding to the economic crisis.

The discussion in this section of the article first reviews the situation in other VAT jurisdictions and then analyzes options for reform that some countries have implemented.

**Comparison of Other VAT Jurisdictions with Canada**

Europol, the European Union’s law enforcement agency, estimated that the VAT gap totalled approximately €160 billion in 2014.\textsuperscript{153} As noted above, missing-trader

\begin{footnotesize}
\begin{itemize}
  \item 146 See Ferede and Dahly, supra note 13, at 6 and 20.
  \item 148 Ibid.
  \item 149 Ibid., at 14.
  \item 152 Ibid., at 28.
  \item 153 European Union for Law Enforcement Cooperation, Europol Review 2016-2017 (The Hague, the Netherlands: Europol, 2017), at 58. This number includes losses attributable to fraud, bankruptcies, and financial insolvencies.
\end{itemize}
\end{footnotesize}
and carousel fraud could account for €40 billion to €60 billion of the annual VAT losses in the European Union, with other forms of unintentional and intentional non-compliance making up the remainder.

India, whose national GST came into effect on July 1, 2017, has already encountered a significant problem of non-compliance with its ITC system. In 2018-19, 1,620 cases of fake invoices were registered, involving fraudulent ITC claims of Rs112 billion (approximately Cdn$2 billion) under the GST. In the first six months of 2019, 535 cases of fake invoices were detected, involving fraudulent ITC claims totalling approximately Cdn$478 million.

ITC fraud in India has led to the introduction of strict supplier verification requirements, thereby delaying or denying refunds. An increase in verification requirements and auditing powers is a common response to ITC fraud. In Canada, this is exemplified by the duty-of-verification cases discussed above and recent commitments to crack down on tax evasion and tax avoidance, through audits and other enforcement measures.

Increasing the resources available to the CRA to address the problem of non-compliance is an approach that has been endorsed in recent federal budgets. Specifically, the federal budgets between 2015 and 2019 committed $1.4 billion to combatting tax evasion and aggressive tax avoidance, and to improve compliance. This money would be used to hire additional auditors and specialists, develop business intelligence infrastructure, increase verification activities, and improve the quality of investigative work that targets criminal tax evaders. There was no breakdown of how much of this $1.4 billion commitment was to be allocated to addressing non-compliance with the GST regime more broadly or the ITC rules specifically.

The international tax dialogue (ITD) (an initiative sponsored by the IMF, the OECD, and the World Bank, to facilitate discussion of tax matters among national tax

156 Ibid.
158 See, for example, Canada, Department of Finance, 2016 Budget, Budget Plan, March 22, 2016, at 216. The 2016 budget committed $444.4 million over five years for the CRA to enhance its efforts to constrain tax evasion and tax avoidance.
159 See supra note 158.
officials and international organizations) has counselled national tax officials against using their audit powers to control evasion. Specifically, a paper prepared for the 2005 ITD conference on the VAT argued that “massive checking of refunds and invoices is self-defeating. The benefits of such a program are very unlikely to offset the considerable administrative and compliance costs they involve.”160 Since 2005, however, advancements in technology and the rise in the use of electronic invoicing (e-invoicing) mean that checking invoices is less administratively burdensome than it was at the time that those views were expressed.

The continued ratcheting up of the compliance requirements related to the existing Canadian ITC system will impose increasing costs on business. An imposed duty of verification and RQ’s increasingly aggressive audits have had the effect of adding to the compliance burden for both taxpayers and the tax authorities. Neither of these strategies is a suitable long-term solution to the problem of non-compliance with Canada’s ITC system. Alternatives must be sought, because a broad toolkit for combatting non-compliance is essential.

The CRA’s voluntary disclosure program (VDP) is one tool that promotes a broader compliance strategy in Canada and seeks to strike a balance between fairness to taxpayers and revenue generation.161 The VDP allows taxpayers to disclose previous omissions or errors in their tax reporting, in exchange for protection from criminal prosecution and civil penalties, and partial relief for accrued interest, provided that they satisfy the conditions in Information Circular IC00-1R4.162 The VDP can result in lower costs for the tax authorities than a traditional audit and are a strong tool for taxpayers faced with a tax liability for their non-compliance. International sources provide other tested measures that Canada could add to its toolkit for combatting non-compliance with the GST/HST and ITC rules.

**Moderate Reform Options Based on Other VAT Jurisdictions**

Discussions on reform options routinely begin with the suggestion that the tax code should be simplified as a starting point. As revealed by the data above, some non-compliance is the result of a failure to understand the requirements for claiming an ITC. At least one study has measured the complexity of the GST regime.163 It found that between the tax’s inception in 1993 and 2011, the number of court cases related to the GST had increased by 56 percent. Some of those cases likely involved

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162 *Information Circular IC00-1R4,* “Voluntary Disclosures Program,” March 21, 2014.

problems with ITC claims. Consideration of wholesale reform options for the GST is beyond the scope of this article, but the OECD has proposed several changes in VAT collection methods as more moderate reform options to combat fraud.

International tax authorities are implementing a variety of responses to VAT fraud and non-compliance. The OECD has classified these responses within three areas:

1. Changes in VAT collection methods, such as domestic reverse charges and split payments;
2. Reinforcement in taxpayer’s reporting obligations; and
3. International administrative cooperation and exchange of information.\textsuperscript{164}

These areas are considered below, before a review of options proposed or implemented in Canada. As a general comment, it should be noted that, internationally, both VAT thresholds\textsuperscript{165} and VAT rates are typically higher than the thresholds and rates for Canada’s GST/HST.\textsuperscript{166}

**Domestic Reverse Charges and Split Payments**

Reverse-charge mechanisms for business-to-business transactions shift the liability to remit the VAT from the supplier to the purchaser. Practically, the recipient of the goods or services reports both its input tax and output tax on such transactions in its VAT return, and no net tax is payable on the transactions. This approach removes the possibility for suppliers to disappear without remitting the collected VAT.

Canada uses a reverse-charge mechanism with respect to certain sales of real property by non-residents and some supplies between provinces.\textsuperscript{167} In the ITC context, the CRA could allow GST/HST registrants in certain problem industries to remit the tax payable on their inputs directly; however, if a reverse-charge mechanism is applied only to certain transactions or industries, it may simply shift the problem to other areas. The alternative—applying such a mechanism universally—would fundamentally change how the GST/HST is collected.

A split-payment mechanism has the supplier charge the VAT to its customers according to the usual rules, but the VAT paid by the customer is remitted directly to the tax authorities through the use of intermediaries. Intermediaries such as banks, credit card companies, and online service providers are organized to split the gross taxes between the supplier and the ultimate recipient of the goods or services.

\textsuperscript{164} OECD, *Consumption Tax Trends 2018*, supra note 147, at 60.

\textsuperscript{165} In the EU member states, for example, the VAT thresholds range from nil to upward of Cdn$100,000.

\textsuperscript{166} See, for example, European Union, Council Directive 7166/18 of 10 April 2018 on Amending Directive 2006/112/EC on the Common System of Value Added Tax as Regards the Obligation To Respect a Minimum Standard Rate. This directive mandates that the minimum VAT rate among EU members is 15 percent. Many states have a VAT rate in excess of 20 percent.

\textsuperscript{167} See, for example, subsection 221(2).
amount paid by the customer into a net amount and a VAT amount. The latter is remitted to the tax authorities. This mechanism also prevents suppliers from disappearing with unremitted VAT.

The downside to a split-payment mechanism is the potential high cost of implementation, since this measure would substantially change the way businesses and tax administrators handle the GST/HST. It would also shift the compliance burden from the taxpayer onto intermediaries. Canada does not currently use a split-payment mechanism.

Canada could also defer the payment of ITC refunds, rather than provide full immediate credit. In France, the tax authorities must issue a refund within six months of the claim, but that time limit can be extended for an additional three months. This approach could affect the cash flow of some businesses and would require some adjustment, but it may deter fraudulent suppliers since there would be more chance of a suspect claim being flagged for audit. The COVID-19 pandemic has highlighted cash flow concerns in some businesses, which have been addressed by federal and provincial aid packages. Possible cash flow issues with respect to the deferred issuance of an ITC refund would need to be researched further prior to implementing a deferred refund regime similar to the one adopted in France.

In the Iris Technologies case, the taxpayer cited cash flow concerns in seeking an order of mandamus that would compel the CRA to pay an ITC refund that was withheld during an audit. The results of the audit suggested that the business was engaged in a carousel scheme. The business argued that the withholding of the ITC claim was causing financial hardship and would force the company into bankruptcy. The company was ultimately unsuccessful, in part because it appeared to have exaggerated the impact of the delayed refund.

**Increasing Reporting Requirements**

Several countries have increased their reporting obligations for certain VAT registrants so that transactions are reported to the tax authority periodically or in near-real time. E-invoicing is one real-time reporting method being adopted internationally. E-invoicing regimes require “businesses to issue invoices in a prescribed electronic format containing mandatory information and transmit these invoices to a specified electronic system in real time.” The invoices are approved by the tax authority prior to being sent to customers. Paper returns are not valid for the purposes of claiming a VAT refund. Increased reporting allows for almost instantaneous auditing, meaning that tax authorities can detect overstatements or anomalies sooner.

168 Iris Technologies, supra note 140.


E-invoicing is one method that the European Union has implemented in response to an estimated VAT gap of €137.5 billion in 2017. As of April 18, 2020, all business-to-government transactions in the EU member states must be reported in the form of an e-invoice. Worldwide, a 2018 survey found that in 82 surveyed jurisdictions, 57 had a regulation related to e-invoicing and e-invoicing was mandatory in 10 states.

Mandatory reporting has been implemented in Italy for business-to-business and business-to-consumer transactions. In Italy, registrants must transmit their draft invoices via the Sistema di Interscambio (SDI) platform, which is run by the Italian tax authorities. The SDI acts as an invoice pre-approval mechanism. Each draft invoice is validated by SDI; then, if it is approved, it is transmitted to the purchaser. Accordingly, in Italy, a valid invoice cannot be issued and sent to a purchaser without prior approval from the tax authorities. Failure to comply can result in penalties up to 180 percent of the charged VAT.

France plans to follow Italy’s lead in implementing real-time reporting. Beginning in 2023, all business-to-business transactions in France will require that e-invoices be submitted to the tax authorities’ Chorus Pro portal for clearance before they are sent to the customer. The collected data will then be used to complete draft VAT returns, which will be sent to the registrant for review. This approach reduces the compliance burden for registrants since they do not have to complete the returns themselves. In case of error, the registrant will be able to apply for an adjustment to the draft VAT return.

The approaches described above would reduce the number of disputes over ITC claims arising from missing information. A proposed e-invoicing system could prevent the transmission of a document where certain information is missing or invalid (such as the supplier’s GST/HST registration number). The system could be linked with the GST/HST registry to ensure that the supplier’s name listed on an e-invoice matches the listed GST/HST registration number. Where the applicable tax is not


remitted, the Canadian tax authorities may still allege that the supplier was not the true supplier. The administrative resources gained by Canadian tax authorities through the implementation of an e-invoicing system could be directed to more stringent verification of the information provided by registrants.

An obvious downside to real-time and near-real-time reporting is the initial compliance cost and the administrative cost of developing and implementing the system. In most VAT jurisdictions, including Canada, businesses are not required to provide tax authorities with details of every transaction, unless they are audited. Ongoing costs once the system is implemented may not be as burdensome.\(^\text{176}\)

The additional costs of increased reporting obligations for large companies may not be significant where those businesses are able to integrate the process into their sales and accounting software and point-of-sale equipment. Italy has a VAT threshold of €65,000 (approximately Cdn$99,000), so many smaller businesses are not required to use the SDI system. Canada could consider raising the GST registration threshold to leave some of the smallest businesses outside this system.

In recognition of the potential impact of mandatory e-invoicing on small businesses, the Italian authorities created a smart phone application (app), App FatturaE, which enables businesses to create and transmit e-invoices on their phone.\(^\text{177}\) The possibility of introducing smart phone invoicing apps suggests that the compliance burden associated with enhanced reporting obligations for small businesses may not be as great as previously thought, and the use of this technology merits further research.

Another alternative is the adoption of the SAF-T (standard audit file for tax), which is a standardized format promoted by the OECD to facilitate the collection of information from businesses’ accounting systems (invoices, payments, and general ledger) for submission to tax authorities.\(^\text{178}\) The SAF-T format is meant to simplify tax compliance and tax audits, since the information is more accessible. The data are required to be transmitted either at the request of the tax authority or periodically. Portugal’s tax revenues increased by 13 percent in 2013 following the implementation of this model, and the cost to both the tax authority and taxpayers was lower than expected.\(^\text{179}\) Periodic reporting in an international standardized format allows for administrative cooperation among countries that have implemented the SAF-T format. In theory, standardized e-invoicing schemes may eventually allow for all international transactions to be reported and transmitted to the tax authorities of

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\(^\text{176}\) Lukic, supra note 169.

\(^\text{177}\) Fattura Elettronica.


the relevant countries in real time. This may reduce the use of some international schemes that rely on the zero-rating of exports or certain cross-border supplies.

**International Administrative Cooperation**

International administrative cooperation to combat international VAT fraud has already been undertaken. The rise of digitization has expedited this need for international cooperation, as the OECD has recognized. In 2017, Canada joined more than 90 other jurisdictions in implementing the OECD’s common reporting standard and began data sharing in 2018. This initiative allows for coordinated efforts against fraudulent transnational schemes.

The ITD has also recommended higher thresholds for VAT registration and an increased audit focus on high-risk taxpayers. This would leave the majority of businesses free of compliance costs. The data from my study suggest that Canada’s documentation requirements impose a disproportionate burden on smaller businesses. Non-compliance with the applicable substantive rules for claiming ITCs is also apparent among smaller businesses. Canada could consider implementing different GST thresholds for businesses that provide only services and those that sell only goods. More research would have to be done to determine the viability of increasing or otherwise changing the GST registration thresholds in Canada.

**Reform Options Implemented or Proposed in Canada**

A number of reform options are already being implemented in Canada, namely, the attestation de Revenu Québec, education efforts aimed at registrants, and the use of data collection and reporting technology.

**Attestation de Revenu Québec**

The federal government should follow Quebec’s lead in introducing a form of the attestation de Revenu Québec. The attestation is currently required only for certain construction contracts, public contracts, and contracts or arrangements with temporary help agencies, but could be expanded to encompass other problem industries with reported evidence of GST fraud. A free, publicly accessible electronic database could be created in which the attestations could be stored for search and verification,

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181 See Organisation for Economic Co-operation and Development, *Standard for Automatic Exchange of Financial Information in Tax Matters, Implementation Handbook*, 2d ed. (Paris: OECD, 2018). The common reporting standard calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions annually. This is done to facilitate cross-border tax transparency on financial accounts held abroad. Ibid., at paragraph 1.


183 Ibid.
similar to the “My Account” program maintained by RQ.\textsuperscript{184} Businesses could rely on the information held in the database to verify their suppliers, thereby resolving some of the issues in the duty-of-verification cases discussed earlier.

The attestation is limited in that it only certifies that the business is compliant as of the date of the application. This limitation is mitigated to some extent by the relatively short validity period (roughly three months) for each attestation, although, as mentioned earlier, a business can apply for automatic renewal. Because a business has to reapply every few months, there is some ongoing confirmation that the business has remained compliant. Automatic renewal eases some of the compliance burden on taxpayers who would otherwise have to reapply every few months, although the corresponding administrative requirement to verify a business’s ongoing compliance remains.

Similar to the reverse-charge mechanism, while the attestation can address industry-specific situations, it may have the effect of shifting fraudulent activities to other industries.

\textit{Educational and Other Measures To Remedy Unintentional Non-Compliance}

The cases reviewed in this article show, in part, that there is some misunderstanding of the applicable rules for claiming ITCs. In Satterthwaite’s study, the complexity of the GST/HST scheme was one reason cited by small suppliers for why they had not registered.\textsuperscript{185} Further education may be required to ensure that the ITC rules are not misapplied by registrants.

Satterthwaite proposed various options to remedy misconceptions about the complexity of registering for the GST.\textsuperscript{186} These options included providing a dedicated GST/HST help line for entrepreneurs to call or offering education on voluntary GST registration to small suppliers. The CRA already provides a GST/HST help line to assist taxpayers with technical inquiries. It should be noted, however, that the auditor general’s 2017 fall report on the CRA’s call centres found that 30 percent of the information provided by agents was incorrect;\textsuperscript{187} and at least two of the cases reviewed in this study involved taxpayers relying on erroneous advice from the CRA, to their detriment.\textsuperscript{188} Care must be taken to ensure that any proposal for further education is accurate in its content and that taxpayer relief is available where CRA errors lead to a tax debt.

\textsuperscript{184} See Revenu Québec, My Account (www.eveneasier.ca).
\textsuperscript{185} Satterthwaite, supra note 30, at 801.
\textsuperscript{186} Ibid., at 803.
\textsuperscript{188} See, for example, By-Pass Ranch Ltd. \textit{v. The Queen}, 2017 TCC 14; and Academy of Applied Pharmaceutical Sciences \textit{v. The Queen}, 2014 TCC 171.
Remission orders are one form of taxpayer relief, providing a remedy for incorrect advice or information from a Canadian tax authority with respect to the application of technical tax rules. A recent study by Singer found that 65.6 percent of remission orders that specified government error or delay as the reason for granting the order related to the application of the GST/HST. Access-to-justice concerns arise where a misunderstanding of complex ITC rules results in a tax debt.

In 2016, the CRA piloted a GST/HST compliance letter campaign in which 6,000 letters were sent to registrants with suspected errors. The campaign was meant to help taxpayers understand their obligations and correct any errors. It is unclear whether the letter campaign has continued, but media reports suggest that similar soft-toned nudge letters have failed to change taxpayers’ behaviour. Other studies have shown that letters sent from the tax authority to taxpayers providing audit rates and penalty rates have substantially reduced the rate of evasion, at least in the short run.

On the other hand, tax practitioners are not sure that written material is sufficient to properly educate the public on the underground economy and fraud; instead, they prefer seminars or workshops as a more effective way of communicating with taxpayers about compliance issues. Studies in the United States and Colombia have also shown that in-person contact is more effective than letters where the goal is to educate.

Measures to remedy unintentional non-compliance with the ITC rules could include informational sessions hosted by industry organizations. The federal government could also develop an app that uses decision-making trees to help registrants to determine whether they can claim an ITC on a specific supply. This could automate the application of legal tests. Registrants may feel more comfortable using an app than calling the CRA. An app would also provide consistent advice to taxpayers and may provide a safeguard against CRA agents giving incorrect technical advice.

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193 Canada Revenue Agency, Public Affairs Branch, Background Qualitative Research with Tax Practitioners, prepared by Milward Brown (Ottawa: CRA, February 2007).

194 Slemrod, supra note 192, at 919-23.
Different research methodology should also be canvassed as a means to determine the extent of non-compliance with the ITC rules and the GST/HST regime in Canada. Random audits are an integral starting point for measuring non-compliance. Slemrod has advocated for randomized controlled trials and the wider availability of administrative data as a methodology to study non-compliance in the tax system. Although one can never know what methodologies the CRA is implementing for its internal use, the available public information suggests that Canada is not currently using the best research tools, particularly with respect to the estimations of the tax gap.

Canada currently measures its GST/HST tax gap using a top-down methodology as opposed to a bottom-up methodology. Top-down methodology uses independent external data (such as national accounts data) to estimate the tax base, which is then used to calculate a theoretical value of tax that should be paid and collected by applying the relevant tax rate. Bottom-up methodology uses the tax administration’s taxpayer data (such as audit results, accounting data, and assessment data) to estimate the taxes theoretically owing. These calculations contribute to overall knowledge on non-compliance with the GST/HST system, but more could be done.

The CRA, in its tax gap report, admits that the best methodology to determine the tax gap would be a bottom-up approach (which is generally more reliable than the top-down approach) using a “representative sample of taxpayers, randomly selected from a known population that is subject to audit.” A more reliable estimate of the tax gap would better inform decision makers as they consider how to address the problem of non-compliance. The relative attractiveness of a particular reform option depends on how bad the problem is. Consequently, it is necessary to consider the different research methodologies that may be used to determine the extent of non-compliance with the ITC rules and the GST regime before selecting any reform options.

195 Ibid. The justification for randomized controlled trials is that a control group is required for research purposes. For example, if a particular tax authority action (A) was followed by a change in the level of non-compliance (B), there would be data that could, in theory, show that A caused B, or that there were other events that caused B. See Alan Macnaughton’s review of Slemrod’s article, supra note 192, in the Current Tax Reading feature, (2020) 68:1 Canadian Tax Journal 391-408, at 403.


197 Ibid.

198 Ibid. The CRA notes that “top-down estimates are limited in their usefulness from a tax administration perspective because the estimates are aggregate and can only indicate whether the tax administration collects a significant portion of the taxes that should be paid”: ibid., at paragraph 2.2(a).
Technology and Increased Reporting Obligations

Analytics and blockchain technology could be developed and used. Canada already uses data analytics to some extent in selecting which files to audit.\(^\text{199}\) Ainsworth has argued that blockchain technology could solve weaknesses in VAT schemes by creating a registry of digital invoices that would allow tax authorities to both see and verify the taxes paid on a given transaction, thereby increasing audit efficiency.\(^\text{200}\) The European Union has committed some €340 million to developing blockchain technology to combat VAT fraud.\(^\text{201}\)

One of the primary questions relating to the use of blockchain technology is how to move data into the blockchain. The answer may be to add a new reporting requirement, that data be uploaded prior to or immediately following each transaction.

Real-time or periodic reporting requirements along with the adoption of e-invoicing should be considered in Canada. These additional requirements may impose a burden on businesses, but (as noted earlier) many large companies would likely be able to integrate the process into their sales and accounting software. For smaller businesses, the advancement of technology may mitigate the compliance burden.

A smart phone app similar to Italy’s App FatturaE could be developed, which would allow transactions to be completed and transmitted only if all relevant data were included, thereby ensuring that small businesses met the documentation requirements for claiming ITCs. The completed invoices could be uploaded periodically for review by the tax authority or for approval before being sent to customers. Various smart phone invoicing and billing apps are already in use in Canada, so a transition to e-invoicing and real-time reporting may be easier than it seemed to be when these options were initially proposed. The compliance cost of increased reporting requirements in Canada merits further research.

Quebec has already implemented certain enhanced reporting measures in the restaurant and bar industry to address concerns with unreported and underreported sales. In 2009, RQ began testing sales recording modules (SRMs), which were meant to address the erasure of sales records by programs embedded into electronic cash registers.\(^\text{202}\) Establishments that have an SRM must file a sommaire périodique des


\(^{200}\) Richard T. Ainsworth and Andrew Shact, Blockchain (Distributed Ledger Technology) Solves VAT Fraud, Boston University School of Law, Law and Economics Research Paper no. 16-41 (Boston: BU School of Law, October 2016).


ventes (periodic sales summary) with RQ each month, even if no commercial transactions are recorded. Failure to file the periodic sales summary results in a penalty of $25 per day late up to a maximum of $2,500.\textsuperscript{203} Evidently, Canada already has some experience with enhanced reporting obligations in particular industries.

If the compliance burden of implementing increased reporting obligations is still perceived to be too high for smaller businesses, the GST threshold could be raised. An increased GST threshold would allow many businesses to operate outside the proposed reporting system. The upfront cost of an increased reporting system may be high, but Canada could copy existing reporting programs being used internationally instead of developing its own.

A benefit of enhanced reporting is that pre-filled GST/HST returns could be provided by Canadian tax authorities to registrants, as has been proposed in other countries.\textsuperscript{204} These draft returns could be sent to registrants, and registrants could apply to amend them if necessary. The use of pre-filled forms could substantially reduce the compliance burden for registrants.

E-invoicing may also reduce the number of disputes with the CRA relating to claims for ITCs. The specified information that would be mandatory in the e-invoices, such as the supplier’s GST/HST registration number, could be verified in real time by the tax authority. Pre-validated invoices would reduce the number of cases with respect to the documentary requirements needed to claim an ITC. Certification of suppliers’ compliance through a system similar to the attestation de Revenu Québec, in conjunction with e-invoicing and more stringent vetting of applicants for GST registration, may also reduce instances of fraudulent behaviour by suppliers.

E-invoicing and enhanced reporting obligations are becoming more popular among tax authorities in VAT jurisdictions around the world. They have the potential to increase compliance, and in turn increase revenue. More research is required before Canada considers whether to implement such reforms, but the potential benefits are promising.

\textbf{BALANCING THE NEED FOR REFORM AND THE INTERESTS OF HONEST TAXPAYERS}

This article provides evidence of significant problems in Canada’s GST regime relating to registrants’ non-compliance with the ITC rules. The reliance of tax authorities on increasingly aggressive audits and increased supplier verification


\textsuperscript{204} See, for example, Victor Italo Villalon Mendez, “Pre-Filled VAT Form in Chile,” Inter-American Center of Tax Administrations, January 29, 2018 (www.ciat.org/pre-filled-vat-form-in-chile/?lang=en). Chile is one of a few countries (Spain and Italy are two other examples) in which it is proposed that the tax authorities will provide pre-filled VAT returns to registrants for review, approval, and amendment if required.
requirements is at least partly self-defeating, in that these approaches arguably increase the administrative costs of the GST and make the rules harder to enforce. When the GST regime becomes difficult to enforce, the compliance burden is shifted unfairly from dishonest to honest taxpayers.

Estimates have shown that in 2015 Canadian businesses spent more than $37.1 billion and, on average, 105 business days a year in complying with regulations from all levels of government, including GST/HST reporting and remittance obligations. These numbers are simply too high. Recent policies implemented in response to the COVID-19 pandemic show that swift change and reduced bureaucracy are possible, although they come with risks.

This article concludes with proposals to improve the GST regime in Canada by addressing various issues with non-compliance relating to ITC claims. Among these proposals are legislative changes with respect to the collection and remittance of GST/HST, based on methods used abroad. Admittedly, the reform options may significantly alter how the GST/HST is collected and remitted in Canada and would have a corresponding impact on how ITCs are claimed.

E-invoicing and enhanced reporting obligations should be considered in Canada, since the documentation requirements would be fulfilled immediately and the tax authorities could both see and verify the taxes paid on any given transaction. The mechanisms available take many forms, as discussed above. The adoption of a modified version of Quebec's attestation de Revenu Québec in other provinces and the creation of a central, publicly available electronic database would allow taxpayers to discharge any duty of verification with respect to their suppliers. The problems are multifaceted, and while some solutions may decrease fraudulent activity or the need for more stringent supplier verification requirements, they would not address other areas of concern. Maintaining a balance between preventing non-compliance and ensuring economic efficiency and fairness is difficult, but possible, with the reforms proposed here. Honest GST/HST registrants require solutions that do not unduly increase their compliance burden as the tax authorities seek to prevent losses from fraudulent activities and overstatements resulting from misunderstanding or error.

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205 Cruz et al., supra note 31, at 6. These statistics are based on a 2014 survey of Canadian businesses undertaken by the Canadian Federation of Independent Business (CFIB). Between the time of a similar survey conducted in 2012 by the CFIB and the 2014 survey, the annual compliance costs for businesses in Canada had risen by more than $5 billion, and the hours that the average business spent on compliance had increased by 12 percent. See ibid., at 6.

Impact of Tax Advisers and Corrupt Tax Auditors on Taxpayer Compliance

Viswanath Umashanker Trivedi and Amin Mawani*

PRÉCIS
Se fondant sur deux expériences, cette étude examine les décisions des contribuables quant au montant de revenu à déclarer lorsqu’ils et elles sont en présence de vérificateurs de l’impôt et, après la déclaration, en présence de conseillers fiscaux, respectivement. Dans la première expérience, nous examinons l’observation fiscale des contribuables en présence et en l’absence de vérificateurs corrompus. Dans la deuxième expérience, nous examinons l’observation fiscale des contribuables en présence de vérificateurs de l’impôt corrompus, et nous la comparons avec l’observation fiscale des contribuables en présence de conseillers fiscaux dont ils ont retenu les services après avoir fait l’objet d’une vérification. Les pots-de-vin demandés par des vérificateurs corrompus aux contribuables faisant l’objet d’une vérification sont exprimés sous la forme d’un pourcentage des impôts et des pénalités à payer.

La séquence des événements dans la première expérience est la suivante : 1) le contribuable décide du pourcentage de revenu à déclarer à l’administration fiscale; 2) le contribuable apprend si il ou elle fait l’objet ou non d’une vérification; et 3) le contribuable paie les impôts impayés et les pénalités s’il fait l’objet d’une vérification par un vérificateur non corrompu, ou le contribuable décide de payer ou non un pot-de-vin si le vérificateur est corrompu. Dans la deuxième expérience, la 3e étape est remplacée par la suivante : le contribuable doit décider d’offrir ou non un pot-de-vin au vérificateur de l’impôt sans engager de conseiller fiscal, ou de retenir les services d’un conseiller fiscal (pour le règlement des litiges) en l’absence d’un vérificateur de l’impôt corrompu pour contester les pénalités et la sous-déclaration de revenu. Les enseignements que les participants ont tirés aux premières étapes de l’expérience peuvent influer sur leur choix de déclaration aux étapes suivantes.

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Les résultats de notre première expérience montrent que l'observation des règles par les contribuables est globalement réduite par la simple présence d'un vérificateur de l'impôt corrompu, même lorsque la recherche de pots-de-vin n'offre aucun avantage pécuniaire net après impôt aux contribuables. Cela démontre les effets corrosifs des vérificateurs corrompus. L'observation des règles par les contribuables diminue encore davantage lorsque les contribuables tirent des avantages pécuniaires nets de l'octroi d'un pot-de-vin au vérificateur corrompu.

La deuxième expérience consiste à examiner si l'intervention d'un conseiller fiscal professionnel augmente ou diminue le pourcentage du revenu déclaré par rapport à l'observation de base en présence d'un vérificateur de l'impôt corrompu. Si le conseiller fiscal joue le rôle de contrôleur et d'autorité morale, le pourcentage de revenu déclaré par le client contribuable pourrait augmenter en présence d'un conseiller fiscal. Cependant, si le conseiller fiscal ne fait qu'annuler les pénalités fiscales imposées au contribuable, le pourcentage de revenu déclaré par le client contribuable pourrait diminuer. Les résultats de nos expériences montrent qu'en l'absence de vérificateurs corrompus, les conseillers fiscaux sont plus à même d'améliorer l'observation fiscale du contribuable que l'observation de base en présence d'un vérificateur de l'impôt corrompu, agissant de connivence avec le contribuable. Cela suggère que les conseillers fiscaux servent effectivement de gardiens de la morale du système fiscal.

**ABSTRACT**

Using two experiments, this study examines taxpayers’ decisions on how much income to report in the presence of tax auditors and post-reporting tax advisers, respectively. In the first experiment, we examine taxpayers’ compliance in the presence and absence of corrupt auditors. In the second experiment, we examine taxpayers’ compliance in the presence of corrupt tax auditors and compare it with their compliance in the presence of tax advisers retained by the taxpayers upon being audited. The bribes sought by corrupt auditors from audited taxpayers are expressed in the form of a percentage of taxes and penalties payable.

The sequence of events in the first experiment is as follows: (1) the taxpayer decides what percentage of income to report to the tax authority; (2) the taxpayer finds out whether or not he or she is audited; and (3) the taxpayer pays any unpaid taxes and penalties if audited by a non-corrupt auditor, or decides whether to pay a bribe if the auditor is corrupt. In the second experiment, step 3 is replaced by the taxpayer having to decide whether to bribe the corrupt tax auditor without hiring a tax adviser, or to retain a (dispute resolution) tax adviser in the absence of a corrupt tax auditor to contest the penalties and underreporting of income. Participants’ learning from earlier rounds of the experiment can affect their reporting choice in subsequent rounds.

The results of our first experiment show that overall taxpayer compliance is reduced in the mere presence of a corrupt tax auditor, even when bribe-seeking may offer no net after-tax monetary benefits to the taxpayers. This demonstrates the corrosive effects of corrupt auditors. Taxpayer compliance declines even further when taxpayers receive net monetary benefits from bribing the corrupt auditor.

The second experiment examines whether the involvement of a professional tax adviser increases or decreases the percentage of income reported compared to the baseline compliance in the presence of a corrupt tax auditor. If the tax adviser serves as a gatekeeper and moral authority, the percentage of income reported by the taxpayer client could increase in the presence of a tax adviser. However, if the tax adviser...
effectively serves to simply override the tax penalties imposed on the taxpayer, the percentage of income reported by the taxpayer client could decrease. Our experimental results show that in the absence of corrupt auditors, tax advisers are better at improving taxpayer compliance compared to the baseline compliance in the presence of a collusively corrupt tax auditor. This suggests that tax advisers do serve as moral gatekeepers for the tax system.

**KEYWORDS:** CORRUPTION ■ TAX AUDITS ■ COMPLIANCE ■ ADVISERS ■ EXPERIMENTAL ■ ECONOMICS

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**INTRODUCTION**

Underreporting of income for tax purposes—or tax evasion—is costly for many jurisdictions, including Canada and the United States. On the basis of Statistics Canada data, the Canada Revenue Agency (CRA) estimated that the underground economy in Canada created a tax gap of $6.5 billion in federal income taxes for the 2014 tax year.¹ The Internal Revenue Service (IRS) in the United States estimated the average net tax gap for the 2011-2013 period to be $381 billion.² Tax authorities

counter this behaviour with tax audits and the assessment of penalties when the taxpayer is found to be underreporting income. Underreporting of income may be facilitated by collusively corrupt tax auditors who demand bribes as high as the legally sanctioned penalty for underreporting, plus unpaid taxes, or tax advisers who can mitigate the impact of a tax audit and collect a fee for their service.

Corruption and taxpayer non-compliance are pervasive in developing countries as well as being present in western industrialized countries. A global survey on fraud published in 2014 found that 19 percent of executives had encountered bribery or corruption in developed markets (including Canada), compared to 54 percent in emerging markets. Hindriks, Keen, and Muthoo refer to some high-profile tax evasion cases in Italy, the United Kingdom, and the United States. In Canada, investigations of alleged tax fraud in the Quebec construction industry led to the dismissal or suspension of nine officials employed in the CRA’s Montreal tax services office. Senior team leaders and auditors were implicated in the case, in which two construction companies conspired with CRA insiders to defraud the government of $4 million in taxes owing. The review by the CRA indicated that such tax fraud extended beyond the construction industry. In another case, a CRA auditor was alleged to have received $150,000 from a taxpayer for allowing the deduction of a $2.3 million business investment loss to which the taxpayer was not entitled. It has been suggested that high-profile cases constitute only a fraction of the reported

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8 Ibid.

instances of “high-risk misconduct” within the CRA.\textsuperscript{10} Corruption and tax evasion often coexist and reinforce each other.\textsuperscript{11} In a globalized economy, the impact of corruption on tax evasion is a matter of concern in all countries of the world.

Tax auditors and tax advisers differ on many dimensions. Tax auditors work on behalf of the government to ensure (if they are not corrupt) that taxpayers are complying with the tax code and to collect the right amount of taxes (no more and no less). By contrast, a tax adviser is an advocate of the taxpayer (the client) and works to reduce the amount of taxes owing as much as is legally possible. A tax adviser may serve as a “moral gatekeeper” and refuse to accept clients that chronically underreport their income, whether he or she does so altruistically or to protect his or her professional standing (since the adviser’s licence to practise and future insurance premiums may be at stake if he or she develops a reputation for attracting dishonest clients).

Devaney and Mohamed\textsuperscript{12} have discussed how audited taxpayers can rely on tax advisers to assist them, after the assessment, with reducing taxes payable and penalties assessed. In most jurisdictions, tax authorities cannot automatically apply the penalty when the taxpayer understates his or her income. In Canada, subsection 163(2) of the Income Tax Act\textsuperscript{13} provides for penalties of up to 50 percent of the additional tax assessed where the taxpayer made a false statement “knowingly, or under circumstances amounting to gross negligence.”\textsuperscript{14} If the dispute goes to court, the tax authority must demonstrate that the taxpayer knew that the amount was taxable, that the taxpayer had sufficient knowledge of tax, and that the underreporting

\textsuperscript{10} Daniel Leblanc, “Documents Reveal Hundreds of ‘High-Risk Misconduct’ Cases at CRA,” \textit{Globe and Mail}, April 29, 2012 (www.theglobeandmail.com/news/politics/documents-reveal-high-risk-misconduct-cases-at-cra/article4104022). While the incidence of corrupt tax auditors as a proportion of all tax auditors is likely low in Canada and other industrialized countries, the fact remains that it is quite high in other jurisdictions. We are interested in whether the directional findings among Canadian participants are similar to the directional findings in other jurisdictions where corruption may be more prevalent.


\textsuperscript{13} RSC 1985, c. 1 (5th Supp.), as amended.

of income could not have arisen simply as a result of misplacing a tax slip.\textsuperscript{15} A penalty assessed for gross negligence requires showing that the taxpayer’s actions were intentional and dishonest, as established in the \textit{Venne} case:

“Gross negligence” must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.\textsuperscript{16}

Tax advisers engaged in dispute resolution can help by pointing out that the tax authority may not have the evidence to establish intention or suggest indifference. Most taxpayers would not be aware of such defences. Thus, penalties assessed by tax auditors may be mitigated if taxpayers retain professional advisers after being assessed, to challenge the auditors with appropriate filing of documents and more sophisticated arguments based on knowledge of tax law.\textsuperscript{17} It follows that tax advisory fees may serve as a substitute for additional taxes and penalties, or even as a substitute for bribes proposed by corrupt tax auditors.\textsuperscript{18}

Research on the impact of the presence of corrupt tax auditors and tax advisers on taxpayer compliance is sparse. A corrupt tax auditor can benefit the taxpayer by seeking a bribe in return for ignoring income evaded by the taxpayer, thereby saving the taxpayer from having to pay the larger amount of unpaid tax and the penalty thereon. “Collusive” corruption arises when corrupt public auditors and private taxpayers collude to share rents generated by illicit underreporting of income.

Collusive corruption is usually cooperative and cost-reducing for taxpayers, since it involves tax auditors requesting bribes for fully or partially overlooking the incidence of underreported income. Collusive bribery can grease the wheels in workplaces that provide few incentives for tax auditors.

\textsuperscript{15} \textit{De Couto (Alco Windows Inc.) v. The Queen}, 2013 TCC 198.
\textsuperscript{16} \textit{Venne v. The Queen}, 84 DTC 6247, at 6256 (FCTD).
\textsuperscript{17} In most jurisdictions (including developed countries), taxpayers assessed in tax audits are presumed to be guilty until they prove themselves innocent. The onus of proving innocence is on the taxpayers and not the tax auditors because taxpayers uniquely possess the information required to determine their incomes and associated tax liabilities. Taxpayers’ net benefits are affected once they consider the costs associated with proving their innocence. However, when imposing penalties for underreporting income, tax authorities generally have to prove gross negligence.
\textsuperscript{18} As suggested in the text above, in a pre-filing context, a tax adviser may improve taxpayers’ general compliance behaviour by, for example, turning down a tax engagement with a client who seems inconsistent or not forthcoming, since the expected costs of serving such a client (in particular, potential professional insurance payouts) may be higher than the benefits (fees earned).
While a taxpayer’s intrinsic ethical foundation may or may not be invariant to outside influences,\textsuperscript{19} social norm theory\textsuperscript{20} and social identity theory from psychology and economics\textsuperscript{21} allow for the possibility that the presence of a collusive tax auditor could erode the ethics of taxpayers and reduce taxpayer compliance. Bobek, Roberts, and Sweeney\textsuperscript{22} explain how social norms (including beliefs of friends and important others) could also increase taxpayer compliance (relative to the results using economic models alone).

Relative to the benchmark effect of a corrupt tax auditor, taxpayers may be more or less compliant in the presence of a (dispute resolution) tax adviser. If the tax adviser is regarded as a gatekeeper and moral authority, the percentage of income reported by the taxpayer may increase. In contrast, if the tax adviser is seen as legitimizing tax evasion, the percentage of income reported by the taxpayer client may decrease. In this context, as suggested above, tax advisory fees may serve as a substitute for unpaid taxes and penalties, or even as a substitute for bribes requested by corrupt tax auditors. Thus, in an experimental setting, tax advisers as gatekeepers can be compared with the role of tax auditors.

We conduct two experiments using tax terminology and a between- and within-subjects design to examine (1) the impact of the presence of a corrupt tax auditor and (2) the relative impact of the presence of a dispute resolution tax adviser (compared to the presence of a corrupt tax auditor) on individual taxpayer compliance. The sequence of events is as follows:

- The participant (“the taxpayer”) decides what percentage of income to report to the tax authority.
- The taxpayer finds out whether or not he or she is audited.
- If audited, the taxpayer decides to bribe or not to bribe the auditor (in the absence of a tax adviser).

In experiment 2 only, the taxpayer decides to retain a (dispute resolution) tax adviser to contest the penalties and underreporting of income. Since there are multiple rounds in the experiment, participants’ learning from earlier rounds can affect their reporting choices in subsequent rounds (even though all rounds are independent of each other). In both experiments, the participants were either fourth-year undergraduate accounting majors or first-year graduate students pursuing their master of accountancy degree at a Canadian business school.

The first experiment, using a between-subjects design, examines the impact of the presence of corrupt auditors who—in collusion with the audited taxpayers—seek different levels of bribes in lieu of unpaid taxes and penalties. Once taxpayers know that they are being audited by a collusively corrupt auditor, they can report higher income up to the amount of their true income in an attempt to create moral distance between themselves and the auditor. This reduces the corrupt auditor’s bribe (since such bribes are a function of the unreported income) and may or may not reduce taxpayers’ after-tax income (since higher reported incomes trigger higher taxes). Taxpayers could also underreport income, since the bribe never exceeds the unpaid taxes and penalty (otherwise nobody would agree to pay a bribe), and this could increase their after-tax income. The results of our experiment show that the mere presence of a collusively corrupt auditor in cases where the bribe requested exactly equals the additional taxes and penalties payable (that is, where the taxpayer derives no net after-tax monetary benefit from colluding with the tax auditor) reduces taxpayer compliance. When such an auditor also confers monetary benefits on the taxpayers (by accepting bribes less than the legally sanctioned penalty plus taxes payable), taxpayer compliance is further reduced. In other words, colluding with a corrupt auditor may be in the tax-minimizing citizen’s best interest, whether or not such an auditor confers after-tax monetary benefits on the taxpayer.

Our second experiment examines whether the presence of a professional tax adviser (in the absence of a corrupt tax auditor) improves compliance compared to compliance in the presence of a collusively corrupt auditor (in the absence of a tax adviser) when the after-tax monetary benefits to taxpayers are held constant. Our results show that the percentage of income reported in the presence of a tax adviser (and in the absence of a corrupt auditor) is significantly higher compared to the percentage of income reported in the presence of the corrupt auditor (and in the absence of a tax adviser).

Our study contributes to the existing literature on taxpayer compliance in multiple ways. Prior literature documents that interactions of taxpayers with tax auditors and (dispute resolution) tax advisers can have a significant influence on taxpayer compliance.23 Prior studies on the impact of corrupt auditors on compliance have

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focused mainly on corporate taxpaying behaviour and/or have used high-level data on individuals derived from national surveys. These studies have generally found that corruption has a negative impact on overall compliance.

In contrast, this study focuses on individual compliance decisions. Compliance decisions by firms are the culmination of complex decisions involving multiple individuals and competing business objectives. Thus, the tax compliance decisions of firms may not reflect how individuals make compliance decisions in the presence of corruption. Further, high-level survey data can obscure how specific stimuli influence individual tax compliance decisions. More specifically, the studies cited above have not differentiated between the impact of the mere presence of corrupt tax auditors offering no net after-tax monetary benefit to taxpayers and the impact of corrupt auditors offering different levels of positive monetary benefits to taxpayers (which this study examines). As noted above, our results indicate that even when the taxpayer receives no after-tax monetary benefit, the mere presence of a corrupt tax auditor may still reduce taxpayer compliance. When the presence of a collusively corrupt tax auditor also confers after-tax monetary benefits, taxpayer compliance is further reduced.

In addition, our results show that taxpayer compliance is higher in the presence of a dispute resolution tax adviser (engaged after the assessment is received) compared to compliance in the presence of a collusively corrupt tax auditor. To our knowledge, this is the first study to examine in an experimental context the impact of the presence of a collusively corrupt tax auditor and the impact of the presence of a dispute resolution tax adviser on taxpayer compliance.

Our study uses the experimental methodology to explain certain psychological behaviour observed in individuals’ tax-reporting decisions, with potential implications for policy. Since the mere presence of collusively corrupt auditors can decrease taxpayer compliance, tax authorities aiming to maintain a high level of compliance—not just in countries where corruption is endemic, but also in other countries—should ensure that their organizations are both free and perceived to be free of corrupt auditors. Non-compliance is greater when the collusive auditor offers net after-tax monetary benefits to taxpayers. However, compliance does not

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decrease monotonically with higher monetary benefits to taxpayers, presumably because taxpayers can enjoy such incremental benefits without further increases in non-compliance. Therefore, tax authorities should design their audit procedures so that audits that do not result in additional taxes and penalties, and audits involving forgiveness of penalties, should require higher-level approvals. Audit procedures should also be designed to be consistent across taxpayers and to minimize the possibility of providing discretionary monetary benefits to taxpayers. Our results suggest that the involvement of tax advisers could be encouraged as well, since this could have a positive impact on overall tax compliance.

The rest of the article is organized as follows. We begin with a description of our model, including references to the literature and theory. We then set out the details of the experiments, followed by a description of the results. We end with some brief concluding remarks.

**THE MODEL**

**Taxpayer Against a Corrupt Tax Auditor**

We model in an experimental setting a rational taxpayer who knows the amount of his or her income, the tax law on calculating and reporting income, the penalty for underreporting income, the probability of being audited by a corrupt tax auditor, and the probability of being detected for underreporting income. The taxpayer must decide how much income to report to the tax authority in the presence of a tax auditor who is corrupt.

The taxpayer earns income of \( Y \), decides to report \( \alpha Y \), where \( 0 \leq \alpha \leq 1 \), and pays a proportional income tax equal to \( t\alpha Y \). The amount of taxes evaded is \( t(Y - \alpha Y) \).

The taxpayer is audited with a fixed probability of \( p \). If found to have underreported income, the taxpayer faces a penalty, \( s \), in addition to the unpaid tax liability uncovered by the tax auditor.

The taxpayer faces a collusively corrupt auditor with a fixed probability of \( k \), where \( k = 0 \) would imply no corruption and \( k = 1 \) would imply that all tax auditors are corrupt. To simplify the experimental task, we assume that all auditors are corrupt \((k = 1)\) in the corrupt auditor condition and all auditors are not corrupt \((k = 0)\) in the no corrupt auditor condition. If audited by a corrupt tax auditor, the taxpayer can escape the penalty and tax on the unreported income by paying a bribe in the amount of \( b \times s \times t + c \times t \) on the income evaded of \((Y - \alpha Y)\), where \( 0 < b \leq 1 \) and \( 0 < c \leq 1 \). In other words, the bribe is not greater than the officially sanctioned penalty plus tax on the unreported income, since otherwise no taxpayer would pay the bribe without coercion or extortion. We assume that the auditor knows or is
able to detect the true income of the taxpayer during the audit. We ignore additional costs involved in conducting the audit. The setting with \( b < 1 \) and \( c \leq 1 \) ensures that the taxpayer is always better off when audited by a collusively corrupt tax auditor.

Within the experiment, we fix \( s = 1 \) (or a penalty equal to the unpaid tax liability) to achieve experimental simplicity as well as to provide a sufficient deterrent; therefore, the penalty plus tax owed equals \((s + 1)t(Y - \alpha Y)\) or \(2t(Y - \alpha Y)\). If the unpaid tax liability \([t(Y - \alpha Y)]\) is $1, the unpaid tax liability plus penalty will be $2. Again, we set \( c = 1 \) in all our treatments, for experimental simplicity. Further, we fix \( b = \frac{1}{2} \) in our “positive” treatment for both experiments 1 and 2, and set \( b = \frac{1}{10} \) in the “almost same” treatment in experiment 1. (These treatments are explained below.) We assume that the taxpayer can afford to pay the bribe and is therefore ready to engage with a corrupt tax auditor. This finding is consistent with Singh’s game theory model.26 Our model predicts that taxpayers will reduce the percentage of income reported (\( \alpha \)) in the presence of collusively corrupt tax auditors because such auditors will offer taxpayers an opportunity to pay a lower bribe (\( b < 1 \)) than the required higher penalty (\( s = 1 \)) for underreporting income. If \( b = 1 \) and \( c = 1 \), the taxpayer will report as if there were no corrupt tax auditors (even if corrupt auditors exist in the system), since the taxpayer will not collusively benefit from being audited by a corrupt tax auditor. We test this expectation in our “exact same” treatment of experiment 1, as described further below.

Taxpayers may not always behave as rational economic agents as predicted by our model. Our treatments are therefore designed to reflect the tension between economic and non-economic reasons for compliance. Gino, Ayal, and Ariely,27 for example, argue that observing others’ behaviour may change one’s own dishonesty by affecting the saliency of the ethical nature of the contemplated decision. As a result, the presence of corrupt tax auditors may influence taxpayers to perceive tax evasion as being less unethical. The change in perception can make taxpayers less compliant in the presence of corrupt tax auditors compared to a setting without corrupt tax auditors. Farrar, Kaplan, and Thorne28 also explore the role of tax authorities in taxpayers’ compliance decisions.

Observing the unethical behaviour of another person can also change the participant’s understanding of social norms relating to such dishonest behaviour.29

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28 Farrar et al., supra note 23.

Reno, Cialdini, and Kallgren\(^\text{30}\) posit two types of social norms: descriptive norms and injunctive norms. Descriptive norms influence the decisions that people make in specific situations, while injunctive norms influence people’s approval or disapproval of decisions in specific situations. According to norm-focus theory,\(^\text{31}\) the specific norm that comes into play depends on the social context involved. Trivedi, Shehata, and Lynn point out the need for tax authorities to develop programs that “enhance and appeal to a taxpayer’s moral conscience and reinforce social cohesion.”\(^\text{32}\)

In the context of tax evasion, the presence of corrupt tax auditors may change taxpayers’ perception regarding the appropriate social norms relating to such behaviour. Alm\(^\text{33}\) notes that there seems to exist a social norm of tax compliance that can be affected by the institutions that individuals face. In the context of this article, taxpayers may perceive tax auditors as authority figures—consistent with Farrar et al.\(^\text{34}\) Furthermore, the bribe proposed by the collusively corrupt tax auditor could be economically advantageous to the taxpayer since it is no greater than the sum of unpaid taxes plus penalties. The taxpayer may therefore be susceptible to influences of descriptive norms rather than injunctive norms. In such situations, taxpayers may view tax auditors as being pragmatic and like themselves, and thereby identify themselves with the tax auditors and emulate their behaviour. According to social identity theory,\(^\text{35}\) group members use their own group to maintain and enhance a positive social identity and self-esteem, and therefore are impelled to conform to the norms that provide them with an in-group identity. Consequently, the presence of collusively corrupt tax auditors may indicate to taxpayers that tax evasion is socially acceptable, potentially making them less compliant. It is in this context that the presence of a corrupt tax auditor could influence the taxpayer to reduce compliance even when the corrupt auditor does not confer any incremental economic advantage. The presence of a corrupt tax auditor could reduce compliance even further if the request for a bribe is also economically beneficial to the taxpayer.

Our research questions examine whether taxpayer compliance changes in the presence of a corrupt tax auditor and the level of the bribe requested.\(^\text{36}\) We therefore


\(^{31}\) Supra notes 29 and 30.


\(^{33}\) Alm, supra note 23.

\(^{34}\) Farrar et al., supra note 23.

\(^{35}\) Supra notes 21 and 22.

\(^{36}\) While this study is silent on distribution issues of collusive and coercive corruption, Hindriks et al. conclude that corruption is “unambiguously regressive: the richest have most to gain from evading taxes” whereas the poor “have few taxes to evade”: Hindriks et al., supra note 6, at 397.
propose the following hypothesis about collusively corrupt tax auditors in alternate form:

\[ H_1: \text{Taxpayer compliance will depend on the presence or absence of a} \]
\[ \text{collusively corrupt tax auditor.} \]

**Taxpayer Compliance and the Tax Adviser**

Holmes\(^{37}\) argues that tax lawyers can both facilitate tax evasion and serve as gatekeepers for tax authorities, but that this dual role can sometimes muddle the net impact of their involvement. Wakolbinger and Haigner\(^{38}\) demonstrate in an experimental setting that peer advice—especially from low-compliance participants—reduces taxpayers’ compliance rates.

We restrict our focus to the case where the taxpayer hires the tax adviser after becoming aware that he or she is being audited (as opposed to hiring at the time of filing the tax return). The main reason for setting the timing of this decision is to ensure that the taxpayer’s economic benefit from the presence of a tax adviser is identical to the economic benefit from engaging with a corrupt tax auditor. Some tax advisers specifically promote their services to taxpayers who have been selected for audit scrutiny by tax authorities.\(^{39}\)

A tax adviser may act as a gatekeeper interested in accurate tax reporting or conversely as an advocate for the client who is more interested in reporting the lowest taxable income possible. Relying on the tax adviser’s guidance could either reduce the penalties assessed as a result of a tax audit or reduce the “moral cost” (or both). Individuals may use “moral wiggle room” to act in their self-interest when they have conflicting motivations, or may take advantage of moral wiggle room when a tax adviser is involved, and this could lead to less compliance.\(^{40}\)

The tax adviser is presumed to be familiar with how the tax authority resolved similar compliance issues with other taxpayer clients, and thus to be able to improve the taxpayer’s chances of escaping penalties for underreporting income. If a tax adviser’s services could potentially mitigate tax penalties, it follows that tax advisory fees may serve as a substitute for tax penalties or even as a substitute for bribes proposed by corrupt tax auditors.


We examine in an experimental setting, using a within-subjects design, whether the presence of a professional tax adviser (in the absence of a corrupt auditor) increases or decreases the percentage of income reported compared to the percentage of income reported in the presence of a collusively corrupt tax auditor (and in the absence of a tax adviser). When the after-tax monetary benefit to the taxpayer from the presence of the tax adviser and the benefit from the presence of the tax auditor are held constant, the relative impact on the taxpayer’s compliance in these two different settings is unclear. From the perspective of norm-focus theory, the presence of either a tax adviser or a collusively corrupt tax auditor could influence taxpayers to focus on descriptive norms.

However, tax auditors may be viewed as being more authoritative than tax advisers, and thus better able to guarantee the final tax liability position of audited taxpayers. Taxpayers may therefore prefer bribing the tax auditor compared to engaging a tax adviser and may be more comfortable being less compliant in the presence of the auditor. On the other hand, engaging a tax adviser may provide taxpayers with greater assurance of avoiding penalties and higher taxes imposed by tax auditors. From a social norms and social identity perspective, taxpayers may be better able to maintain or enhance a positive social identity, self-esteem, and social cohesion in the presence of a tax adviser when the adviser is regarded as an in-group member. If this were the case, the percentage of income reported by the taxpayer client could decrease in the presence of the adviser compared to the presence of the auditor. We therefore test the following hypothesis in alternate form:

$H_2$: Taxpayer compliance in the presence of a (post-filing or dispute resolution) tax adviser will be different from compliance in the presence of a collusively corrupt tax auditor.

**EXPERIMENTS**

**Experiment 1: Compliance in the Presence of a Corrupt Tax Auditor**

We conducted a computer-based experiment using z-Treex with 82 participants (44 females and 38 males) in fourth-year undergraduate or first-year graduate studies. These participants were enrolled in advanced financial accounting and managerial tax-planning courses at a major Canadian university. Of the 82 participants, 53 indicated that they had previously filed a tax return, with a mean tax-filing experience of 3.1 years.42 Table 1 provides details about the demographic variables relating to the participants.


42 While all our participants were students, they included individuals with a diversity of tax-filing experience. Further, many of our master’s-level students had returned to university after being in the job market for several years. Our master’s program includes non-traditional students.
The experiment was conducted over 13 sessions with an average of 8 participants per session. The participants took an average of 75 minutes to complete the experiment and earned on average $15 per hour. Participants were told not to disclose the details of the experiment to any other students who may participate in subsequent sessions. Instructions on steps and decisions to be taken by the participants were conveyed via the computer. (These instructions are reproduced in the appendix to this article.) Three practice rounds were administered in each session to allow the participants to become familiar with the procedures of the experiment. These practice rounds did not count toward the participants’ final earnings. We called the currency used “lira,” with 100 liras being equal to Cdn$1.

Participants were provided with an initial endowment of 500 liras for showing up for the experiment. Their cumulative earnings from the experiment were added to or subtracted from their initial endowment, and the final amount (converted to dollars) was paid to them by cheque immediately after the experiment ended.

with backgrounds from the sciences and humanities; thus, our subject pool was not made up of accounting undergraduates alone. Many of our undergraduate students had summer jobs, and therefore taxable incomes to report and taxes to pay. Finally, our university program draws a significant proportion of immigrant and first-generation students from countries where corruption among tax auditors is higher than in Canada. Thus, while our participants may not have experienced interactions with corrupt tax auditors at first hand, they may not be totally unaware of the phenomenon of corrupt government officials, including tax auditors.
Participants were provided with an endowed income of 100 liras for each round of the experiment. A review of the literature supports our belief that endowing our participants, instead of requiring them to earn their income, did not introduce any bias that would invalidate the results of our experiment.

Participants were then asked to report to the tax authority any portion from zero to 100 percent of their income and pay a 30 percent income tax on the income reported. After the reporting of their income, participants faced the possibility of their income being audited with a probability of 30 percent—a high rate adopted from prior research. The high rate was also used to ensure that a sufficiently high proportion of our participants would be exposed to being audited by a corrupt auditor during the course of the experiment. Using an audit rate that is more reflective of the audit rate obtained in the real world (around 2 percent) would imply that a high proportion of our participants would never experience being audited within the scope of the experiment. The audit uncovered all undisclosed income in the reporting period being audited with a probability of 1. Upon being audited, participants had to pay taxes on the unreported income plus a penalty equal to the unpaid

43 We decided to endow our participants with identical incomes, instead of requiring them to earn their income, in order to keep the duration of the experiment within 75 minutes. In our experience, 90 minutes is the maximum time for participation in an experiment before fatigue sets in. We also recognized that most of our students commute, and this placed a premium on their time. The average earnings from the experiment were designed to reflect the participants’ opportunity costs. Earned historical income (instead of endowed income) could potentially introduce another source of variance among participants that we wanted to avoid, namely, differences in incomes and associated wealth. In a tax compliance context such as ours, the impact of requiring participants to earn their income versus endowing them with income is uncertain.


46 Further, the impact of the audit rate on taxpayer compliance is not of primary interest in this study. We are unaware of any reason why our findings relating to the directional impact of the variables of interest in our study, in the presence of a relatively high audit rate, would not extend to a low audit rate environment outside the laboratory.
Each round was independent of the other rounds, and the decisions of other participants had no effect on the economic payoff to a particular participant. Participants were asked to decide on the percentage of their income that they wanted to report to the tax authority over 16 rounds, divided into two sets of 8 rounds each. The first set of 8 rounds had no corrupt auditor; therefore, no bribes were requested, and the full amount of taxes and penalty was paid to the tax authority. The second set of 8 rounds included a corrupt auditor, offering participants the choice of bribing the auditor instead of paying the unpaid taxes and penalty. The type of corrupt auditor was tested using a between-subjects treatment and included the following three treatments:

1. **Positive.** In this case, the collusively corrupt auditor demanded that the participants (taxpayers) pay a bribe equal to the taxes owed plus half the penalties required under the law (that is, $c = 1$ and $b = \frac{1}{2}$). If the tax assessed on unreported income was $1$ and the penalty was equal to the assessed tax, a non-corrupt auditor would require taxpayers to pay $2$, while a positive corrupt auditor would demand $1.50$.

2. **Almost same.** In this case, $b = 0.9$ and $c = 1$. The taxpayer in this context would be asked to pay a bribe of $1.90$, derived as the sum of $1$ in unpaid taxes and a penalty of $0.90$. In this treatment, the cash outflow required to pay the bribe was almost, but not exactly, the same as the cash outflow resulting from refusing to pay the bribe. We administered this treatment in order to examine whether taxpayer compliance would be affected by the modest after-tax monetary benefit conferred by the presence of the collusively corrupt auditor.

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47 To control for order effects, we administered separate sessions reversing the within-subjects auditor/no auditor treatment by introducing the corrupt auditor in the first 8 rounds, followed by no corrupt auditor in the next 8 rounds for 21 of the 40 participants in the positive between-subjects treatments. Preliminary analysis did not reveal any order effects. Therefore, we did not reverse the order of administering the auditor/no auditor in the within-subjects treatment for the remaining two treatments, exact same and almost same, since they are similar to the positive treatment. Given the absence of order effects, we combined the data for a specific treatment and lined up the data such that results for the 8 rounds with no corrupt auditor were listed first and the other data listed next. Our analysis reported below is based on this rearranged data set. Our decision not to reverse the order of administering the auditor/no auditor within-subjects treatment for some of our between-subjects treatments meant that the number of participants in those two treatments (25 in the exact same treatment and 17 in the almost same treatment) was less than the number of participants in the other treatment (40 in the positive treatment). In those sessions where no corrupt auditor treatment was administered first, the three practice sessions were also administered without the corrupt auditor. In contrast, in the sessions where the within-subjects corrupt auditor treatment was administered first, the three practice rounds were also administered with the corrupt auditor present. Appropriate instructions were provided at the beginning of the second 8 rounds introducing either the corrupt or the non-corrupt auditor, depending on what was introduced first. No additional practice rounds subsequent to these additional instructions were administered.
tax auditor.\textsuperscript{48} The after-tax monetary benefit was made large enough (we hoped) to overcome the psychological or mental cost to taxpayers of changing their compliance behaviour, but not large enough to provide a significant economic advantage to them.

3. \textit{Exact same}. In this case, \( b = 1 \) and \( c = 1 \). The taxpayer in this context would be asked by the corrupt auditor to pay a bribe of $2, derived as the sum of $1 in unpaid taxes and a penalty of $1. This treatment imposes exactly the same cash outflows on taxpayers whether the auditor is corrupt or not. We administered this treatment in order to examine whether taxpayer compliance would be affected by the mere presence of a collusively corrupt tax auditor where such presence conferred no economic advantages or disadvantages to taxpayers. When there is no difference in taxpayers’ monetary outcomes from the presence or absence of a collusively corrupt tax auditor, the research question being examined is whether psychological factors and social norms alone can affect taxpayer compliance.

\section*{Experiment 2: Compliance in the Presence of Collusively Corrupt Tax Auditor Versus a Dispute Resolution Tax Adviser}

A second computer-based experiment was designed using z-Tree,\textsuperscript{49} with similar economic incentives to those in experiment 1 and similar (but different) participants. The objective was to assess the tax compliance effects in the presence of a collusively corrupt tax auditor and to compare those effects, while holding everything else constant, with the tax compliance effects in the presence of a professional tax

\textsuperscript{48} A priori it is unclear whether participants’ compliance behaviour would change in the mere presence of a corrupt auditor, absent any monetary benefits, in our exact same treatment (discussed below). Therefore, we also administered the almost same treatment, with an after-tax monetary benefit of 10 percent to the taxpayer in the presence of the corrupt auditor. Again, a priori it is unclear whether or not this relatively modest after-tax monetary benefit would be sufficient to change participants’ compliance behaviour in the presence of the corrupt auditor. Another reason for administering the almost same treatment—in addition to the positive treatment—is that compliance may not decrease linearly when going from the exact same treatment to the almost same treatment, and then to the positive treatment despite a monotonically increasing positive impact of the bribe on taxpayers’ expected after-tax income. More specifically, the positive impact of the bribe on taxpayers’ expected after-tax income under the positive treatment is sufficiently positive for taxpayers to report higher after-tax incomes (and pay higher taxes) compared to income reported under the almost same treatment and still end up with a higher expected after-tax income. For example, the after-tax expected income when a taxpayer reports 50 percent of 100.00 liras of income results in reported income of 76.00 liras under the exact same treatment and 76.45 liras under the almost same treatment. Under the positive treatment, the expected after-tax income is 76.60 even when 60 percent of 100.00 liras of income is reported. This demonstrates that participants in the positive treatment can increase their compliance without hurting their expected after-tax income compared to taxpayers in the other two treatments.

\textsuperscript{49} Supra note 41.
adviser (and a non-corrupt tax auditor). The corrupt auditor and the tax adviser were each present only when the other was absent. All auditors were corrupt in the first 8 of a total of 16 rounds, and all auditors were non-corrupt in the last 8 rounds; however, we did not explicitly inform the participants that the auditors in the latter rounds were non-corrupt.

This experiment was conducted using 47 new participants over six different sessions with an average of 8 participants per session. Of the 47 participants, 27 indicated that they had previously filed a tax return, with a mean tax-filing experience of 3.72 years. Table 2 provides details on the demographic variables relating to the participants.

The experiment took an average of 75 minutes to complete, and the participants earned on average $15 per hour. As in experiment 1, participants were told not to disclose the details of the experiment to any other students who may participate in subsequent sessions. Instructions on steps and decisions to be taken by the participants were conveyed via the computer (see the appendix). Participants were asked to decide on the percentage of their income that they wanted to report to the tax authority, first in the presence of a corrupt tax auditor (for 8 rounds), and then in the presence of a tax adviser (and a non-corrupt tax auditor—also for 8 rounds), both of which could reduce taxpayers’ uncertainty regarding their tax liability. Differences in the percentage of income reported between these two contexts were tracked over the 16 rounds to see if learning was taking place, and the differences were computed and analyzed.

50 We achieved this change by framing the bribe as either a payment of a fee to a tax adviser or a payment of a bribe to a corrupt tax auditor (see the appendix for details). Everything else was kept constant in order to achieve a single manipulation. The experimental design, incentives, and participants were similar to the positive treatment of experiment 1. We used only the positive treatment in experiment 2 since the payoffs to the participants from hiring the tax adviser in this treatment are consistent with the premise that taxpayers will hire tax advisers only when such hiring is beneficial to them. In other words, it is not clear why taxpayers would hire tax advisers if doing so did not result in a net expected after-tax monetary benefit. Participants realized no after-tax monetary benefit from hiring the tax adviser in the exact same treatment and realized only a marginal after-tax monetary benefit in the almost same treatment. By extension, therefore, we also did not employ a fully crossed 2 × 2 design with corrupt/non-corrupt and adviser/auditor as the two dimensions.

51 The order of the presence of the tax auditor and the tax professional was reversed for approximately half of the participants. No order effects were detected, and therefore data from all participants were combined for subsequent data analysis. We set the payoffs to our participants in the presence of the tax adviser to be identical to the payoffs in the presence of the corrupt auditor since our intent is to test, ceteris paribus, whether participants’ behaviour would be different in the mere presence of one of these two individuals. We acknowledge that the payoffs to taxpayers in the real world when hiring a tax adviser may very well be different from the payoffs in the presence of a corrupt tax auditor. However, introducing differential payoffs to our participants in the presence of a tax adviser and a corrupt tax auditor respectively would introduce an additional dimension that, while adding mundane realism to our experiment, would not be as helpful in achieving our objective.
RESULTS

Experiment 1: Compliance in the Presence and Absence of a Corrupt Tax Auditor

Overview of the Data Analysis

We are primarily interested in finding out if and how the presence or absence of a corrupt auditor affected participants’ tax reporting behaviour. Our dependent variable is “percentage reported,” or income reported as a proportion of income earned in the individual rounds in two settings: first, in the absence of a corrupt auditor; and second, in the presence of a corrupt auditor. We are particularly interested in the difference in compliance between some of the rounds with and without the corrupt auditor. Since there could be learning occurring in the early rounds of each of the two sets of 8 rounds (with and without the corrupt auditor), using data from all 8 rounds in our analysis could confound our results. On the other hand, using data from only the last 1 or 2 rounds of each set (the 7th and 8th in the first set and the 15th and 16th in the second set) is also beset with the problem of random variation in behaviour across individual rounds, and potential end-of-experiment strategies (even though participants were not told at the outset how many rounds there would be). Therefore, while we present and analyze results using data from all 8 and only the last 4 (3) rounds from the two sets respectively, our inferences are based on results obtained from data from only the last 4 (3) rounds. Our analysis of differences in compliance is within subjects (that is, we examine whether these differences are significant within each between-subjects treatment).

Figure 1 shows the average percentage of income reported in the absence and presence of the collusively corrupt auditor respectively for each of the three
between-subjects treatments. This is further separated by the order in which the within-subjects treatment of the presence of a corrupt auditor was administered in the case of the positive treatment. While there is variation in the level of compliance across the different treatments, we are not interested in such variation. Rather, we are interested in whether or not the presence or absence of a corrupt auditor made

Notes:
Percentage of income reported denotes the average percentage of income reported by the participants in each of the eight rounds in the two within-subject treatments (presence or absence of the corrupt auditor).

The order of administering the within-subjects auditor/no auditor treatment was reversed in the positive treatment, identified with the legend reverse positive above. There was no difference in the impact of the within-subjects auditor/no auditor treatment regardless of the order of administering the treatment—that is, whether the corrupt auditor was introduced in the first eight or the last eight rounds. Consequently, during data analysis, we combined the data for all positive treatments respectively and lined up the data such that the eight rounds with no corrupt auditor were listed first and the other data listed next. The results reported in the accompanying tables are based on this rearranged data set. Further, we did not reverse the order of administering the auditor/no auditor in the within-subjects treatment for the remaining two treatments (exact same and almost same) since they are similar to the positive treatment.
a difference to the compliance behaviour of our participants, and whether such differences are significantly different between the three between-subject treatments (that is, difference-in-difference). Note that the direction of change in compliance in the presence and absence of the corrupt auditor is identical irrespective of the initial level of compliance and the order of administering our within-subjects treatment in the positive (that is, positive versus reverse positive) treatment. Therefore, we believe that our results are not due to mean reversion from extreme initial compliance levels. As a result, we rule out any impact that the initial difference in compliance may have on the inferences made in our study for the different between-subject treatments.

**Within-Subjects Difference**

Panel A of table 3 reports results from nine different mixed models, three for each of the three between-subjects treatments using all 8 rounds (the last 4 and the last 3 rounds) from each of the two sets, the first without the corrupt auditor and the second with the corrupt auditor. The two fixed effects in these models are labelled “intercept” and “set,” the latter representing whether the data are from the first set, without the corrupt auditor, or the second set, with the corrupt auditor. “Subject” refers to the participant whose data is included in the model as a random effect. Panel B of table 3 reports tests of significant differences between mean compliance in the first versus the second set for each of the three between-subject treatments.

Both panels A and B of table 3 show that when data from the last 4 (3) rounds in each of the two sets are used, there is a statistically significant difference in compliance ($\alpha = 0.10$) between the two sets of data. For the two between-subjects treatments (positive and almost same), the statistical significance is at $\alpha = 0.05$ for all but one of the eight tests. These results suggest that the mere presence of the corrupt auditor in the exact same treatment is enough to reduce taxpayer compliance, thereby allowing us to reject the null hypothesis in $H_1$. Taxpayers decreased income reported by an average of 8.63 liras (9.11 liras) between the last 4 (3) rounds in the absence and presence of the collusively corrupt auditor respectively. This represents a 13.02 percent (13.97 percent) decrease in compliance relative to the average compliance in the absence of the corrupt auditor. This is a significant decrease in compliance for the exact same treatment given that there is no change in the taxpayers’ after-tax monetary position driven by the presence or absence of the corrupt auditor. Compliance decreased further in the almost same and positive treatments where the corrupt auditor further offered positive net after-tax monetary benefits to the taxpayer. Taxpayers reduced the income reported in the almost same treatment by an average of 12.10 liras (14.73 liras) between the last 4 (3) rounds in the absence and presence of the collusively corrupt auditor. This represents an

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52 We confirmed the results presented in this article by estimating corresponding non-parametric tests (results not presented).

53 All tests are two-tailed.
TABLE 3  Experiment 1—Results

Panel A: Results from mixed model using data from all 8, last 4, and last 3 rounds from the 1st and 2nd sets respectively

<table>
<thead>
<tr>
<th>Source</th>
<th>All eight rounds</th>
<th>Last four rounds</th>
<th>Last three rounds</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Numerator df</td>
<td>Denominator df</td>
<td>F</td>
</tr>
<tr>
<td>Positive</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>1</td>
<td>39</td>
<td>195.54</td>
</tr>
<tr>
<td>Set (1st and 2nd)</td>
<td>1</td>
<td>599</td>
<td>27.94</td>
</tr>
<tr>
<td>Almost same</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>1</td>
<td>16</td>
<td>83.02</td>
</tr>
<tr>
<td>Set (1st and 2nd)</td>
<td>1</td>
<td>254</td>
<td>2.15</td>
</tr>
<tr>
<td>Exact same</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intercept</td>
<td>1</td>
<td>24</td>
<td>93.80</td>
</tr>
<tr>
<td>Set (1st and 2nd)</td>
<td>1</td>
<td>374</td>
<td>1.57</td>
</tr>
</tbody>
</table>

(Table 3 is concluded on the next page.)
### TABLE 3 Concluded

Panel B: Tests of significant difference between mean compliance in the 1st versus 2nd set using data from all 8, last 4, and last 3 rounds respectively

<table>
<thead>
<tr>
<th></th>
<th>1st set mean(^b)</th>
<th>2nd set mean(^b)</th>
<th>Standard error</th>
<th>df</th>
<th>Difference in mean(^b)</th>
<th>Standard error</th>
<th>df</th>
<th>Sig.(^c)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Positive</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All 8</td>
<td>70.772</td>
<td>59.806</td>
<td>4.783</td>
<td>42.938</td>
<td>10.966</td>
<td>2.075</td>
<td>599</td>
<td>0.000</td>
</tr>
<tr>
<td>Last 4</td>
<td>70.825</td>
<td>59.825</td>
<td>4.979</td>
<td>47.291</td>
<td>11.000</td>
<td>3.029</td>
<td>279</td>
<td>0.000</td>
</tr>
<tr>
<td>Last 3</td>
<td>71.650</td>
<td>59.400</td>
<td>5.031</td>
<td>51.496</td>
<td>12.250</td>
<td>3.652</td>
<td>199</td>
<td>0.001</td>
</tr>
<tr>
<td><strong>Almost same</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All 8</td>
<td>62.654</td>
<td>56.743</td>
<td>6.856</td>
<td>19.166</td>
<td>5.912</td>
<td>4.035</td>
<td>254</td>
<td>0.144</td>
</tr>
<tr>
<td>Last 4</td>
<td>65.647</td>
<td>53.544</td>
<td>7.382</td>
<td>22.278</td>
<td>12.103</td>
<td>5.802</td>
<td>118</td>
<td>0.039</td>
</tr>
<tr>
<td>Last 3</td>
<td>64.882</td>
<td>50.157</td>
<td>8.212</td>
<td>21.965</td>
<td>14.725</td>
<td>6.340</td>
<td>199</td>
<td>0.023</td>
</tr>
<tr>
<td><strong>Exact same</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All 8</td>
<td>62.775</td>
<td>59.145</td>
<td>6.459</td>
<td>26.614</td>
<td>3.630</td>
<td>2.902</td>
<td>374</td>
<td>0.212</td>
</tr>
<tr>
<td>Last 4</td>
<td>66.290</td>
<td>57.660</td>
<td>6.538</td>
<td>29.925</td>
<td>8.630</td>
<td>4.244</td>
<td>174</td>
<td>0.044</td>
</tr>
<tr>
<td>Last 3</td>
<td>65.187</td>
<td>56.080</td>
<td>6.640</td>
<td>32.857</td>
<td>9.107</td>
<td>5.106</td>
<td>124</td>
<td>0.077</td>
</tr>
</tbody>
</table>

\(\text{df} = \text{degrees of freedom}; \text{F} = \text{F value}; \text{Sig.} = \text{statistical significance level.}\)

a Dependent variable: Percentage reported denoting the percentage of income reported by the participants in each of the eight (last four, last three) rounds in the two within-subject treatments (presence or absence of the corrupt auditor). Intercept and set (first and second set of eight rounds each) of eight (last four, last three) are the fixed effects and subject is the random effect.

b Represents the estimated marginal mean of the percentage reported over the eight (last four, last three) rounds in the set derived from the model presented in panel A. The mean difference represents the mean compliance in the first set minus the mean compliance in the second set, and thus represents a decrease in compliance from the first set to the second set in all cases.

c Adjustment for multiple comparisons: Bonferroni.
18.44 percent (22.70 percent) decrease in compliance relative to the average compliance in the absence of the corrupt auditor. Taxpayers also reduced the income reported in the positive treatment by an average of 11.0 liras (12.25 liras) between the last 4 (3) rounds in the absence and presence of the collusively corrupt auditor. This represents a 15.53 percent (17.10 percent) decrease in compliance relative to the average compliance in the absence of the corrupt auditor. Such reductions in compliance arising from the introduction of the corrupt auditor are both statistically and economically significant.

We believe that the significant differences in the results for the almost same and exact same treatments are important for at least two reasons. First, the decrease in compliance in the almost same treatment is on average 4.55 liras (or 7.07 percent) greater than the decrease in compliance in the exact same treatment, despite the relatively modest 10 percent advantage provided by the corrupt auditor to the participants in the former treatment. Second, the economic advantage to the participants in the positive treatment from agreeing to bribe the corrupt auditor was high enough that they could choose to increase their compliance (in an attempt to morally distance themselves from the corrupt auditor), relative to their compliance in the absence of the corrupt auditor, without any decrease in their expected after-tax income. In contrast, the participants in the almost same treatment did not have the same advantage and faced a higher compliance cost. This difference in incentives may possibly explain the lack of a further decrease in compliance in the positive treatment as compared with the decrease in the almost same treatment.

We also collected data on the following control variables: gender, age, marital status, having children, history of having filed a previous tax return, number of years of experience in filing tax returns, whether the participant believed that paying taxes was a moral issue, and whether the participant believed that taxes should always be paid. (Table 1 documents the descriptive statistics for these variables.) None of the control variables, with the exception of gender and age, were statistically significant in explaining taxpayer compliance. The insignificance of marital status can be attributed to the absence of married participants in our sample. The statistical significance of gender in taxpayer compliance is consistent with results found by Chung and Trivedi.54 Females were statistically more compliant than males in our study. Age was negatively associated with compliance. However, given that the participants were between 18 and 25 years of age, with a mean age of 20.7 years, the impact of age on compliance has to be analyzed with caution. More importantly, the inclusion or exclusion of gender and age in our model did not affect the overall results relating to our hypotheses.55

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55 Despite the insignificance of these control variables in explaining the behaviour of the participants in the laboratory, we believe that our experiments were successful in capturing the tax compliance behaviour of the participants and that participants did not view the experiment
Experiment 2: Compliance in the Presence of a Corrupt Tax Auditor (Without a Tax Adviser) and a Tax Adviser (Without a Corrupt Auditor) Respectively

Figure 2 shows that the percentage of income reported is significantly higher in the presence of a tax adviser (and the absence of a corrupt tax auditor) compared to the percentage of income reported in the presence of a corrupt tax auditor alone. Analysis (t-tests) of within-subjects results from experiment 2 show that the presence of a professional adviser improved taxpayer compliance compared to the presence of a collusively corrupt tax auditor (see table 4). The income reported increased by an average of 11.15 (11.89) liras in the presence of the tax adviser alone compared to being in the presence of a collusively corrupt tax auditor alone in the last 4 rounds (the last 3 rounds) of the experiment, thereby allowing us to reject the null hypothesis in H2. This represents a 22.92 percent (24.29 percent) increase in compliance relative to the average compliance in the presence of the corrupt auditor. Such increase in compliance arising from the presence of the tax adviser (absent the corrupt auditor) is significant in both a statistical and an economic sense. These results point to taxpayers’ desire for lower uncertainty and the belief that a collusively corrupt auditor could offer greater final resolution without further reassessments. The results may also reflect taxpayers’ awareness that tax advisers have to abide by their professional codes of conduct. While a tax adviser may successfully help the taxpayer to avoid penalties, advisers cannot provide fail-proof insurance that taxpayers will not be reassessed again. Thus, the presence of a tax adviser, hired after the taxpayer has been chosen for an audit, could lead to an overall increase in the level of taxpayer compliance compared to compliance in the presence of a collusively corrupt tax auditor.

Again, we collected data on the following control variables: gender, age, marital status, having children, history of having filed a previous tax return, number of years of experience in filing tax returns, whether the participant believed that paying taxes was a moral issue, and whether the participant believed that taxes should always be paid. (Table 2 provides the descriptive statistics for these variables.) None of these control variables were statistically significant in explaining the participants’ tax compliance behaviour.57

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56 The percentage of income reported increased from 48.65 and 48.96 in the presence of the corrupt tax auditor to 59.80 and 60.85 in the presence of a tax adviser (absent a corrupt tax auditor).

57 It bears repeating that we believe the participants did not view the experimental task as a mere game but responded to the treatment conditions as intended. Specifically, if the participants had viewed the experimental task as a mere game, they would not likely have shown any
FIGURE 2  
Experiment 2—Percentage of Income Reported by Treatment

Notes:
Percentage of income reported denotes the percentage of income reported by the participants in each of the eight rounds in the two within-subject treatments: the first in the presence of the corrupt auditor alone and the second in the presence of the tax adviser alone.

CONCLUSION

Both collusively corrupt tax auditors and private tax advisers (engaged after the taxpayer has been selected for audit by the tax authority) can increase taxpayer compliance by serving as gatekeepers or monitors. However, both of these actors can also reduce tax compliance if their self-interest trumps public interest and professionalism. In the case of collusively corrupt public tax auditors, taxpayers’ compliance could decrease if the bribes requested by corrupt auditors are lower than the taxes and penalties that taxpayers seek to avoid.58

58 Taxpayers’ revealed preference for paying a bribe to a corrupt auditor instead of paying the unpaid tax and penalty thereon to the government may not be inconsistent with a right-wing ideology that may create a preference for giving money to a private citizen rather than to a government.
The impact of the corrupt auditor was examined in an experimental setting by examining taxpayer compliance behaviour across different levels of bribes paid in lieu of taxes and penalties owed on the unreported income. We examined within-subject income reported over several independent rounds in the presence and absence of the corrupt auditor and found that underreporting of income exists with the mere presence of a collusively corrupt auditor, even in the absence of any economic advantage of such presence to the taxpayer. Thus, while the behaviour of the participants in the study was not economically rational, such behaviour is nonetheless consistent with the psychological and behavioural theories discussed earlier in deriving our hypotheses. Taxpayer non-compliance generally increases with after-tax monetary benefits to the taxpayer in the presence of the corrupt auditor.

In the case of a professional tax adviser hired after the taxpayer has been selected for an audit, compliance could decrease if the taxpayer expects the adviser to successfully reduce the tax penalties and/or successfully contest the assessment of underreported income. We compared the relative impact of a collusively corrupt auditor and a tax adviser on taxpayer compliance to assess whether these actors can serve as substitutes to some extent.59

<table>
<thead>
<tr>
<th>Difference in mean compliance</th>
<th>t</th>
<th>df</th>
<th>Sig. (2-tailed)</th>
<th>Mean difference</th>
<th>Lower</th>
<th>Upper</th>
</tr>
</thead>
<tbody>
<tr>
<td>All 8 rounds (1st set – 2nd set)</td>
<td>−3.60</td>
<td>46</td>
<td>0.001</td>
<td>−9.08</td>
<td>−14.15</td>
<td>−4.01</td>
</tr>
<tr>
<td>Last 4 rounds (1st set – 2nd set)</td>
<td>−3.32</td>
<td>46</td>
<td>0.002</td>
<td>−11.15</td>
<td>−16.79</td>
<td>−5.52</td>
</tr>
<tr>
<td>Last 3 rounds (1st set – 2nd set)</td>
<td>−3.34</td>
<td>46</td>
<td>0.002</td>
<td>−11.89</td>
<td>−17.87</td>
<td>−5.92</td>
</tr>
</tbody>
</table>

df = degrees of freedom; Sig. = statistical significance level.

Notes:
Difference in mean compliance represents the difference in the average percentage of income reported by participants in the eight (last four, last three) rounds of the two sets (first and second set of eight rounds each) respectively, in the presence of the corrupt auditor alone and in the presence of the tax adviser alone. This difference represents an increase in mean compliance from the first set to the second set.

59 From a government’s perspective, bribes demanded by a corrupt auditor are clearly a deadweight loss since they are not likely to be reported and taxed as income. In contrast, tax advisory fees are at least somewhat recouped by taxing the adviser on his or her income, and potential penalties are collected by the government.
In our within-subjects test, compliance in the presence of a tax adviser alone was higher compared to compliance in the presence of a collusively corrupt tax auditor alone, all else being held equal. This suggests that the tax adviser, hired after the taxpayer has been selected for an audit, can and does serve as a substitute for a collusively corrupt tax auditor. Such behaviour suggests that taxpayers may consider dealing with a corrupt tax auditor as a better alternative for resolving their final tax liability—perhaps because the corrupt auditor may have the power to forgive penalties. Our study focused only on the dispute resolution role of the tax adviser engaged post-filing and post-assessment, and not on tax advisers engaged in tax planning before taxpayers file their income tax returns. Our findings therefore hold only for tax advisers engaged in dispute resolution, whose role can be described as akin to that of a defence lawyer. Our justification for this limited role of an adviser in our study is that we are interested in the impact of the presence of tax advisers versus the presence of corrupt tax auditors on taxpayer compliance—that is, we are only interested in testing whether these two actors are substitutes for each other when the economic outcomes to the taxpayer are identical.

Our study is subject to several limitations. While our two experiments used the language of tax compliance, our laboratory findings may not be generalizable to the outside world. Furthermore, the behaviour of participants from fourth-year undergraduate or first-year master of accountancy programs, with tax-filing experience, may not represent the tax-filing behaviour of taxpayers at large. Nonetheless, a strength of the study is that it was conducted using participants in Canada, a country in which corruption among tax officials appears to be relatively uncommon. Thus, we believe that the results of the study could be of value to a country known for tax corruption.

Another limitation of our study is that we do not explore the impact of the simultaneous presence of a tax adviser and a corrupt tax auditor on taxpayer compliance. The moral gatekeeper role of the tax adviser is likely to be much more crucial in such a context. We defer the issue of the interactive effects of the presence of these two actors to future studies. A further limitation of the study is that while we motivated our hypotheses with theories relating to social norms, we did not elicit the social norms of the participants and test whether such norms affected their compliance behaviour. Finally, while we provided economic incentives for the participants’ decisions, those economic incentives may not have been sufficient to motivate their behaviour.
APPENDIX INSTRUCTIONS TO PARTICIPANTS, EXPERIMENTS 1 AND 2

Experiment 1: Instructions to Participants in the Presence of a Corrupt Tax Auditor Treatment

WELCOME TO THE EXPERIMENT ON THE ECONOMICS OF DECISION MAKING
WE WILL USE AN EXPERIMENTAL CURRENCY, LIRA, IN THIS STUDY WHERE 100 LIRAS = $1 CANADIAN.

YOU WILL BE PROVIDED WITH AN INITIAL SHOWUP FEE OF 500 LIRAS (EQUIVALENT TO $5 CANADIAN).

You will earn some income in liras each period. Your task will be to decide how much of that income to report to the tax authority. You can choose to report any amount from zero to the full amount of your income for the period.

You will pay tax on the income reported by you. The tax to be paid will be calculated using the tax rate for the period disclosed to you. You will not pay tax on the income not reported by you.

Once you have made your choice on the income to be reported, your report will be audited at a probability equal to the audit rate disclosed to you. A random number generator will be utilized to determine whether your income report will be audited. If the random number generated is equal to or less than the disclosed audit rate, your income report will be audited. Otherwise, your income report will not be audited. The probability of being audited in a period is random and is independent of both the probability of being audited in other periods, as well as the probability of others being audited.

IF YOUR INCOME REPORT IS NOT AUDITED:

After-tax income retained = Income earned in the period – The tax paid in the period.

IF YOUR INCOME REPORT IS AUDITED:

If you are audited, you will have to additionally pay (i) the unpaid tax on the unreported income, and (ii) penalty (calculated as a percentage of the unpaid tax).

After-tax and after-penalty income retained = Income earned in the period – Tax paid on the income – Penalty on the unpaid tax in the period.

THERE WILL BE THREE PRACTICE PERIODS BEFORE THE ACTUAL PERIODS BEGIN. YOUR DECISIONS IN THE PRACTICE ROUNDS WILL NOT IMPACT YOUR EARNINGS FROM THIS EXPERIMENT.

YOUR TOTAL AFTER-TAX AND AFTER-PENALTY EARNINGS IN LIRAS AT THE END OF THE EXPERIMENT WILL BE PAID TO YOU IN CANADIAN DOLLARS AT THE RATE OF 100 LIRAS = $1 CANADIAN.

CHANGE IN THE EXPERIMENTAL DETAILS:

Everything will remain the same as before EXCEPT WHEN YOU GET AUDITED.

IF AUDITED IN A PERIOD: The tax auditor may offer to accept a bribe equal to the tax owed by you on the unreported income + ONLY HALF of the penalty owed by you (i.e., YOU SAVE HALF OF THE PENALTY PAYABLE BY AGREEING TO PAY THE BRIBE).
You can either ACCEPT or DECLINE the request for a bribe.

**IF YOU ACCEPT THE BRIBE REQUEST:** You have to additionally pay only the bribe requested.

Your after-tax and after-bribe income from that period = Your income for the period − Tax paid by you − The bribe you agreed to pay.

**IF YOU DO NOT ACCEPT TO PAY THE BRIBE REQUEST:** You have to additionally pay the tax owed by you on the unreported income + the FULL penalty on such unpaid taxes.

Therefore, your income after tax and penalty from that period = Your income for the period − Tax on the full income − The penalty on the unpaid tax.

**Experiment 2: Instructions to Participants in the Corrupt Tax Auditor Versus Tax Adviser Treatment**

**WELCOME TO THE EXPERIMENT ON THE ECONOMICS OF DECISION MAKING**

**WE WILL USE AN EXPERIMENTAL CURRENCY, LIRA, IN THIS STUDY WHERE 100 LIRAS = $1 CANADIAN.**

**YOU WILL BE PROVIDED WITH AN INITIAL SHOWUP FEE OF 500 LIRAS (EQUIVALENT TO $5 CANADIAN).**

You will earn income in liras each period. Your task will be to decide how much of your income to report to the tax authority. You can choose to report any amount from zero to the full amount of your income for the period.

You will pay tax on the income reported by you. The tax to be paid will be calculated using the tax rate for the period disclosed to you. You will not pay tax on the income not reported by you.

Once you have made your choice on the income to be reported, your report will be audited at a probability equal to the audit rate disclosed to you. A random number generator will be utilized to determine whether your income report will be audited. If the random number generated is equal to or less than the disclosed audit rate, your income report will be audited. Otherwise, your income report will not be audited. The probability of being audited in a period is random and is independent of both the probability of being audited in other periods, as well as the probability of others being audited.

**IF YOUR INCOME REPORT IS NOT AUDITED:**

After-tax income retained = Income earned in the period − The tax paid by you in the period.

**IF AUDITED IN A PERIOD:** The tax auditor will offer to accept a bribe equal to the tax owed by you on the unreported income + ONLY HALF of the penalty owed by you (i.e., YOU SAVE HALF OF THE PENALTY PAYABLE BY AGREEING TO PAY THE BRIBE).

You can either ACCEPT or DECLINE the bribe request.

**IF YOU ACCEPT THE BRIBE REQUEST:** You have to pay the additional bribe requested.

Your after-tax and after-bribe income retained for the period = Your income earned for the period − Tax paid by you − The bribe you agreed to pay.
IF YOU DO NOT ACCEPT THE BRIBE REQUEST: You have to pay the additional tax owed by you on the unreported income + the FULL penalty on such unpaid taxes.

Therefore, your income after tax and penalty retained for the period = Your income earned for the period − Tax on the full income − The penalty on the unpaid tax.

THERE WILL BE THREE PRACTICE PERIODS BEFORE THE ACTUAL PERIODS BEGIN. YOUR DECISIONS IN THE PRACTICE ROUNDS WILL NOT IMPACT YOUR EARNINGS FROM THIS EXPERIMENT.

YOUR TOTAL EARNINGS IN LIRAS AT THE END OF THE EXPERIMENT WILL BE PAID TO YOU IN CANADIAN DOLLARS AT THE RATE OF 100 LIRAS = $1 CANADIAN.

CHANGE IN THE EXPERIMENTAL DETAILS:
Everything will remain the same as before EXCEPT WHEN YOU GET AUDITED.

IF AUDITED IN A PERIOD: A tax advisory firm will offer you a tax-planning scheme that will reduce your entire penalty. The cost of this tax-planning scheme is half the penalty imposed by the tax authority. Therefore, if you acquire the tax-planning services, you will have to additionally pay the tax owed by you on the unreported income plus an advisory fee to the firm equal to HALF of the original penalty assessed on you. (THE NET RESULT IS THAT YOU SAVE 50% OF THE ORIGINAL PENALTY ASSESSED BY ENGAGING THE TAX ADVISORY FIRM.)

You can either ACCEPT or DECLINE the services of the tax advisory firm.

IF YOU ACCEPT THE SERVICES OF THE TAX ADVISORY FIRM: You have to pay the tax owed on the unreported income + a fee to the firm equal to half of the penalty originally assessed on you.

Your after-tax and after-fee income retained for the period = Income earned in the period − Tax paid on that income − The advisory fee.

IF YOU DO NOT ACCEPT THE SERVICES OF THE TAX ADVISORY FIRM: You have to pay the tax owed by you on the unreported income + the FULL penalty on such unpaid taxes.

Therefore, your income after tax and penalty from that period = Income earned in the period − Tax on that income − The penalty on the unpaid tax.
Policy Forum: Editors’ Introduction—Wealth Taxation

The practice of taxing a broad measure of wealth by imposing an annual tax waned considerably among member countries of the Organisation for Economic Co-operation and Development (OECD) between 1990 and 2017, declining from 12 countries to 4.1 Administrative complexity mixed with tax-avoidance considerations led governments to reassess whether the revenue from annual wealth taxes was worth the cost. As 2019 approached, an annual wealth tax seemed destined to disappear as a modern policy tool.

Interest in wealth taxation was revived in early 2019 when US Senator Elizabeth Warren made an annual wealth tax central to her campaign to become the Democratic presidential candidate in the 2020 election. Subsequently, in Canada, the federal New Democratic Party included an annual wealth tax proposal in its platform for the 2019 election. At the same time, wealth taxation has moved from being an odd corner of academic research to a pressing topic of tax policy debate.

To advance the debate, in this Policy Forum we present two articles on wealth taxation. The first article, by Andrew Jackson and Toby Sanger, lays out the economic case for an annual wealth tax. Motivated by a concern for reducing inequality, the authors argue that the case for the tax is strong and that the administrative problems can be mitigated. The second article, by Graham Purse, makes the case for a different form of wealth taxation. An accession tax does not levy taxes annually but instead taxes interpersonal transfers (at death or before) in the hands of the recipient. Purse argues that an accession tax has better economic and administrative properties than an annual wealth tax.

The push for wealth taxation is now part of the tax policy conversation in Canada. Academic research on the practicalities of wealth taxation—the if, why, how, and when—has lagged behind the policy conversation. This Policy Forum aims to stimulate further research on the topic in order to better inform future discussion and debate.

Kevin Milligan
Alan Macnaughton
Editors

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Policy Forum: The Case for an Annual Net Wealth Tax

Andrew Jackson and Toby Sanger*

PRÉCIS
Le public et les décideurs politiques montrent un intérêt renouvelé pour les impôts sur la fortune comme réponse possible au problème de l’inégalité de la richesse. Cet article décrit la tendance récente à l’augmentation de l’inégalité de la richesse, et les facteurs qui y contribuent dans les pays développés, y compris le Canada. Les auteurs font valoir qu’un impôt annuel sur la fortune pourrait et devrait contrer cette tendance, et qu’un tel impôt est à la fois justifiable sur le plan économique et réalisable sur le plan technique. Ils affirment que l’imposition du revenu du capital ne résout pas adéquatement le problème de l’accumulation de grandes fortunes en grande partie en franchise de l’impôt, et qu’un impôt annuel sur la fortune est préférable aux impôts fonciers, qui excluent l’imposition des actifs financiers et sont prélevés sur le patrimoine brut plutôt que sur le patrimoine net. L’article répond en détail aux principales critiques concernant un impôt annuel sur la fortune, en faisant valoir qu’un tel impôt est nécessaire pour parvenir à une répartition plus équitable de la richesse tout en générant des recettes supplémentaires.

ABSTRACT
The public and policy makers are showing a renewed interest in wealth taxes as a possible response to the problem of wealth inequality. This article describes the recent trend of rising wealth inequality, and the factors contributing to it, in developed countries, including Canada. The authors argue that an annual wealth tax could and should counter the trend, and that such a tax is both justifiable on economic grounds and technically feasible. They assert that the taxation of capital income does not adequately address the largely tax-free accumulation of large fortunes, and that an annual wealth tax is preferable to property taxes, which exclude the taxation of financial assets and are levied on gross rather than net wealth. The article responds in detail to major criticisms of an annual tax on wealth, arguing that such a tax is needed to achieve a more equal distribution of wealth while raising additional revenues.

KEYWORDS: WEALTH TAXES ■ INEQUALITY ■ TAX POLICY ■ TAX REFORM ■ CAPITAL TAXES ■ ECONOMIC GROWTH

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INTRODUCTION

Growing inequalities in wealth worldwide have contributed to renewed interest in wealth taxes. The first part of this article provides a brief description of wealth inequality in Canada and how tax policy has contributed to it; discusses why extreme inequalities in wealth are not deserved or beneficial; and summarizes recent proposals from US and Canadian politicians for annual net wealth taxes.

A number of experts who agree that growing wealth inequality is a problem that should be addressed by tax changes argue that there are better alternatives than an annual wealth tax. In the second part of the article, we summarize and counter the various critical arguments raised. While a number of different measures are needed, we conclude that an annual net wealth tax with a high threshold would be an effective way to address wealth inequality by targeting individuals at the very top of the wealth distribution.

GROWING INEQUALITIES IN INCOME AND WEALTH

Inequalities in income and wealth have increased significantly in recent decades in many affluent countries, including Canada. The rise in inequality has been especially pronounced at the very top of the income and wealth spectrum.

Globally, the top 26 billionaires in 2018 had as much wealth as the bottom 50 percent of the world’s population.1 In Canada, the 87 wealthiest families (households) had net wealth of $259 billion in 2016, equivalent to the combined net

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wealth of the 12 million Canadians at the bottom of the wealth distribution.\textsuperscript{2} More shocking perhaps is the rate of growth: between 2012 and 2016, the wealth of those 87 families rose by 37 percent—more than two and a half times the overall average increase in net wealth over that period.\textsuperscript{3}

Data reported by the Organisation for Economic Co-operation and Development (OECD) and by Statistics Canada show that wealth inequality has increased, including at the top; however, these data understate the extent of the disparity, since household surveys do not adequately account for wealth held by the top 1 percent.\textsuperscript{4} Annual calculations by Credit Suisse estimate that Canada’s top 1 percent increased their share of net wealth from 17.9 percent in 2010 to 25.7 percent in 2019. This is very similar to the 25.6 percent share of total wealth that the parliamentary budget officer (PBO) estimated that Canada’s top 1 percent held in 2016.\textsuperscript{5}

\begin{itemize}
\item \textsuperscript{2} David Macdonald, \textit{Born To Win: Wealth Concentration in Canada Since 1999} (Toronto: Canadian Centre for Policy Alternatives, July 2018) (www.policyalternatives.ca/publications/reports/born-win). Statistics Canada’s Survey of Financial Security for the 12 million cited included both financial and non-financial tangible capital assets. The wealth of the vast majority of Canadians is concentrated in private pensions and non-financial assets, such as principal residences, other real estate, and vehicles. Together these amount to, on average, 80 percent of total assets held by Canadians. See Statistics Canada, “Survey of Financial Security, 2016,” \textit{Daily}, December 7, 2017 (www150.statcan.gc.ca/n1/daily-quotidien/171207/dq171207b-eng.htm). Assets held by the wealthiest families are predominantly financial assets. While there has been a lively debate about whether the value of human capital should be included in wealth distribution calculations, we believe that a clear distinction should be made between capital and wealth.
\item \textsuperscript{3} Macdonald, supra note 2, at 8. The mean average net wealth of all Canadians increased from $584,600 in 2012 to $669,300 in 2016—an increase of 14.4 percent over this period, according to the Survey of Financial Security, supra note 2. The average net wealth of the 87 wealthiest Canadian families increased from $2.17 billion in 2012 to $2.98 billion in 2016—an increase of 37 percent. Figures are in 2016 constant dollars.
\item \textsuperscript{5} Survey data omit ultra-high net wealth individuals, so some researchers combine them with lists of the wealthiest, such as those produced by Forbes to create a synthetic database. See Giles Keating, Michael O’Sullivan, Anthony Shorrocks, James B. Davies, and Rodrigo Lluberas, \textit{Global Wealth Report 2010} (Zurich: Credit Suisse Research Institute, October 2010); and Anthony Shorrocks, James Davies, and Rodrigo Lluberas, \textit{Global Wealth Report 2019} (Zurich: Credit Suisse Research Institute, October 2019) (www.credit-suisse.com/about-us/en/reports-research/global-wealth-report.html). For the PBO data on Canada’s top 1 percent, see Nigel Wodrich and Aidan Worswick, \textit{Estimating the Top Tail of the Family Wealth}
HOW TAX POLICY HAS CONTRIBUTED TO WEALTH INEQUALITY

Many factors have contributed to growing inequalities, but significantly they include tax policy changes that lowered tax rates for capital and business income, particularly during the 2000-2015 period. A 2016 study modelling historical changes in wealth distribution in the United States found that “the most important factor—by far—behind the developments [in wealth inequality] is the significant decline in tax progressivity that began in the late 1970s.” While similar analysis has not been carried out in Canada, recent increases to top personal income tax rates in a number of provinces and by the federal government in 2016, along with some anti-avoidance measures (such as constraints on the diversion of wealth through private corporations), have restored progressivity at the top end; however, it is too early to tell whether these changes will reverse growing inequalities.

Analysis of the incidence of the overall Canadian tax system (including income, sales, payroll, property, and other taxes) found that tax policy measures reduced the overall effective tax rate on the top 1 percent to the extent that by 2005 it was lower than the rate for all other income groups, including the lowest income decile. With opportunities for wealthy individuals and businesses to shelter their assets and income through international tax planning, the effective tax rates at the very top end are very likely lower than these incidence studies calculate.

Over 90 percent of the firms listed on the S&P/TSX60—representative of the largest corporations in Canada—have at least one subsidiary based in a tax haven.
Assets reported by Canadian corporations located in the top 12 tax havens increased from $9 billion in 1988 to $353 billion in 2018, more than doubling as a share of total Canadian direct investment abroad, from 11 percent to 27 percent.11

**ARE EXTREME WEALTH INEQUALITIES DESERVED OR BENEFICIAL?**

Some will argue that the rich deserve their wealth because it is a product of an economic contribution to society: just deserts for hard work. However, more than half of the wealthiest 87 families in Canada inherited a large part of their wealth, including all but one of the top 10 on the Canadian Business Richest 2017 list.12 The wealthiest individuals and families in Canada are predominantly the scions or founders of large corporations, whose wealth is based on their significant share ownership. These corporations are often dominant in their markets, giving them leverage to achieve higher growth and returns, limit competition, control costs, and expand their economic power.

Piketty argues that

> the idea that strictly private property exists and that certain people have an inviolable natural right to it cannot withstand analysis. The accumulation of wealth is always the fruit of a social process, which depends, among other things, on public infrastructures (such as legal, fiscal, and educational systems), the social division of labor, and the knowledge accumulated by humanity over centuries. Under such conditions, it is perfectly logical that people who have accumulated large amounts of wealth should return a fraction of it to the community every year.13

Societies with greater economic equality have better social and health outcomes measured by a wide range of indicators, including outcomes for those at the top of the economic spectrum.14 Emotional well-being increases with income, but only up to an annual income level of about US$75,000, after which it plateaus, while evaluation-of-life measures plateau at slightly higher levels.15

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12 Macdonald, supra note 2, at 14 and 23.


15 See Daniel Kahneman and Angus Deaton, “High Income Improves Evaluation of Life, but Not Emotional Well-Being,” in *Proceedings of the National Academy of Sciences of the United*
While previously many had assumed that tradeoffs between equity and efficiency justified inequalities and trickle-down economic policies, more recently even mainstream economic organizations such as the International Monetary Fund (IMF) and the OECD have become increasingly concerned about growing inequalities. These organizations and other mainstream economists now argue that excessive inequalities are hampering economic growth.\textsuperscript{16}

Both Piketty and the OECD have argued that there is a natural tendency for wealth disparities to increase if measures, including more progressive taxes, are not in place to counter growing extreme concentrations of wealth. As the OECD has observed, “wealth begets wealth.”\textsuperscript{17} Those with high incomes can save more, returns increase with wealth, and those with wealth can more easily borrow money at lower rates of interest, allowing them to borrow more and accumulate more wealth. Wealth also begets power, enabling the wealthy to influence policies and the development and prosecution of legislation to suit their interests.\textsuperscript{18}

THE RECENT RESURGENCE OF INTEREST IN WEALTH TAXES

Wealth and property taxes are among the oldest forms of taxes, but only a handful of wealthy countries now levy an annual tax on broadly defined individual net wealth. Only four OECD countries still had an annual wealth tax in 2017, down from 12 in 1990.\textsuperscript{19}

\textsuperscript{16} For instance, one of the IMF’s flagship reports stated, “While some inequality is inevitable in a market-based economic system, excessive inequality can erode social cohesion, lead to political polarization, and ultimately lower economic growth”: International Monetary Fund, \textit{Fiscal Monitor, October 2017: Tackling Inequality} (Washington, DC: IMF, 2017), at ix (www.imf.org/en/publications/fm/issues/2017/10/05/fiscal-monitor-october-2017). In 2014, the OECD reported that “[n]ew OECD analysis suggests that income inequality has a negative and statistically significant impact on medium-term growth”: Organisation for Economic Co-operation and Development, Directorate for Employment, Labour and Social Affairs, \textit{Focus on Inequality and Growth} (Paris: OECD, December 2014), at 2 (www.oecd.org/social/Focus-Inequality-and-Growth-2014.pdf). Osberg states that “[t]here is now a growing chorus of economists arguing that increasing inequality implies Western economies have a structural tendency to secular stagnation, due to an excess and ever increasing flow of savings coming from the rising incomes of the very affluent”: Lars Osberg, \textit{The Age of Increasing Inequality: The Astonishing Rise of Canada’s 1%} (Toronto: Lorimer, 2018), at 143. While these analyses focus on income inequality, there are strong correlations between income and wealth inequality.


\textsuperscript{18} Ibid.

\textsuperscript{19} Ibid., at 16.
All OECD countries have some form of tax on immovable property—the main asset held by individuals in middle and lower income groups—but very few levy recurrent taxes on the main types of assets held by the top income groups, particularly various forms of financial assets. Many OECD countries also have some form of wealth transfer tax, such as an inheritance or estate tax, but revenues from these taxes have also been low and declining over time. In contrast, revenues from immovable property taxes are relatively significant and have grown as a share of tax revenues in recent decades.20

The resurgence of interest in the taxation of wealth was sparked in part by the arguments made by Piketty in his 2014 book, that economic and political power will become even more concentrated over time, and will result in a form of patrimonial capitalism, unless strong measures are taken to more equally redistribute wealth and political power.21 While Piketty may have ignited much interest, he was not the first prominent proponent of annual wealth taxes in recent years. The IMF’s October 2013 fiscal monitor report estimated the potential revenues from recurrent net wealth taxes for a number of countries, indicating that a 1 percent tax on the wealthiest 10 percent of households would generate revenues averaging about 1.0 percent of gross domestic product (GDP) for Group of Seven countries and 0.6 percent of GDP for Canada.22

Political interest in wealth taxes was further raised during the recent US Democratic primaries, in which Senators Elizabeth Warren and Bernie Sanders included in their respective campaigns proposals for an annual tax on very large holdings of wealth. Warren called for a 2 percent tax on fortunes exceeding $50 million, rising to 6 percent on fortunes exceeding $1 billion.23 Sanders proposed an even higher top tax rate of 8 percent on fortunes exceeding $10 billion, which he estimated would generate $4.35 trillion over a decade.24 When Warren first proposed her wealth tax on Twitter, she articulated a view that many no doubt agreed with: “The ultra-rich have rigged our economy & rigged our tax rules. We need structural change. That’s why I’m proposing something brand-new: An annual wealth tax on the tippy-top 0.1%.”25

20 Ibid., at 22.
In the 2019 Canadian federal election campaign, the New Democratic Party (NDP) also called for an annual wealth tax, levied at a rate of 1 percent on net wealth of more than $20 million.\(^\text{26}\) The PBO estimated that this would raise revenues averaging $7 billion annually over the next decade.\(^\text{27}\)

While these proposed wealth taxes are expected to generate significant revenues, raising revenues is only one of their objectives for the proponents. As Piketty wrote, a wealth tax “would never be more than a fairly modest supplement to the other revenue streams on which the modern social state depends. . . . [T]he goal is to stop the indefinite increase of inequality of wealth.”\(^\text{28}\)

There is now strong popular support for wealth taxes in many countries, including Canada. In 2019, 67 percent of Canadians polled supported a wealth tax of 2 percent on individuals with assets of more than $50 million.\(^\text{29}\) More recently, 75 percent supported a wealth tax in the range of 1 to 2 percent on the assets of Canada’s wealthiest.\(^\text{30}\) Support for a wealth tax is not limited to those who would not have to pay it. In recent years, a number of organizations of the wealthy and privileged have been formed—notably, Patriotic Millionaires and Resource Generation in the United States, and the Resource Movement in Canada—which have been outspoken in calling for more progressive taxes, including wealth taxes.

**Arguments Against—and For—an Annual Net Wealth Tax**

Despite the growing support for the taxation of wealth, many who accept that income and wealth should be more equally redistributed believe that annual net wealth taxes are not the best tool to achieve this. For example, Boadway and Pestieau argue that the objectives of an annual wealth tax could be better achieved by reform of existing capital income taxes and by the introduction of wealth transfer taxes such as inheritance taxes.\(^\text{31}\)

In a similar but more extensive analysis, the OECD concludes that while

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\(^{28}\) Piketty, *Capital in the Twenty-First Century*, supra note 21, at 518.


there is a case for addressing wealth inequality through the tax system . . . there are limited arguments for having a net wealth tax on top of broad-based personal capital income taxes and well-designed inheritance and gift taxes. However, there are stronger arguments for having a net wealth tax in the absence of broad-based capital income taxes and taxes on wealth transfers.32

While Canada has relatively broad taxes on personal income from capital, income from capital is taxed at preferential rates, and a range of exemptions and avoidance opportunities exists.33 Canada also has relatively low wealth transfer taxes: there are currently no taxes on inheritances or gifts, such as those imposed in many other countries, and provincial probate fees on estates are set at comparatively low rates and can be fairly easily avoided through tax-planning measures. These considerations suggest that in Canada, in the words of the OECD, there may be “stronger arguments for having a net wealth tax.”

Given the powerful opposition to the taxation of wealth, it is important to address the major arguments that have been levied against adopting an annual wealth tax. These include the following:34

- An annual wealth tax would be inferior to equivalent taxation of annual income from that wealth since it would not apply to above-average or windfall gains.
- Accumulated wealth that remains untaxed as personal income could be subject to inheritance taxes instead.
- An annual wealth tax could result in double taxation.
- Annual wealth taxes could have detrimental effects on savings, investment, and economic growth.
- Some individuals would who be subject to an annual wealth tax may be cash-poor and may not have the liquid funds available to pay the tax annually.
- An annual wealth tax would lead to capital flight and expatriation and/or increased tax avoidance and evasion.
- There would be difficulties in valuing some assets.

32 The Role and Design of Net Wealth Taxes in the OECD, supra note 17, at 98–99.
33 Arguments for lower taxes on income from capital can be based on the tax integration view of comprehensive income—that the total effective tax rate should be similar whether income flows directly to households or through corporations—and/or on the economic argument that lower rates of tax on income from capital will stimulate investment and economic growth. But as Boadway has argued, Canada’s tax system clearly taxes capital income preferentially, and the integration argument is neither convincing nor compelling since Canada’s income tax system has moved more toward a consumption-based system and its economy has become more globalized. See Robin Boadway, “Rationalizing the Canadian Income Tax System” (2019) 67:3 Canadian Tax Journal 643–66. Significant cuts to corporate income tax rates, to the taxation of income from capital, and to the marginal effective tax rate on investment over the past two decades have failed to increase rates of business investment as a share of the economy.
It should be emphasized that the annual wealth tax proposed recently in Canada by the NDP would have a high threshold, applying only to wealth in excess of $20 million. It would also have a modest rate of just 1 percent annually, which is similar to the average property tax rate across Canada. This is a significantly higher threshold than the wealth taxes that still exist, or existed until recently, in European countries. In those countries, the thresholds above which wealth taxes applied in 2017 (or in the latest year of operation) ranged from €67,550 in Switzerland to €1.3 million in France. Because the characteristics, forms of wealth, and current tax treatment of the wealthy differ from those for the merely rich and middle class, some arguments levied against wealth taxes in general are less relevant to an annual tax that would apply only to the very wealthiest; however, other arguments may be of concern to individuals who are not at the top of the wealth spectrum.

The alternative forms of wealth tax that both the OECD and Boadway and Pestieau propose as being preferable to an annual wealth tax—reform of capital income taxes and the imposition of inheritance taxes—are commendable but would arguably be more challenging than the introduction of a targeted annual tax on the very rich.

An Annual Wealth Tax Versus a Capital Income Tax

The main criticism advanced by both the OECD and Boadway and Pestieau is that, if an annual wealth tax is conceptualized as an alternative to taxation of the future capital income returns from that wealth, it would apply only to expected returns, and not to actual above-expected or windfall gains. In some cases, the effective tax rate on those returns would be lower or higher than the equivalent tax rate on capital income. However, this criticism applies only if an annual wealth tax is considered as an alternative to taxation of the income from future presumptive returns from wealth.

36 The Role and Design of Net Wealth Taxes in the OECD, supra note 17, at 81, table 4.2.
37 Increasing the capital gains inclusion rate would be a straightforward measure, but it would likely be more politically challenging since it would affect a larger share of the population. Graduated capital gains inclusion rates could be introduced, building on lifetime capital gains exemptions, but these would make the system even messier, and would apply only when capital gains were realized. While inheritance taxes may be popular among economists, they appear to be much less popular among the general public. A UK YouGov poll found that inheritance taxes were considered by far the least fair of 11 different types of taxes, with only 22 percent of respondents considering them fair: Stephan Shakespeare, “Voters in All Parties Think Inheritance Tax Unfair,” YouGov, March 19, 2015 (https://yougov.co.uk/topics/politics/articles-reports/2015/03/19/inheritance-tax-most-unfair). An inheritance tax would likely need to be introduced at a lower threshold and accompanied by a range of anti-avoidance measures. While there would, of course, be many challenges with introducing an annual wealth tax, the relatively small number of individuals who would be subject to the tax would reduce the overall compliance and administration costs.
assets. If an annual wealth tax is seen as compensation for the past undertaxation of the income and wealth that accrued into these fortunes, this criticism does not apply. An annual wealth tax can instead be viewed as a tax on the accrued value of the assets’ historical endowments and returns, less consumption and any transfers or gifts.

In fact, Boadway and Pestieau acknowledge that

[if] the wealth had been accumulated from above-normal returns due to windfall gains or monopoly rents, taxing them ex post might be justified to the extent that the tax system did not tax them as they were earned . . . [and] would reinforce the case for progressive wealth taxation.\(^{38}\)

This certainly appears to be a widespread view and perhaps explains why there is such strong popular support for wealth taxes.

An annual wealth tax provides certain advantages over taxation of capital income. It would apply to the gains accrued on an annual basis, instead of upon realization. This makes it fairer in relation to other forms of income taxes, and also avoids the problems associated with tax planning for large realized capital gains.

In addition, an annual wealth tax could cover a broader range of assets than capital income taxes, including not just those that generate monetary income but also real property, art, luxury boats, vehicles, and other high-value non-financial investments. It could also apply to assets that might not ever be adequately taxed as capital income during the lifetime of the wealthy individual and so could be passed on tax-free to heirs (assuming that there are no inheritance or estate taxes).

**An Annual Wealth Tax Versus an Inheritance Tax**

Annual wealth taxes provide an advantage over inheritance taxes in that the wealth is taxed immediately and on an annual basis, rather than years hence at death. Many of the world’s wealthiest billionaires today are relatively young, and so inheritance taxes, if they were introduced, would likely not be levied on their wealth for decades, if at all. Some wealthy individuals choose to give away much of their wealth during their lifetime, and trusts and foundations can form another vehicle for tax avoidance. As Alepin has highlighted, low disbursement requirements allow private foundations to grow perpetually tax-free, while providing potentially larger tax benefits to their founders—and tax losses to governments—than the amounts disbursed annually.\(^{39}\)

\(^{38}\) Boadway and Pestieau, supra note 31, at 8.

Double Taxation

Another criticism of an annual wealth tax is that it could result in double taxation; however, double (and sometimes triple) taxation is common. With low rates of tax on savings, investments, and capital income, and numerous opportunities for tax avoidance, an annual wealth tax that is levied on the very wealthy might not result in much double taxation at all—and in some cases could be the only time that these individuals are effectively taxed.

Savings and Investment

There are, of course, valid concerns that an annual wealth tax would have negative effects on savings and investment. Studies have found relatively small negative effects of annual wealth taxes on real behaviour or savings. This may be because there have been sufficient opportunities for tax avoidance, and perhaps the real effects would be stronger if opportunities for tax avoidance and evasion were more limited. But despite the steep cuts in taxes on business and capital income over the past two decades, business investment as a share of the economy has declined rather than increased, as capital and wealth have become more concentrated.

Given that many of the larger fortunes in Canada have been established through inheritances and/or through businesses that have attained a dominant position in their industry, an annual wealth tax that applied only to the ultra-wealthy could arguably also have positive economic impacts if it weakened the dominance of those businesses and ultimately resulted in greater competition. As Saez and Zucman state, “[t]he economics literature suggests that a highly progressive wealth tax could in fact have a positive effect on innovation.”

40 See The Role and Design of Net Wealth Taxes in the OECD, supra note 17, at 62.

41 Canada’s combined federal-provincial corporate income tax rate was cut from 42.9 percent in 1999 to 26.1 percent in 2012 (a reduction of about 40 percent) and has stayed close to that rate since, but business investment in machinery and equipment as a share of the economy has declined almost in lockstep with these decreasing tax rates. Canada’s marginal effective tax rate on new business investment has been cut by much more, from 44.3 percent in 1999 to 13.8 percent in 2019 (a reduction of almost 60 percent), but also with no discernible positive impact on business investment. See Toby Sanger, Corporate Income Tax Freedom Day: 7 January 2020 (Ottawa: Canadians for Tax Fairness, 2020) (https://www.taxfairness.ca/sites/default/files/resource/corporate_income_tax_freedom_report_2020.pdf). Brennan, however, argues that corporate income tax rate reductions have contributed to greater corporate concentration, which has led to lower investment and slower growth; he suggests that the cuts to corporate rates could “go down as one of the great public policy blunders of the past generation”: Jordan Brennan, Do Corporate Income Tax Reductions Stimulate Growth? (Ottawa: Canadian Centre for Policy Alternatives, November 2015), at 30 (https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/11/Do_Corporate_Income_Tax_Rate_Reductions.pdf).

While an annual wealth tax might, as intended, slow the growth of large fortunes, it is unlikely that it would prevent the very wealthy from investing in a significant way. Indeed, it could make them look for higher-risk, higher-rate of return productive investments rather than just holding cash and low-rate-of-return bonds. This is because an annual wealth tax might encourage billionaires to pursue more aggressive investment in the hope of maintaining the higher value of their assets.

**Liquidity**

There is legitimate concern that some individuals who would be subject to an annual wealth tax would not have adequate income or liquidity to pay their wealth tax bills without disposing of assets. However, this concern could be addressed by allowing tax deferrals or payment by instalment, as suggested in Senator Warren's proposal.\(^{43}\) The ultra-wealthy who would be most affected by an annual wealth tax would no doubt have more diversified holdings, access to credit, and the ability to plan for more available cash to pay their annual tax bills.

**Capital Flight and Expatriation**

A further argument against an annual wealth tax is that it could result in capital flight and relocation by those subject to the tax. While some researchers found significant capital flight from France following its introduction of a highly publicized wealth tax in 1989, others have found limited mobility and expatriation.\(^{44}\) Saez and Zucman, and Senator Warren, have proposed that a wealth tax could be combined with measures to limit capital flight, such as an exit tax of 40 percent of net wealth for those who renounce their citizenship.\(^{45}\)

**Tax Evasion**

A common objection to an annual wealth tax is that it can be easily avoided through tax evasion. This certainly could have been the case in the past, but the rules of the game are changing as a result of the OECD’s base erosion and profit-shifting (BEPS) reforms and the implementation of more stringent anti-avoidance measures by national governments. By far the largest share of assets held by the wealthiest individuals is represented by their equity ownership of either listed or privately held corporations.\(^{46}\)

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\(^{43}\) See Warren, supra note 23.

\(^{44}\) The Role and Design of Net Wealth Taxes in the OECD, supra note 17, at 66.

\(^{45}\) See Saez and Zucman, supra note 42, and Warren, supra note 23.

The Independent Commission for the Reform of International Corporate Taxation (ICRICT) notes:

Despite the scale of hidden wealth . . . the existing data-collection infrastructure includes potentially powerful tools for transparency, including the recent adoption of tax transparency measures, such as the automatic, multilateral exchange of bank accounts data at a global level between tax authorities, public registries of beneficial ownerships and exchange between tax authorities of country-by-country reporting from multinational companies.47

Following the passage of the US Foreign Account Tax Compliance Act48 in 2010, foreign banks now routinely report foreign assets to the US tax authorities, under the threat of severe sanctions. A global asset registry, as proposed by Piketty and ICRICT, would combine existing data with additional data collected by national authorities.49

Tax enforcement and compliance are matters of political will, and tax dodging and evasion can be countered by setting strong standards for disclosure, eliminating opportunities for avoidance through legislative changes, strengthening anti-avoidance rules, increasing penalties, and increasing resources for investigation, enforcement, and prosecution. As Milligan concludes, elasticity of taxable income, which reflects both income shifting to avoid taxes and real economic factors, is not an immutable measure but “changes with circumstances and can be affected by a government’s choices about tax legislation and enforcement.”50

Valuation

One serious objection to an annual wealth tax is that it is sometimes hard to value assets, including shares in partnerships and private corporations that are not regularly traded on the stock market and thus cannot always be priced regularly. However, Saez and Zucman note that these assets at most constitute about 20 percent of the wealth of the very rich, and since they are often traded on at least an occasional basis, a reasonable valuation by tax authorities is possible.51 Saez and Zucman argue that the government could help to set a market for these assets—for example, by allowing companies to pay tax in the form of shares, which could then be sold, rather than in cash. The government could give itself the right

49 ICRICT, supra note 47, at 5.
50 Milligan, supra note 7, at 710.
to buy shares in private assets at rates close to the declared value as a deterrent to underreporting.

**CONCLUSION**

While others have argued that the taxation of wealth could be better accomplished through other measures, our review of the arguments against and for an annual wealth tax concludes that an annual net wealth tax with a high threshold would be a well-targeted way to address growing inequality of wealth at the very top, and is likely more immediately feasible than the alternatives proposed.

We agree that Canada’s system of capital taxation should be reformed and that inheritance taxes should be reintroduced, but doing so at this time would likely be more challenging than the introduction of a new tax on the very wealthy. Undertaking comprehensive tax reform, as some have proposed, is of course an attractive idea, but it would take many years to complete, and the outcomes are uncertain. Targeted fixes can be more quickly achievable and more effective in the short term.

An annual net wealth tax could not only be targeted at the ultra-wealthy, but also cover a broader range of assets than are covered by capital income taxes, and it should do so in order to prevent avoidance. There are valid concerns about the impact of an annual wealth tax on savings and investment, about capital flight and tax evasion, and about liquidity and valuation; however, the same concerns would be present with any alternative measures, and they could largely be addressed. For example, an annual net wealth tax on the assets of the very wealthy could not only stimulate competition by reducing the dominant position of those business owners in industry, but also motivate them to look for higher-risk, higher-rate-of-return productive investments. Concerns about liquidity could be dealt with by allowing tax deferrals or payment by instalment.

To target those at the top, a wealth tax for Canada should be introduced at a high threshold—for example, wealth in excess of $20 million, as the NDP has proposed—and with a broad base covering worldwide net assets. Those assets could include shares and other property held in corporations, trusts, immovable property, high-value jewellery, artwork, and other luxury goods such as yachts and vehicles; limited exemptions might be provided for principal residences and pensions. The new wealth tax should be accompanied by an exit tax, to prevent capital flight, and by reforms to improve the transparency of asset ownership (such as the creation of a global asset registry), along with a range of other reforms now under consideration to prevent international tax avoidance and evasion.

The approximately $7 billion in annual revenues that would be generated by an annual wealth tax levied at a rate of 1 percent on net assets is a significant enough amount. While a tax at this rate would limit asset growth, it would not put too large a dent in the overall wealth held by those at the top, given the very large difference in growth rates for the assets of the wealthiest compared to average household wealth.

It is both reasonable and practical to add a wealth tax to Canada’s current arsenal of fair taxes—one that would be levied at a low but rising rate on very large fortunes.
The aim would not be just to raise extra revenues, but also to compensate for the lower effective tax rates and the substantial economic rents that many of the wealthy have been able to achieve, and to limit the concentration of wealth and economic power among a few.
Policy Forum: Taxing Wealth Transfers in Canada Using an Accession Tax

Graham Purse*

PRÉCIS
Les impôts sur le transfert de fortune ont une longue histoire au Canada : le rapport Rowell-Sirois préconisait une gestion fédérale; le rapport Carter soulignait l'importance d'inclure les transferts de fortune dans le revenu. Pourtant, à partir des années 1980, les impôts sur le transfert de fortune avaient largement disparu au Canada. Cet article plaide en faveur de l'examen d'un impôt progressif sur le transfert de fortune, qui impose les transferts de fortune dans les mains des bénéficiaires. Ce type d'impôt comporte de nombreux avantages administratifs par rapport à l'impôt annuel sur la fortune qui a la cote dans les débats populaires actuels.

ABSTRACT
Wealth transfer taxes have had a long history in Canada: the Rowell-Sirois report suggested federal administration; the Carter report emphasized the importance of including wealth transfers in income. Yet by the 1980s wealth transfer taxes had largely disappeared in Canada. This article makes the case for consideration of an accession tax, which taxes wealth transfers in the recipients’ hands. An accession tax has significant administrative advantages over the annual wealth tax featured in current popular debates.

KEYWORDS: WEALTH TAXES • INHERITANCE TAX • SUCCESSION DUTIES • FISCAL POLICY • ECONOMIC POLICY • HISTORY

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INTRODUCTION
This article is concerned with wealth transfer taxes (WTTs) in Canada—specifically, gift and death taxes levied on the recipients of wealth transfers rather than the transferors. Taxes on the recipients of wealth transfers are generally referred to as accession, inheritance, or donee-based taxes.

I will examine worldwide approaches to wealth taxation, briefly summarize the history of WTTs in Canada, and discuss some economic and administrative challenges associated with WTTs. I conclude that, to the extent that wealth and income inequality raise concerns, more consideration could be given to accession taxes in Canada instead of annual wealth taxes.

APPROACHES TO WEALTH TAXATION
Governments commonly consider three tax bases in designing a tax system: consumption, income, and wealth. There are three classes of wealth taxes: capital gains taxes (CGTs), annual wealth taxes (AWTs), and WTTs. WTTs can, in turn, be categorized according to the payer of the statutory levy (the donor or the donee) and the timing of the transfer—during the lifetime of the donor (an inter vivos transfer) or on the donor’s death (a mortis causa transfer, by bequest). This categorization is depicted in table 1.

In 2017, of the 35 member countries of the Organisation for Economic Co-operation and Development (OECD), 22 had a WTT, 4 had an AWT, and almost all had some form of CGT. Of the 22 with a WTT, 19 used a recipient-based tax, 2 used a donor-based estate tax, and 1 (Switzerland) used a combination of the two, depending on the canton. The number of developed countries with AWTs has decreased significantly since the 1990s. At present, Canada has neither an AWT nor

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1 Lithuania has since joined. See Organisation for Economic Co-operation and Development, “Where: Global Reach” (www.oecd.org/about/members-and-partners).
4 Evans et al., supra note 2, at 106. (New Zealand does not have a CGT.)
5 Ibid.
6 In 1990, 12 OECD countries had an AWT. Burman and Slemrod, supra note 3, at 136.
a WTT; instead, it has relied on a CGT to tax wealth on death. This tax is applied on a 
deemed realization of capital gains at the time of death, subject to some exceptions.8

Twenty of the 22 OECD countries with a mortis causa WTT also have an inter 
vivos WTT.9 Having both makes sense: it prevents avoidance by modifying the timing 
of wealth transfers.10 However, taxes on death are more common, since there is an 
“easily identifiable event” and vesting can be made “conditional upon the payment 
of the tax.”11

**DEVELOPMENT OF WTTs IN CANADA**

This section discusses the historical development of WTTs, and the trend away 
from them, in Canada.

In 1892, four Canadian provinces imposed succession duties.12 By 1903, all 
provinces in the federation had WTTs.13 In 1913, such taxes constituted almost 
40 percent of total provincial tax revenues.14 Calls for inheritance and estate taxes 
came from farmers’ parties in several provinces in the 1910s.15

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7 Subsection 70(5) of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein 
referred to as “the ITA”).

8 For a spousal transfer exemption, see subsection 70(6) of the ITA. There are also certain 
farm- and fishing-related exemptions in section 70 of the ITA. For discussion, see, for example, 
Graham Purse, “How To Give Away the Farm When You’ve Bought the Farm” (2014) 7:5 
Taxes & Wealth Management (available on Taxnet Pro).

9 Evans et al., supra note 2, at 106.

10 In a jurisdiction with only a mortis causa WTT, inter vivos transfers would not be taxed; in a 
jurisdiction with only an inter vivos WTT, a motivation would exist to make transfers by 
bequest.

11 James A. Mirrlees, Stuart Adam, Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, 
Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, *Tax by Design: The Mirrlees 
Review* (Oxford, UK: Oxford University Press, 2011), at 348 (herein referred to as “the 
Mirrlees review”).

12 See Wolfe D. Goodman, “Death Taxes in Canada, in the Past and in the Possible Future” 

13 David G. Duff, “The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia, and 

14 Ibid.

15 By 1919, farmers’ parties in five provinces had called for a “heavy” graduated inheritance tax on 

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**TABLE 1  Categorization of Wealth Transfer Taxes**

<table>
<thead>
<tr>
<th>Statutory levy</th>
<th>Lifetime (inter vivos) transfer, by gift</th>
<th>Transfer on death (mortis causa), by bequest</th>
</tr>
</thead>
<tbody>
<tr>
<td>On giver, or donor (donor-based)</td>
<td>Gift tax</td>
<td>Estate tax</td>
</tr>
<tr>
<td>On recipient, or donee (donee-based)</td>
<td>Accession tax</td>
<td>Accession tax</td>
</tr>
</tbody>
</table>
The 1940s were a major period of transition in the evolution of WTTs in Canada. In May 1940, the Royal Commission on Dominion-Provincial Relations (the Rowell-Sirois commission) released its report.16 The report noted that the imposition of succession duties had been left entirely to the provinces up to that time.17 The report distinguished between donor- and donee-based WTTs; described the problem of double taxation for estates with assets in more than one jurisdiction; explained that the yields would be much less variable if these taxes were levied nationally rather than provincially; and concluded that the existing system of provincial succession taxation was detrimental to the Canadian economy.18 The report also stated that, if provinces chose to retain their control over inheritance taxes, uniformity was desirable.19 The commission’s recommendations on wealth transfer taxation were unpopular with the government of Ontario, which opposed federal attempts to interfere with the provincial regime.20

In 1941, Parliament enacted the Dominion Succession Duty Act, which applied to estates.21 The DSDA utilized a donee-based approach, with tax being payable by each “successor.”22 Its passage marked the first time that the government of Canada had levied inheritance taxes.23 Commenting in 1948 on Canada’s approach to the taxation of wealth transfers, Courtice explained that the DSDA was imposed “in the hope of centralizing all succession duty taxation in the Federal Government, as recommended by the Rowell-Sirois Report.”24 In 1959, Pozer described the DSDA

16 Canada, Report of the Royal Commission on Dominion-Provincial Relations, Book II, Recommendations (Ottawa: King’s Printer, 1940) (herein referred to as “the Rowell-Sirois report”).
17 Ibid., at 117.
18 Ibid., at 117-19. See also A.R. Courtice, “Succession Duties,” Report of the 1948 Tax Conference, 1948 Conference Report (Toronto: Canadian Tax Foundation, 1949), 61-72, at 68: “The Dominion is better able to negotiate reciprocal arrangements with other countries. It is unreasonable for a foreign nation to have to deal with nine separate provinces.”
19 Rowell-Sirois report, supra note 16, at 117-20: “If our financial recommendations are not adopted, and if the provinces still elect to retain inheritance taxes, we think that every effort should be made to work out a common inheritance tax program.”
21 Dominion Succession Duty Act, 1941, 4-5 George VI, c. 14 (herein referred to as “the DSDA”). See Goodman, supra note 12, at 1362.
22 Section 10 of the DSDA. The tax varied according to the relationship between the donor and the donee, and the monetary value of the benefit, with a preferential rate applying where the relationship was close. The tax also took into account the age of the recipient relative to the monetary value of the benefit.
24 Courtice, supra note 18, at 66.
as “merely a collocation of the various provincial Succession Duty Acts.”

Following the end of the Second World War, all provinces except Quebec and Ontario temporarily gave up their succession duties, along with certain other taxes, in exchange for federal grants; the provincial moratorium on succession taxes was to last until at least 1952.

In 1958, the Estate Tax Act replaced the DSDA. The ETA levied tax on the estate (that is, a donor-based tax) and also applied to real property located outside Canada.

In 1966, the Royal Commission on Taxation (the Carter commission) recommended replacing estate taxes with an all-encompassing definition of income that would include gifts and inheritances. As Duff has noted, because inheritances would form part of the recipient’s income, the Carter commission “recommended that separate wealth transfer taxes should be repealed.” The commission found the present system “illogical, inequitable, and inadequate,” and recommended that property should be freely transferable within the family unit, including to minor children.

In the federal budget delivered on June 18, 1971, the government announced that it was introducing a tax on capital gains and eliminating estate taxes. When the federal government abandoned estate taxes, most provinces announced new succession duties or increased their existing succession duties. However, provincial estate taxes began to disappear, a trend that continued throughout the decade.

In 1975, Ontario and Quebec continued to ease estate taxes, perhaps in response to the federal government’s decision to tax capital gains on death. In 1978, the federal government extended inheritance tax exemptions to incorporated farms and farm partnerships; previously, the exemption had applied only to non-incorporated farms. By April 1979, all provinces except Quebec had

26 See Duff, supra note 13, at 71; and Courtice, supra note 18, at 66.
27 Estate Tax Act, SC 1958, c. 29 (herein referred to as “the ETA”). See Goodman, supra note 12, at 1362.
28 See section 2 of the ETA, and Pozer, supra note 25, at 90.
30 Duff, supra note 13, at 92.
32 Canada, Department of Finance, 1971 Budget, Budget Speech, June 18, 1971, at 12.
33 Goodman, supra note 12, at 1361.
abandoned their succession duties.\textsuperscript{36} Quebec increased exemptions in 1983 and ultimately repealed its gift and death taxes on May 27, 1986.\textsuperscript{37}

**THE CASE FOR AN ACCESSION TAX**

In this section, I explain how an accession tax might operate and then set out the economic case for such a tax. Finally, I draw comparisons with an AWT.

**How an Accession Tax Would Operate**

A WTT on donees should apply regardless of whether transfers are made inter vivos or mortis causa. This view is supported by the United Kingdom’s Mirrlees review (a wide-ranging study of tax policy and design, completed in 2010).\textsuperscript{38} Moreover, both types of WTTs are used in OECD countries.\textsuperscript{39}

The Mirrlees review recommended an accession tax based on total gifts received over the donee’s lifetime.\textsuperscript{40} Fleischer\textsuperscript{41} and Duff\textsuperscript{42} also recommend an accession


\textsuperscript{37} Goodman, supra note 12, at 1370. It should be noted here that probate fees (which are considered to be a tax: *Eurig Estate (Re)*, [1998] 2 SCR 565) continue to exist under various provincial probate laws; see, for example, Saskatchewan’s Administration of Estates Act, SS 1998, c. A-4.1, and Ontario’s Estates Administration Act, RSO 1990, c. E.22. Probate fees are generally a modest percentage of the fair market value of the assets governed by the will requiring probate, and numerous forms of planning exist to minimize or avoid probate fees, although these can have significant consequences: see, for example, *Dunnison Estate v. Dunnison* , 2017 SKCA 40, in which an asserted bare trust to avoid probate failed, leading to an outright gift to an estranged son; and *Hilmoe v. Hilmoe*, 2018 SKCA 92, in which probate planning resulted in a second wife obtaining the family farm instead of the natural children. Multiple will planning (for example, where a person has two wills, one for assets that require probate and a second for assets that do not require probate) may be undertaken to minimize probate fees. In addition, alter ego trusts and joint partner trusts (which must meet specific requirements in subparagraph 104(4)(a)(iv) of the ITA) can be used to avoid such fees.

\textsuperscript{38} Mirrlees review, supra note 11, at 358.

\textsuperscript{39} See the discussion above under “Approaches to Wealth Taxation.”

\textsuperscript{40} Mirrlees review, supra note 11, at 357. Importantly, an accession tax considers lifetime receipts whereas an inheritance tax considers transfers annually. On this point, see Ray D. Madoff, “Considering Alternatives: Are There Methods Other Than the Estate and Gift Tax That Could Better Address Problems Associated with Wealth Concentration” (2016) 57:3 *Boston College Law Review* 883-92, at 886.


tax based on cumulative receipts. The underlying logic is that each gift cannot be considered in isolation; otherwise, tax could be mitigated by dividing gifts into small instalments.\textsuperscript{43} The Carter commission warned of this possibility.\textsuperscript{44} The French system, introduced in 1992, takes into account gifts made within 10 years prior to death.\textsuperscript{45} Canada’s DSDA considered gifts within three years of death, as did the successor statute, the ETA.\textsuperscript{46}

Whatever form an accession tax would take, it would have to be coordinated with the rules for withdrawals from registered retirement savings plans (RRSPs)\textsuperscript{47} and take into account any challenges associated with taxing interests in trusts.\textsuperscript{48} The design should also consider whether a WTT would function as separate legislation or be integrated with the existing federal ITA.\textsuperscript{49}

Fleischer recommends WTTs on donees at increasing marginal rates.\textsuperscript{50} While donee-based taxes can be progressive or flat,\textsuperscript{51} progressive rates may be appealing because of diminishing marginal utility.\textsuperscript{52} Moreover, progressive rate structures appear to be prevalent in existing WTTs in Europe.

One significant advantage of the donee-based approach is that it militates against the characterization of a WTT by anti-death-tax campaigners as a form of double taxation.\textsuperscript{53} That is, the donee-based WTT is not levied upon the “thrifty and hardworking donor.”\textsuperscript{54} Similarly, Graetz has observed that “[p]eople are far less

\begin{itemize}
\item Carter report, supra note 29, vol. 3, at 473.
\item Pozer, supra note 25, at 92.
\item Madoff, supra note 40, at 889-90.
\item Fleischer, supra note 41, at 913.
\item Duff, supra note 42, at 912.
\item Ibid., at 911.
\end{itemize}
sympathetic to repeal [of the US estate tax] when they view the estate tax as a tax on Paris Hilton, rather than on Conrad Hilton.”

The Carter commission was quite broad in its formulation of WTTs, recommending the inclusion of all property received from another tax unit, including gifts, transfers for inadequate consideration, debt forgiveness, succession transfers, and relief payments for dependants. Exemptions from WTTs may include certain dollar amounts before the tax takes effect or lower rates for transfers to children or spouses. Germany, Italy, and France each take into consideration the relationship between the donee and the donor in their inheritance tax regimes, and countries may offer preferable treatment when the transfer is to a charity. This was also true of the now-repealed Swedish inheritance tax. The Mirrlees review asserted that there is a stronger argument for taxing wealth transferred to the next generation as opposed to persons of equivalent age.

Assets such as businesses and farms present their own problems in the context of wealth transfers. In Germany, for example, over half of corporate transfers appear to be exempt from inheritance tax, potentially limiting its utility in raising revenue. Dodge has noted that a “recurring political leitmotiv” is that estate taxes cause the breakup of family farms and business, but observes that this claim has been met with questioning academic scrutiny.

A WTT gives rise to evasion and avoidance concerns. For example, in 1965, the Economist explained that, where the tax is donor-based, an avoidance technique might include taking up domicile in a low-tax jurisdiction. In the US context, Batchelder has recently proposed that, out of necessity, any WTT will require complex rules to counter avoidance strategies. In Canada, the general anti-avoidance rule

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58 Henrekson and Waldenström, supra note 43, at 1232.
59 Mirrlees review, supra note 11, at 356.
60 Loutzenhiser, supra note 51, at 844. This has been referred to as the bugaboo of estate and gift tax regimes; see Madoff, supra note 40, at 890.
63 On the topic of avoidance, see Kopczuk, supra note 49, at 330.
65 See Lily L. Batchelder, “Leveling the Playing Field Between Inherited Income and Income from Work Through an Inheritance Tax,” in Jay Shambaugh and Ryan Nunn, eds., Tackling
(GAAR) and civil penalties against tax advisers under the ITA\textsuperscript{66} may assist with enforcement, and a statutory mechanism to counteract generation-skipping planning (such as taxes upon grandchildren) would be necessary.

Sweden provides an interesting example of a tax system in which a WTT failed. Henrekson and Waldenström argue that bracket creep and increasing housing prices meant that almost one-third of adult heirs had to pay inheritance tax in Sweden; this was instrumental in its unpopularity and ultimate abolition.\textsuperscript{67} The threshold for inheritance tax in Sweden occasionally dropped below twice the annual income of workers, and thus the tax increasingly affected the middle class.\textsuperscript{68} Two major events ultimately triggered the repeal of the Swedish WTT: first, in the 1980s, it was reported that four notable families had left the country to avoid the inheritance tax;\textsuperscript{69} and second, stock prices of Astra (now AstraZeneca) fell concurrently with the death of a founder, leading to a tax rate on that estate in excess of 100 percent.\textsuperscript{70}

**The Economic Argument for an Accession Tax**

Views differ on wealth as a base for taxation. In the United Kingdom, the Meade report concluded that wealth confers a benefit upon its owner and “is therefore a proper subject for tax.”\textsuperscript{71} Similarly, in the US context, Fleischer has expressed concern that large wealth transfers confer “unearned power and influence.”\textsuperscript{72} She finds the notion of the “creation of a hereditary plutocracy”\textsuperscript{73} to be antithetical to US democratic ideals.\textsuperscript{74} It is reasonable to assert that plutocracy is also implicitly, if not explicitly, contrary to Canadian notions of democracy.\textsuperscript{74}

Inheritances are just as relevant as income and savings with respect to the measurement of well-being, and both income and savings are generally taxed in...
Canada. Unlike income and savings, however, there is no deferred pleasure (for example, work over leisure) or deferred consumption (for example, saving instead of buying a new boat) for inheritances. Inheritances thus represent the obtaining of money at no opportunity cost, and are therefore properly subject to taxation on the basis of fairness and economic incentives.

Much of the WTT literature focuses on equality of opportunity. A progressive WTT is a policy available to limit “the transmission of inter-generational inequality.” Where the rates are high, a WTT may limit transfers of large fortunes to future generations. Thus, despite affecting potentially a small pool of taxpayers, a WTT can have important distributional implications and can be “unusually progressive,” although it will typically generate little revenue.

Wealth transferred to a recipient is relevant to considerations of equity. Advocates of an accession tax tend to emphasize equality of opportunity and the potential for the “Carnegie effect” to reduce the labour efforts of recipients of large wealth transfers. The “Carnegie effect” refers to the American philanthropist Andrew Carnegie, who had spoken out in favour of a progressive tax on wealth transfers in 1889.

**ACCESSION TAXES AND AWTs**

Recently, scholars such as Piketty, and Saez and Zucman have called for AWTs. This is likely in part because tax systems that rely on income and/or consumption as the tax base do not provide for a direct tax on wealth. This failure to tax wealth

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75 Canada’s tax system does, however, provide tax-favoured treatment for certain assets. Examples include the tax-exempt status of investment income earned in tax-free savings accounts; the deferred taxation of contributions to RRSPs and registered pension plans; the exemption from capital gains and imputed rental income for owner-occupied housing; the exemption from accrual taxation of savings in registered disability savings plans (RDSPs) and registered education savings plans; and complex partial withdrawal exemption rules in the case of RDSPs.

76 See Samuel D. Brunson, “Afterlife of the Death Tax” (2019) 94:2 Indiana Law Journal, 355-88, at 381: “Heirs would owe taxes on their receipts at the same rate as workers who earned the same amount of money and enjoyed the same consumption potential.”

77 Batchelder, supra note 65, at 50. This proposition is also true for inter vivos gifts.

78 Meade report, supra note 71, at 318.

79 Evans et al., supra note 2, at 104.

80 Meade report, supra note 71, at 317.

81 See Kopczuk, supra note 49, at 330 and 333.

82 See generally the Mirrlees review, supra note 11.


84 Mirrlees review, supra note 11, at 349.

85 Graetz, supra note 55, at 808.

86 There has been a robust recent debate regarding wealth taxes, particularly since the publication of Thomas Piketty’s *Capital in the Twenty-First Century*, trans. Arthur Goldhammer.
can create inequities, because wealth confers prestige and influence upon its holder.\textsuperscript{87} An AWT may improve vertical and horizontal equity,\textsuperscript{88} because the possessor obtains advantages from holding wealth,\textsuperscript{89} but the distribution of the tax burden among persons with different levels of well-being remains contentious.\textsuperscript{90} Saez and Zucman suggest that a progressive wealth tax would require a “comprehensive base.”\textsuperscript{91} They argue that the effects on innovation would be modest,\textsuperscript{92} and note that there is “scant empirical evidence” of migratory effects.\textsuperscript{93}

Despite some recent popular support for AWTs, there is robust academic literature that opposes them. The Mirrlees review concluded that AWTs are not appealing.\textsuperscript{94} Duff has suggested that periodic taxes on wealth (for example, AWTs) are a “poor substitute” for a WTT.\textsuperscript{95} Similarly, Boadway and Pestieau argue that AWTs face significant administrative challenges, and that CGTs and WTTs are preferable.\textsuperscript{96}

In a paper prepared for the Mirrlees review, Boadway, Chamberlain, and Emerson argue that AWTs are in decline and “have failed to live up to expectations.”\textsuperscript{97}


\textsuperscript{88} However, an accession tax also would improve horizontal and vertical equity. See Brunson, supra note 76, at 381.


\textsuperscript{90} Burman and Slemrod, supra note 3, at 142.

\textsuperscript{91} Emmanuel Saez and Gabriel Zucman, “How Would a Progressive Wealth Tax Work? Evidence from the Economics Literature,” \textit{ICRICT}, June 17, 2019, at 5 (www.icrict.com/you-should-also-read/2019/6/17/how-would-a-progressive-wealth-tax-work-evidence-from-the-economics-literature). ("ICRICT" refers to the Independent Commission for the Reform of International Corporate Taxation.) Advocates of AWTs do make important points about wealth inequality. However, in light of the myriad practical problems with AWTs, it is worthwhile to consider whether an accession tax could be a more workable solution to the problem, as I suggest in this article.

\textsuperscript{92} Saez and Zucman, supra note 91, at 11.

\textsuperscript{93} Ibid., at 13.

\textsuperscript{94} Mirrlees review, supra note 11, at 347.

\textsuperscript{95} Duff, supra note 42, at 908.

\textsuperscript{96} Boadway and Pestieau, supra note 87, at 11.

Evans et al. offer a comprehensive critique of disclosure and valuation problems associated with AWTs. Burman and Slemrod point to a number of problems with AWTs, including “many exemptions and deductions, high levels of avoidance and evasion, and high costs of administration and compliance.” Burman and Slemrod also mention that AWTs create incentives for the wealthy to hide investments in diamonds and antiquities. Finally, because AWTs can reduce the return on savings and business investment, a portion of the tax incidence of an AWT may fall on workers.

WTTs and CGTs may therefore, for practical purposes, remain a better option than AWTs for taxing wealth accumulations, in circumstances in which a government is concerned about inequality, equality of opportunity, or the potential effect of bequests on the recipients’ willingness to work. Moreover, compared to an accession tax, an AWT may suffer from greater avoidance and valuation problems, perverse incentives, intrusive audits, asset monetization, the hiding of assets, and the need to repay taxes when wealth declines. By contrast, an accession tax contemplates the financial position of the donee, preserving horizontal equity, and it may have a less distorting effect on work incentives for recipients. Therefore, more consideration could be given to accession taxes where wealth and income inequality raise concerns; however, the debate remains complex.

CONCLUSION

WTTs existed in Canada for much of the 20th century, but by the 1980s, they had largely disappeared. Yet powerful equity and efficiency arguments can be made for WTTs. While AWTs may enjoy considerable popular support, their disadvantages include many administrative problems, and in that light their dwindling use internationally is unsurprising. In this regard, an accession tax has clear advantages and should be considered, particularly where concerns about growing inequality are paramount.

The main nuance in the WTT debate is that WTTs must be levied on the recipients of transfers in order to (1) respond to some of the objections from anti-double-tax campaigners, (2) preserve work incentives for recipients, and (3) prevent unearned accumulations of wealth. Given the potential advantages of WTTs, it is surprising that recent popular debate has focused almost entirely on AWTs.

98 Evans et al., supra note 2, at 106-15.
99 Burman and Slemrod, supra note 3, at 137.
100 Ibid., at 138.
101 Ibid.
THE ECONOMIC RESPONSE OF GOVERNMENTS IN CANADA TO COVID-19 IN THE FIRST THREE MONTHS OF THE CRISIS

Julie S. Gosselin, Luc Godbout, Tommy Gagné-Dubé, and Suzie St-Cerny*

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. In this article, the authors recount how Canadian governments have responded to the COVID-19 crisis through the economic measures announced between March 11 and May 15, 2020. Their analysis shows that Canadian governments have acted quite rapidly and that, by expanding emergency measures, they have tried to help just about everyone. The authors set out the estimated costs of the various measures, followed by a brief comparison of Canada’s response with the responses of other countries. 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: COVID-19 ■ SPENDING ■ EMERGENCY ■ RELIEF ■ COST ESTIMATES ■ GOVERNMENT EXPENDITURES

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INTRODUCTION

The COVID-19 pandemic, which began as a major health emergency, quickly turned into an unprecedented economic crisis, caused by government-imposed containment measures and the shutdown of many sectors of the economy in order to curb the spread of the virus. Governments have been forced to intervene to an extent not seen since the Second World War. In Canada, the first economic interventions came from the Bank of Canada and aimed to stabilize a financial system “under extreme stress.”

Around the world, the response of central banks to the financial and economic crisis has been aggressive and rapid. On March 4, 2020, the Bank of Canada announced the first of three successive cuts (to date) to its benchmark interest rate.

This article seeks to recount how governments in Canada have responded to the COVID-19 crisis through economic measures announced up to May 15, 2020. It breaks down the federal and provincial fiscal and budgetary responses into two phases, the first comprising emergency measures and the second mitigation measures. The pivotal point between the two periods is marked by the federal government’s announcement, on March 25, 2020, of an income support program (the Canada emergency response benefit, or CERB), intended to provide economic relief to many individuals who could no longer work for reasons related to the pandemic.

A synthesis of the various measures introduced follows, including a discussion of the cost of the support provided to businesses and individuals. Finally, Canada’s response is briefly compared with measures taken by other member countries of the Organisation for Economic Co-operation and Development (OECD).

RESPONDING TO THE VIRUS OUTBREAK

This first part of the article identifies government interventions in Canada up to March 25, 2020, which focused on the immediate response to the virus outbreak. Initially, the priority was to increase the capacity of health-care systems to deal with the pandemic. Across the country, resources were mobilized to purchase protective equipment and strengthen testing capacity. On March 11, Prime Minister Trudeau announced the creation of a fund exceeding $1 billion to finance public health and
research spending, including $500 million for the provinces. The message was clear: “Financial considerations should not and will not be an obstacle to hospitals and health systems making the necessary preparations.”

It quickly became apparent that financial considerations would not hinder support for individuals and businesses. A few announcements were made by the federal government on March 11, but the first substantial measures were revealed the following week. Later, the federal government recognized that the crisis had begun to affect Canadians as of March 15, by retroactively starting its two main employment support programs on that date.

The provincial governments, which have constitutional jurisdiction over health and education, successively closed elementary and secondary schools and declared a state of emergency. As of March 25, 2020, non-essential businesses were shut down in five provinces, including Ontario and Quebec.

**Income Support for Individuals**

The federal government’s first measure to support individuals was to accelerate employment insurance (EI) sickness benefits for workers who were quarantined or forced to self-isolate. In an announcement on March 11, 2020, Prime Minister Trudeau indicated that additional help for other affected Canadians was under consideration; those measures were announced seven days later.

In the meantime, provincial measures targeted emergency support for workers who were directed to self-isolate and who did not qualify for EI benefits. Quebec, Prince Edward Island, Alberta, and Saskatchewan quickly implemented temporary programs to this end. In Alberta and Quebec, the support offered was equal to the maximum amount of EI, but the Alberta program was broader in scope since it extended to workers caring for a dependant in isolation.

The support offered by the provinces was very short term and meant to cover the period until the federal government announced its own program. That announcement came on March 18, in the form of two new emergency allowances, the emergency care benefit and the emergency support benefit, which were projected to cost

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5 See supra note 3.

6 Information from press releases. In general, to increase the readability of this document, the source references for information from press releases are not provided. Interested readers may request the references from the authors.
up to $10 billion and $5 billion respectively. The emergency care benefit was intended for workers who were sick, quarantined, or had to stay at home to care for a family member; it provided $450 a week for up to 15 weeks. The emergency support benefit targeted workers who were not eligible for EI and faced unemployment as a result of the pandemic; its parameters were to be comparable to those of EI.

Most of the emergency support programs announced subsequently in British Columbia, New Brunswick, Prince Edward Island, and Nova Scotia were intended to bridge the gap until individuals who suffered a loss of income received federal assistance.

Broad-based relief measures to reduce pressures on household liquidity were also put in place by the provinces and the federal government. The most substantial were announced on March 18, when the federal government extended the filing and payment deadlines for personal income tax returns. Quebec, the only province administering its own personal income tax, quickly followed suit.

In Alberta, the government cancelled its planned increase in education property tax rates. Relief was also announced for the payment of utility bills in some provinces.

In response to the pandemic, many cities have provided a deferral for the payment of property taxes, which constitute the largest source of municipal revenues.

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8 British Columbia announced a lump-sum payment of $1,000 per person for individuals who suffered a loss of income as a result of the COVID-19 pandemic, including individuals who were eligible for federal programs. Up to April 30, 2020, New Brunswick offered a lump-sum payment of $900.

9 Quebec first announced the postponement of personal income tax filing and payment deadlines on March 17, 2020; it harmonized its deadlines with those of the federal government on March 19, 2020.

10 In British Columbia, individuals who have lost their jobs, are sick, or have suffered wage losses as a result of COVID-19 can receive up to $600 in financial assistance from the BC Hydro Customer Crisis Fund. In Alberta, the government announced, on March 18, 2020, that residential customers would be able to defer payment of their electricity and natural gas bills. The government of Ontario provided a 45-day suspension of electricity pricing by the time of use for residential customers, businesses, and farm operators; in addition, the relief provided in respect of electricity costs for eligible residential customers, farms, and small businesses was increased by $1.5 billion from the amount announced in the 2019 budget. On May 14, 2020, Newfoundland and Labrador announced $2.5 million in funding to cancel interest on overdue electricity bills for residential and business customers for a 15-month period starting June 1, 2020.

11 The announcements came particularly quickly in Montreal and Toronto; Toronto also delayed the due date for the payment of utility bills. The decision to defer the payment of residential property taxes was made in Calgary on April 16, 2020, and about two weeks later in Vancouver.
Other measures put in place at the beginning of the crisis targeted vulnerable groups. For seniors, the federal government reduced the minimum withdrawal from a registered retirement income fund (RRIF) by 25 percent, at an estimated cost of $495 million,\(^\text{12}\) and Quebec aligned its own rules with the measure. For Canadians with student debt funded by the federal government, a six-month moratorium on payments has been implemented, during which time no interest will be calculated; the estimated cost of this measure is $190 million.\(^\text{13}\) Provinces quickly harmonized their student loan programs with the federal initiative.\(^\text{14}\)

To further increase household liquidity, the maximum annual amount of the goods and services tax (GST) credit was doubled, a measure estimated to cost $5.5 billion.\(^\text{15}\) Simply qualifying for the GST credit was sufficient to receive the special lump-sum payment; no loss of income caused by COVID-19 was necessary. In addition, given the parameters of the measure, 1.5 million new beneficiaries were added.

The federal government’s assistance also targeted families with children. Those eligible to receive the Canada child benefit (CCB), including families with high income or facing no earning losses, were granted an additional benefit of $300 per child. The estimated cost of this measure was $2 billion.\(^\text{16}\)

One-time increases in transfers to low- and modest-income families, seniors, and households were also announced in Ontario, Nova Scotia, and British Columbia. In British Columbia, a measure announced on March 25, 2020 targeted lower-income tenants facing income losses and provided rent assistance to their landlords.\(^\text{17}\)

**Liquidity Support for Businesses**

The first federal government measure that aimed to preserve economic relationships between workers and their employers focused on enhancing the EI work-sharing program.\(^\text{18}\) This measure was introduced on March 11, 2020. At the provincial level, Newfoundland and Labrador was the first province to announce support for

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\(^{12}\) See supra note 7.

\(^{13}\) Ibid.

\(^{14}\) Alberta was the first to announce its alignment with the federal measure, on March 18, 2020. One week later, all other provinces had followed suit with the exception of Manitoba, which made its announcement on April 7, 2020.

\(^{15}\) See supra note 7.

\(^{16}\) Ibid.

\(^{17}\) Prince Edward Island announced a similar measure on March 30, 2020. One month later, on April 29, Quebec announced the availability of interest-free loans of $1,500, repayable in August 2021, for tenants whose incomes have decreased. Financial assistance is also available to residents of Quebec who need to postpone their move to their principal residence for reasons related to the pandemic.

\(^{18}\) The program provides benefits to workers who agree to a reduction of their work hours owing to circumstances beyond the control of their employer; these benefits replace 55 percent of lost wages.
workers; the government would provide “compensation to private employers to ensure continuation of pay”19 for employees affected by the self-isolation directive for persons returning from abroad. However, most of the federal and provincial measures that followed were intended to assist businesses in maintaining their cash flow through increased credit availability and easing measures.

On March 13, the federal government announced the establishment of the business credit availability program (BCAP), a $10 billion program designed to provide financing solutions to businesses, including small and medium-sized enterprises (SMEs). A few days later, Prince Edward Island and Nova Scotia created or enhanced programs to facilitate small businesses’ access to credit.20 In Quebec, a new temporary program providing emergency financing to businesses affected by the impacts of COVID-19 was announced on March 19. The Atlantic provinces and Quebec also instituted moratoriums for the repayment of government loans.

In this emergency phase, the most significant cash flow support measures took the form of tax payment deferral. The federal government announced the postponement of corporate income tax and instalment payments on March 18, and the provinces that administer their own corporate income tax (Alberta and Quebec) quickly aligned their own payment deadlines. Saskatchewan and Manitoba were the first to announce the extension of deadlines for sales tax remittances, on March 20 and March 22 respectively; soon after, British Columbia and Ontario introduced payment deferrals for various other indirect taxes. Easing measures for payroll taxes were also implemented in Manitoba, British Columbia, and Ontario. Toronto and Montreal announced property tax deferrals for businesses, as did many other local governments throughout the country.21

Employer payments to the Workers’ Compensation Board (WCB) were deferred in Nova Scotia and Quebec on March 20, 2020.22 Alberta, Saskatchewan, and Ontario announced utility bill easing measures for agricultural and commercial customers.23 In Nova Scotia, the payment terms for small businesses supplying the government were accelerated to 5 days instead of 30.

Some provinces also froze or reduced tax rates. British Columbia delayed provincial sales tax changes and the carbon tax increase planned in its 2020 budget, and

19 Newfoundland and Labrador, “Provincial Government To Provide Compensation to Workers in COVID-19 Self-Isolation,” March 14, 2020 (https://www.gov.nl.ca/releases/2020/exec/0314n02/). The details of this compensation (which were not available until April 29, 2020) included a maximum payment of $500 per week per employee, in coordination with federal assistance.

20 New Brunswick announced a working capital loan program on March 26, 2020.

21 After March 25, 2020, the property tax deadline for businesses was extended by three months in Calgary and 60 days in Vancouver.

22 Between March 23 (in Alberta) and April 3, 2020 (in Manitoba), deferral of WCB premium payments was announced in all of the remaining provinces.

23 Supra note 10.
lowered school tax rates for commercial properties.\textsuperscript{24} In Alberta, WCB premiums for 2020 payable by SMEs were reduced by 50 percent, and the payment of WCB premiums was deferred to 2021 for all employers. In Ontario, the employer health tax exemption was increased for 2020 to include more than 90 percent of private-sector employers.\textsuperscript{25}

Canadian governments also introduced new programs to preserve employment ties. On March 18, one week after the expansion of the EI work-sharing program, the federal government announced a 10 percent wage subsidy to support small businesses experiencing income losses and to “prevent lay-offs.”\textsuperscript{26} All businesses benefiting from the small business deduction\textsuperscript{27} could quickly obtain this three-month subsidy by reducing their employees’ income tax deduction remittances. On the same day, Prince Edward Island unveiled a temporary allowance paid to the employers of workers facing a reduction in their working hours.

Some early support measures targeted vulnerable industries. For farmers and agri-food businesses struggling with cash flow issues, the federal government announced a $5 billion increase in Farm Credit Canada’s lending capacity. The government also provided a six-month deferral of payments for farmers with outstanding loans under the advance payments program as of April 30, 2020.

In the oil-producing provinces, the effects of the pandemic were compounded by a sharp drop in global energy prices, which further eroded the economic outlook. In Newfoundland and Labrador, the premier turned to the prime minister in a call for urgent action, stating that the province was unable to borrow the necessary funds to maintain the operations of government.\textsuperscript{28} In Alberta, the government quickly announced relief measures for the energy and mining sectors.\textsuperscript{29}

\textsuperscript{24} A further reduction in school tax rates for commercial properties was announced on April 16, 2020, resulting in most businesses getting a 25 percent reduction in total property taxes.

\textsuperscript{25} In addition, the Ontario government introduced a refundable tax credit (at a rate of 10 percent, to a maximum credit of $45,000) for investment in regional development (construction, renovation, or purchase of buildings in designated areas).


\textsuperscript{27} As well as not-for-profit organizations and charitable organizations.


\textsuperscript{29} The Alberta government also established an economic council chaired by Jack Mintz to find ways to protect jobs during the economic crisis resulting from the COVID-19 pandemic and the recent collapse of energy prices. The council will also focus on long-term recovery strategies for the crisis, including efforts to accelerate the diversification of Alberta’s economy.
RESPONDING TO THE IMPLEMENTATION OF CONTAINMENT MEASURES AND THE SHUTDOWN OF THE ECONOMY

March 25 was a pivotal date in governments’ response to the crisis, being the day on which the federal government unveiled the CERB. This announcement marked the beginning of a second phase of government interventions. From this point, most announcements would expand the scope of the existing measures to prevent containment from causing too much damage to the labour market and the economy’s production capacity.

Mitigating the Economic Impacts of Containment Measures on Households

One week after introducing the emergency care and support benefits, the federal government replaced these two programs with the CERB. Delivered through the Canada Revenue Agency (CRA), the CERB provided a taxable amount of $500 per week for a maximum of 16 weeks to eligible workers who had stopped working for reasons related to COVID-19.

In the days that followed, temporary emergency benefits were introduced in Prince Edward Island30 and Nova Scotia to bridge the gap until CERB payments commenced. British Columbia announced an increase of $300 per month for all beneficiaries of provincial income support who were not eligible for federal emergency programs.31 In response to the implementation of the CERB on April 6, the governments of Quebec and Alberta terminated their more restrictive emergency support programs for workers. Nearly 80,000 workers used the Alberta program (at a cost of $91 million)32 compared to 13,000 in Quebec (at a cost of $14.5 million).33 It was also on April 6 that the CERB was extended to SME owners who pay themselves through dividends.

Quite soon after the new program came into effect, the financial support obtained through the CERB was compared with the income earned by individuals working at the minimum wage; in Quebec, in April 2020, those individuals had to work 40 hours per week to earn a gross income equivalent to the CERB. Given the possible impacts of CERB on lower-income workers’ incentives to work, on April 3 the Quebec government announced its incentive program to retain essential

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30 In Prince Edward Island, the program targeted workers who no longer qualified for EI. The province also introduced a maximum benefit of $1,000, available until June 16, 2020, for workers who were not eligible for any federal assistance.
31 The BC government also announced that for a three-month period, the receipt of CERB or EI benefits would not affect the aid delivered through its income support programs.
workers (IPREW), which provides a temporary taxable benefit of $100 per week targeting essential services employees earning $550 per week or less.\textsuperscript{34} Wage premiums for employees in the health-care sector have also been introduced in Quebec, as in other provinces.\textsuperscript{35}

On April 15, 2020, the federal government extended CERB eligibility to include seasonal workers and those who had exhausted their EI benefits. In addition, it announced that recipients could earn up to $1,000 per month without losing the benefit. At the same time, the federal government indicated that a new transfer would be made to the provinces and territories to share the costs of a temporary wage top-up program for essential low-income workers, such as Quebec’s IPREW. Estimated at $3 billion, the federal participation was to equal 75 percent of the program’s costs, and each province was to determine its own eligibility criteria and top-up amounts.\textsuperscript{36} In addition to Quebec, Saskatchewan and Prince Edward Island\textsuperscript{37} announced programs for low-wage essential workers. In Nova Scotia and British Columbia, as noted above, wage premiums were implemented specifically for health-care or front-line workers.\textsuperscript{38}

By allowing those who benefit from the CERB to earn up to $1,000 per month, the federal government broadened access to this support program, particularly for self-employed workers who have suffered significant but not total income losses. However, as provinces have begun to relax containment measures, the CERB’s negative effects on incentives to work have been criticized by many.\textsuperscript{39} For example, for workers earning less than $3,000 per month, working part-time while benefiting from the CERB is more lucrative than working full-time.\textsuperscript{40}

\begin{itemize}
  \item To qualify for the benefit for a maximum of 16 weeks, these workers must earn a gross salary of $550 per week or less, have an annual working income of at least $5,000, and have a total annual income of $28,600 or less, all calculated before the benefit.
  \item These wage premiums were announced in Alberta on April 16, 2020 and in Ontario on April 25, 2020. Also see infra note 38.
  \item The announcement was made on April 15, 2020, but it was not until May 7 that the federal government confirmed that all provinces and territories had presented, or were in the process of presenting, a cost-sharing plan to improve the wages of their essential workers.
  \item In Prince Edward Island, the program targets essential workers earning less than $3,000 per four-week period; they will receive a premium of $1,000 per period through their employer.
  \item For example, Nova Scotia introduced a program that offered employees within the health-care system a top-up of $2,000 after four months of work. In British Columbia, front-line workers in the health-care system, social services, and corrections would receive a lump-sum top-up payment of about $4 per hour for a 16-week period starting on March 15, 2020.
  \item Critics include the premiers of Manitoba and New Brunswick, in addition to the premier of Quebec. See Hélène Buzzetti and Marie Vastel, “Un employé peut refuser de travailler et toucher la PCU, confirme Ottawa,” \textit{Le Devoir}, May 12, 2020 (www.ledevoir.com/politique/canada/578761/un-employe-peut-refuser-de-travailler-et-toucher-la-pcu-confirme-ottawa).
  \item With the addition of $1,000 per month earned by working part-time to the $2,000 benefit provided by the CERB, the total income is $3,000; at $20 per hour, an individual would have to work more than 37.5 hours per week to exceed the threshold.
\end{itemize}
In this second phase of policy responses, new targeted measures for students and seniors were introduced. New Brunswick and Saskatchewan introduced emergency support programs for post-secondary students who were directly affected by the pandemic and were not eligible for other financial assistance programs. On April 22, the federal government announced several measures to support post-secondary students, including the creation of the Canada emergency student benefit (CESB), estimated to cost $5.25 billion. Available from May to August 2020, this measure was closely related to the CERB and would provide $1,250 per month to students and recent graduates who were unable to find a full-time job owing to the pandemic.

A few days before the CESB announcement, the Quebec government unveiled a program to support the recruitment of agricultural workers (at an estimated cost of $45 million), including a wage premium of $100 per week. One of the program’s objectives was to encourage the hiring of students. However, the introduction of the CESB, like the CERB, reduced the incentive to earn more than $1,000 per month and partly cancelled the expected effect of the Quebec program.

While the precarious financial situation of many students cannot be denied, the CESB offered them compensation for an income loss that had not yet materialized. At the same time, some workers facing unemployment as a result of the pandemic were not eligible for the CERB—for example, because their 2019 employment income was under $5,000.

The federal government indicated that efforts would be made to ensure that the CERB and the CESB met their financial support objectives while encouraging employment in all circumstances. It is possible that these benefit measures will be modified toward this end in the future, but as of the date of writing, no changes had been announced in this regard.

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43 Eligible students would be able to receive the benefit while earning up to $1,000 per month. Eligible students with dependants and those who are disabled would receive $2,000 per month, matching the amount of the benefit under the CERB.

44 For those working a minimum of 25 hours per week.

45 In Prince Edward Island, the government doubled the grants available to students to encourage them to work in the agricultural sector during the summer. This announcement was made on May 5, 2020.

46 The government provided this assurance during debates in the House of Commons on April 29, 2020, the day that the CESB legislation was passed.
On May 5, 2020, Manitoba introduced a $200 refundable tax credit for seniors. A federal measure to help seniors “get the support they need during the pandemic” was announced the following week: a $300 tax-free lump-sum payment to those eligible for the old age security (OAS) pension plus an additional $200 for seniors eligible for the guaranteed income supplement (GIS). The estimated cost of this measure was $2.5 billion.

Like the one-time GST credit and CCB enhancements, no loss of income as a result of COVID-19 is required for seniors to receive the payment; all beneficiaries automatically qualify. The GIS is specifically targeted to low-income seniors, but all Canadians receiving the OAS will receive $300, regardless of their income. In the latter case, the non-taxable nature of the amount appears harder to justify.

**Mitigating the Impact of the Economic Shutdown on Businesses**

In the second phase of governments’ response to the pandemic, the measures for businesses became more generous and were extended to a larger number of firms. The priority was to avoid business closings or bankruptcies and to preserve economic relationships. In addition to the support for the agricultural and energy sectors, the measures also targeted economic activities most significantly exposed to the impacts of containment measures and social distancing, such as the tourism and cultural industries.

On March 27, 2020, the federal government announced a new 75 percent wage subsidy, the Canada emergency wage subsidy (CEWS). By relying on the payroll mechanism to support workers’ income, the subsidy aimed to preserve employment ties and to facilitate the recovery of economic activities.

The initial terms and conditions of the CEWS were revealed on April 1: a 75 percent taxable wage subsidy targeting companies that had experienced a significant decrease in revenue as a result of the pandemic, capped at $847 per employee per week, for a maximum period of 12 weeks (extended by an additional 12 weeks on May 15). The 10 percent wage subsidy remained available, particularly for businesses unable to qualify for the CEWS.

At the provincial level, Nova Scotia and Saskatchewan announced one-time grant programs targeting small businesses. The Quebec government introduced a subsidy program to help businesses cover the costs of training their employees,

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48 The federal government also provides a full refund of certain employer payroll taxes related to the compensation of employees who remain on the payroll but are unable to work owing to the pandemic. In Quebec, the government announced a tax credit for employees on forced leave.

49 Nova Scotia’s program has been terminated.
among other things. In Newfoundland and Labrador, the support offered by the province’s research and development assistance program was temporarily increased, retroactively to April 1, 2020. Manitoba announced a $7 per hour wage subsidy on April 24, to encourage summer student hiring.

A number of other relief measures were announced by the provincial and federal governments. On March 27, the federal government announced the deferral of GST/harmonized sales tax (HST) remittances; Quebec did the same for the Quebec sales tax (QST). The Quebec government also postponed the dates for remittance of the accommodation tax, a support measure for the tourism and hospitality sectors, which have been severely affected by the economic shutdown.

In addition to the easing measures deployed in several cities across the country, New Brunswick and British Columbia have announced relief for the property taxes under their management. Recognizing that the relief in respect of property taxes provided by municipalities will necessarily affect their revenues, some provinces have implemented measures to mitigate this impact. In Manitoba, restaurants have been offered a payment deferral on their liabilities to Manitoba Liquor and Lotteries. The Manitoba government is also accelerating the removal of $75 million of annual provincial sales tax from property insurance, and the province’s Workers’ Compensation Board will return its $37 million surplus to eligible employers as a credit amounting to 20 percent of contributions paid in 2019.

A first expansion of federal emergency loans was also announced on March 27. The Canada emergency business account (CEBA) provides up to $40,000 in interest-free loans to small businesses and not-for-profit organizations. At the time of the

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50 This is the Programme actions concertées pour le maintien en emploi (PACME), announced on April 7, 2020.
51 In Newfoundland and Labrador, a subsidy of up to $3,500 per full-time job is available to support the hiring of students to help seniors and vulnerable people facing social isolation.
52 British Columbia announced, on April 16, 2020, that local governments were allowed to make interest-free borrowings from their reserve funds to finance their operating expenses. Nova Scotia implemented a $380 million municipal loan program. Saskatchewan announced the acceleration of municipal revenue sharing, and Manitoba announced the acceleration of its operating grants to municipalities.
53 The Newfoundland and Labrador Liquor Corporation also introduced various relief measures for local businesses and announced investments to increase the production capacity of small producers. In British Columbia, payment of liquor licence renewal fees has been deferred for most licence holders.
54 In Manitoba and in Newfoundland and Labrador, other government agencies have announced the return of surplus funds to eligible businesses and individuals. The Manitoba Public Insurance Corporation will redistribute its surplus, owing in part to a decrease in claims during the pandemic. Insured persons will receive an amount based on payments made in 2019. In Newfoundland and Labrador, commercial and residential customers whose electricity rates are based on the fuel costs of the Holyrood Generating Station will receive a variable credit based on their consumption; the expected fuel savings at the plant are therefore provided on an accelerated basis to residential and commercial consumers.
initial announcement, the government indicated that if the loan was fully repaid by December 31, 2022, 25 percent of the loan would be forgiven, up to a maximum of $10,000. In addition to this $25 billion cash flow support program, there are two SME loan programs that together offer financing opportunities totalling $40 billion. Quebec in turn expanded its support for business financing by introducing a working capital loan program for small and medium-sized businesses (SMB) with an initial envelope of $150 million.

On April 16, 2020, the federal government announced that more businesses would qualify for the CEBA. The next day, more than $1 billion in funding was announced through additional programs for businesses that are unable to access a loan through the CEBA or to qualify for the wage subsidy program. In May, a new large employer emergency financing facility (LEEFF) was implemented, as well as expansion of the BCAP to address greater financing needs. On the provincial side, Manitoba and Nova Scotia created loans and grants for businesses that are not eligible for federal measures.

Landlord-tenant relations are a provincial responsibility. On March 27, the Nova Scotia government introduced a program to encourage landlords to defer rent payments from their struggling commercial tenants. Prince Edward Island announced a similar program three days later.

Also on April 16, the federal government announced the creation of the Canada emergency commercial rent assistance (CECRA) program and confirmed the following week that an agreement in principle had been reached with the provinces and territories to share the cost (with the federal government contributing 75 percent and the provinces 25 percent). This program, administered by the Canada Mortgage and Housing Corporation (CMHC), combines loans and grants to owners of mortgage-backed commercial buildings to lower the cost of rent for struggling businesses.

55 On April 22, 2020, CEBA funding was increased to $41.25 billion.
56 Initially, CEBA assistance was restricted to businesses with a total paid payroll in 2019 between $50,000 and $1 million. The expansion means that support through this program is now available for businesses with a total paid payroll between $20,000 and $1.5 million.
57 In particular, the government introduced a temporary wage subsidy program for innovative firms that are not yet generating revenue or are in the early stages of development; the program, along with other measures, is funded through an investment of $250 million in the industrial research assistance program (IRAP). A further $287 million in funding was provided to the Community Futures Network of Canada, as well as $675 million to the regional development agencies for businesses not eligible for existing measures, resulting in the creation of the regional relief and recovery fund (RRRF).
58 In Nova Scotia, eligible businesses will have access to a loan of up to $25,000, a grant of up to $1,500, and a contribution of up to $1,500 for consulting services.
59 Landlords who defer rent payments for commercial tenants whose operations are suspended or limited as a result of the pandemic may be eligible for coverage (to a maximum of $50,000 per landlord and $15,000 per tenant) if they are unable to recover the deferred rent amount.
small businesses. Building owners who participate in the program must absorb at least 25 percent of rental costs.

Additional measures were announced for specific sectors or industries. On March 31, 2020, the Alberta government announced a $1.5 billion investment in the Keystone pipeline project. It subsequently delayed the payment of stumpage fees to support cash flow and employment in forestry companies, as did the government of British Columbia. Saskatchewan implemented a series of relief measures for the provincial oil and gas sector (at a cost of $11.4 million). In Mid-April, to support employment in the energy sector, $1.7 billion in federal funding for the repair of natural environments in Alberta, Saskatchewan, and British Columbia was announced, along with the introduction of a $750 million repayable loan program to reduce greenhouse gas emissions from conventional and offshore oil and gas companies.

On April 17, the federal government also announced the creation of a $500 million emergency fund to provide temporary assistance to the cultural, heritage, and sports sectors. At the provincial level, Prince Edward Island and Quebec have provided loans and relief to the tourism and agricultural sectors, respectively. New Brunswick has launched a program that provides up to $2,000 to support virtual cultural performances by eligible artists, businesses, and cultural organizations.

On May 5, 2020, the federal government announced new support measures for the agri-food sector at a cost of $252 million, as well as a $200 million increase in the Canadian Dairy Commission’s borrowing limit. For fish harvesters who suffered income losses, emergency loan programs and interest relief programs were put in place in Prince Edward Island. On May 14, the fish harvester benefit was unveiled by the federal government. This applies to fish harvesters who are not entitled to the CEWS and who are facing a decline of more than 25 percent in their fishing income. The federal government also announced a grant program of up to $10,000 for self-employed fish harvesters who are not eligible for the CEBA or equivalent measures.

The CMHC website indicates that as of April 30, 2020, CMHC would be working on another mechanism for building owners who do not have mortgage loans. On the same date, Prime Minister Trudeau announced that there may soon be a program for businesses paying monthly rent over $50,000.


The government also proposed changes to EI for fish harvesters (self-employed or otherwise).
COST OF SUPPORT MEASURES

As of May 15, 2020, the federal government had announced more than $150 billion in direct assistance measures for businesses and households. Figure 1 shows the chronology of the major federal announcements made since March 11. The graph also shows the cumulative costs of programs where this information is available.

The largest jumps on the cost curve are associated with the CERB announcement on March 25, part of which was announced on March 18 with the two emergency benefits, and the CEWS announcement on March 27. No costs are added for measures facilitating businesses’ access to credit or for deferrals of tax payments unless these were provided by the federal government.65

Easing Measures

Table 1 presents the main tax easing measures announced; the dates shown refer to the first announcements.

For major federal easing measures, the cost of deferrals granted to support taxpayers’ liquidity is estimated at $85 billion, or $55 billion for income tax66 and up to $30 billion for GST and duties.67 However, since these are deferrals, the final tax loss will be minimal relative to the amount announced. The parliamentary budget officer (PBO) estimates this loss at $679 million for income taxes68 and $92 million for GST.69 The cost essentially reflects the borrowing cost for the government, interest and penalties not collected during the deferral period, and additional defaults resulting from the crisis.

In Quebec, the estimated cost of the deferred payment of personal and corporate income taxes is $8.6 billion; the deferral of QST remittances, $7.3 billion; and accelerated payments of some business tax credits, $600 million.70 In Ontario, the cost of business carryforwards is estimated at $7.9 billion.71

65 Such as the cost of possible writeoffs of 25 percent of CEBA loans.
66 Supra note 26.
71 As well, the estimated cost of deferred payments by municipalities to school boards in Ontario amounts to $1.8 billion. See Ontario, Ministry of Finance, “Ontario’s Action Plan:
FIGURE 1  Key Federal Economic Measures in Response to the COVID-19 Crisis, March 11-May 15, 2020,
Timeline and Estimated Costs in Billions of Dollars

(Figure 1 is concluded on the next page.)
In addition to tax relief measures, the federal government and some provinces have frozen or reduced taxes that mainly affect businesses. Table 2 summarizes the estimated costs of these measures where this information is available.

**Support Measures for Businesses**

Table 3 presents other support measures for businesses, along with preliminary government estimates of the direct costs of these measures. The amounts in parentheses correspond to the financing offered to businesses through various loan or loan guarantee instruments.

As in the case of carryforwards, much of the money available to businesses is not equivalent to government spending. For interest-bearing loans, the net effect could be positive as a result of additional interest revenue. However, the interest-free loans offered will result in interest charges to the government, plus, in the case of the CEBA, the cost of writing off 25 percent of the loans repaid by December 31, 2022 (estimated at $13.75 billion).


TABLE 1  Timeline of Federal and Provincial Easing Measures Introduced Between March 17 and April 28, 2020

<table>
<thead>
<tr>
<th>Individuals:</th>
<th>Income tax</th>
<th>Sales taxes</th>
<th>Other indirect taxes</th>
<th>Payroll taxes</th>
<th>Social contributions</th>
<th>Other&lt;sup&gt;a&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal</td>
<td>March 18</td>
<td>March 18</td>
<td>March 27</td>
<td></td>
<td>March 26</td>
<td></td>
</tr>
<tr>
<td>British Columbia</td>
<td>March 23</td>
<td>March 23</td>
<td>March 26</td>
<td>April 16: School taxes</td>
<td>April 28: Timber dues</td>
<td></td>
</tr>
<tr>
<td>Alberta</td>
<td>March 18</td>
<td>March 23</td>
<td>March 23</td>
<td>March 26</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>March 20</td>
<td>March 22</td>
<td>March 22</td>
<td>April 4: Timber dues</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>March 17</td>
<td>March 22</td>
<td>March 22</td>
<td>April 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>March 17</td>
<td>March 25</td>
<td>March 25</td>
<td>April 6: Property taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newfoundland and Labrador</td>
<td>April 9&lt;sup&gt;b&lt;/sup&gt;</td>
<td>March 25</td>
<td>March 25</td>
<td>March 25</td>
<td>Property taxes</td>
<td>March 26:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

(Table 1 is concluded on the next page.)
The direct cost of federal measures totals more than $64 billion, including $45 billion attributable to the CEWS.74 As of June 1, 2020, $9.4 billion had been paid to businesses in wage subsidies, covering more than 2.5 million workers.75

In the provinces, cost estimates are not available for all programs, but some provinces have indicated overall amounts. In Prince Edward Island, on May 14, 2020, the government announced that the estimated cost of business assistance measures was $40 million.

**Support Measures for Individuals**

Table 4 summarizes the various measures to support individuals. The assistance comes mainly in the form of payments to workers affected by COVID-19 or as lump-sum enhancements of existing transfers. Costs are indicated where this information is available.

The CERB is at the heart of federal assistance to households affected by COVID-19 and accounts for most of the cost of the direct support measures for individuals announced as of May 15, 2020. While on March 18 the cost of the two initial emergency benefits was estimated at $15 billion or less, the estimated cost of the

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74 This estimate does not include the impact of the 12-week extension announced on May 15, 2020. On May 28, 2020, the federal government unveiled new estimates of the total impact of support measures, including significant revisions to the estimated cost of the CEWS, which decreased from $73 billion, as at April 22, 2020, to $45 billion. On April 30, 2020, the PBO estimated the cost of the measure at $76 billion. See Office of the Parliamentary Budget Officer, “Legislative Costing Note: Canada Emergency Wage Subsidy (CEWS) for Employers with Reduced Revenues,” April 30, 2020 (www.pbo-dpb.gc.ca/web/default/files/Documents/LEG/LEG-2021-018-S/LEG-2021-018-S_en.pdf).

<table>
<thead>
<tr>
<th></th>
<th>Sales taxes</th>
<th>Other indirect taxes</th>
<th>Payroll taxes</th>
<th>Social contributions</th>
<th>Property taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal . . . . . . . .</td>
<td>May 6</td>
<td>$281 million&lt;sup&gt;a&lt;/sup&gt;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>British Columbia . . . .</td>
<td>March 23&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
<td>March 23&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Alberta . . . . . . . .</td>
<td>March 23&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
<td>March 23&lt;sup&gt;b&lt;/sup&gt;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manitoba . . . . . . .</td>
<td>April 3:</td>
<td></td>
<td>April 21:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ontario&lt;sup&gt;c&lt;/sup&gt; . . .</td>
<td></td>
<td></td>
<td></td>
<td>March 25:</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$355 million</td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> The federal government is waiving tariffs on critical medical goods, including personal protective equipment.

<sup>b</sup> The cost of cancellation of changes announced in the 2020 budget is not listed.

<sup>c</sup> On March 25, 2020, the government announced the introduction of a refundable tax credit (of 10 percent, up to $45,000) for investment in regional development. The estimated cost of the tax credit was not indicated.

CERB reached $24 billion on March 25, $35 billion a month later, and $60 billion on May 28, bringing the total cost of these support measures to more than $82 billion.

Some provinces have announced their overall envelope for support measures targeting individuals and families. When British Columbia unveiled its COVID-19 action plan on March 23, it estimated the cost of the support for individuals at $1.1 billion. In Prince Edward Island, the estimated cost of measures to assist individuals totalled nearly $30 million.

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<sup>76</sup> The government’s estimate of $35 billion was consistent with that of the PBO. See Office of the Parliamentary Budget Officer, “Legislative Costing Note: Canada Emergency Response Benefit (CERB),” April 30, 2020 (www.pbo-dpb.gc.ca/web/default/files/Documents/LEG/LEG-2021-019-S/LEG-2021-019-S_en.pdf).

<sup>77</sup> As of June 7, 2020, the gross cost of CERB payments to more than 8.4 million Canadians was $44.6 billion. See Government of Canada, “Canada Emergency Response Benefit Statistics” (www.canada.ca/en/services/benefits/ei/claims-report.html).


<sup>79</sup> Prince Edward Island, “Province Provides Update on Public Services, Finances,” May 14, 2020 (https://www.princeedwardisland.ca/en/news/province-provides-update-public-services-finances). These amounts include funds dedicated to support measures for vulnerable groups and the organizations that support them. These other measures are not discussed in this article but have been announced by various provinces, as well as by the federal government. In New
### TABLE 3  Summary of Federal and Provincial Business Support Measures, Including Cost Estimates Where Available

<table>
<thead>
<tr>
<th>Access to financing</th>
<th>Other liquidity support measures</th>
<th>Job support</th>
<th>Industry support</th>
<th>Commercial leases</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Federal</strong></td>
<td>BCAP ($81.3 billion)</td>
<td>IRAP $2.50 million</td>
<td>EI $12 million 10% wage subsidy $1 billion</td>
<td>Agriculture ($5.2 billion) $252 million</td>
</tr>
<tr>
<td></td>
<td>CEBA ($13.8 billion)</td>
<td></td>
<td></td>
<td>Energy ($800 million) $1.7 billion</td>
</tr>
<tr>
<td></td>
<td>RRRF ($962 million)</td>
<td></td>
<td></td>
<td>Culture $500 million Fish harvesters $469 million</td>
</tr>
<tr>
<td></td>
<td>LEEFF</td>
<td></td>
<td></td>
<td>Research $450 million</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>CECRA $3 billion</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>British Columbia</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>CECRA $80 million</td>
</tr>
<tr>
<td><strong>British Columbia</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>Alberta</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>CECRA</td>
</tr>
<tr>
<td><strong>Ontario</strong></td>
<td></td>
<td></td>
<td></td>
<td>CECRA $241 million</td>
</tr>
<tr>
<td><strong>Quebec</strong></td>
<td></td>
<td></td>
<td></td>
<td>CECRA $137 million</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>Table 3 is concluded on the next page.</strong></td>
</tr>
</tbody>
</table>
TABLE 3  Concluded

<table>
<thead>
<tr>
<th>Province</th>
<th>Access to financing</th>
<th>Other liquidity support measures</th>
<th>Job support</th>
<th>Industry support</th>
<th>Commercial leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Brunswick</td>
<td>Working capital loans ($50 million)</td>
<td>Deferrals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>($19 million)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>Loan guarantees ($161 million)</td>
<td>SBIG $20 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>SBCSP ($20 million)</td>
<td>Deferrals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>($3 million)</td>
<td>Delays</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>Working capital loans</td>
<td>Deferrals</td>
<td>Emergency relief</td>
<td>Tourism ($50 million)</td>
<td>Rent deferral</td>
</tr>
<tr>
<td></td>
<td>CBDC ($4.5 million)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Newfoundland and Labrador</td>
<td>Working capital loans</td>
<td>Deferrals</td>
<td>Self-isolation</td>
<td>Fisheries ($250 million)</td>
<td>Rent deferral</td>
</tr>
<tr>
<td></td>
<td>CBDC ($4.5 million)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Invoices $2.5 million(^{\text{b}})</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grants for student jobs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>R &amp; D</td>
<td></td>
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</tr>
</tbody>
</table>

BCAP = business credit availability program; CBDC = Community Business Development Corporation; CEBA = Canada emergency business account; CECRA = Canada emergency commercial rent assistance; CEWS = Canada emergency wage subsidy; EI = employment insurance; IRAP = industrial research assistance program; LEEFF = large employer emergency financing facility; PACME = programme actions concertées pour le maintien en emploi; R & D = research and development; RRRF = regional relief and recovery fund; SBCSP = small business credit and support program; SBEPP = small business emergency payment program; SBIG = small business impact grant; SMB = small and medium-sized businesses.

Note: Costs in dollars (millions or billions) reflect preliminary government estimates of the direct costs of measures. The numbers in parentheses correspond to the financing offered to businesses through various loan or loan guarantee instruments.

- Numbers reflect estimates updated on June 6, 2020. Based on observed takeup, the cost of the CEWS for the first 12-week period decreased from $73 billion to $45 billion.
- The measure also concerns individuals.
TABLE 4  Summary of Federal and Provincial Measures To Support Individuals

<table>
<thead>
<tr>
<th></th>
<th>Emergency support</th>
<th>For eligible families or individuals</th>
<th>For students</th>
<th>For the elderly</th>
<th>For essential workers</th>
<th>Rental assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal</td>
<td>CERB $60 billion$^b$</td>
<td>CCB $1.9 billion</td>
<td>Existing loans</td>
<td>RRIF $500 million</td>
<td>OAS/GIS $2.5 billion</td>
<td>$3 billion</td>
</tr>
<tr>
<td></td>
<td>GST $5.5 billion</td>
<td></td>
<td>$200 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>CESB $5.3 billion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Canadian loans $1.9 billion</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Grants $900 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Youth employment $700 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>British Columbia</td>
<td>Emergency benefit for workers</td>
<td>Climate action, crisis supplement, special needs</td>
<td>Existing loans</td>
<td>Crisis supplement</td>
<td>X</td>
<td>Rental supplement</td>
</tr>
<tr>
<td>Alberta</td>
<td>$91 million</td>
<td></td>
<td>Existing loans</td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>$10 million</td>
<td></td>
<td>Existing loans</td>
<td>$56 million</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manitoba</td>
<td></td>
<td></td>
<td>Emergency support</td>
<td></td>
<td>$1 million</td>
<td></td>
</tr>
<tr>
<td>Ontario</td>
<td>$300 million</td>
<td></td>
<td>Existing loans</td>
<td>$45 million</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Quebec</td>
<td>$14.5 million</td>
<td></td>
<td>Existing loans</td>
<td>RRIF $890 million</td>
<td>IPREW $45 million</td>
<td>SHQ temporary housing</td>
</tr>
</tbody>
</table>

(Table 4 is concluded on the next page.)
<table>
<thead>
<tr>
<th>Province</th>
<th>Emergency support</th>
<th>For eligible families or individuals</th>
<th>For students</th>
<th>For the elderly</th>
<th>For essential workers(^a)</th>
<th>Rental assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Brunswick</td>
<td>$4.5 million</td>
<td></td>
<td>Existing loans</td>
<td>Emergency support</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>Bridge fund $20 million</td>
<td>$2.2 million</td>
<td>Existing loans</td>
<td></td>
<td>$13 million</td>
<td></td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>Income relief, income support, special situations $1 million</td>
<td></td>
<td>Existing loans</td>
<td>Farm team</td>
<td>$17 million</td>
<td>$1 million</td>
</tr>
<tr>
<td>Newfoundland and Labrador</td>
<td></td>
<td></td>
<td>Existing loans</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

CCB = Canada child benefit; CERB = Canada emergency response benefit; CESB = Canada emergency student benefit; GIS = guaranteed income supplement; GST = goods and services tax; IPREW = incentive program to retain essential workers; OAS = old age security; RRIF = registered retirement income fund; SHQ = Société d’habitation du Québec.

\(^a\) An X indicates that the province has announced temporary wage benefits for essential workers. In Quebec and Prince Edward Island, cost includes federal government participation.

\(^b\) Numbers reflect estimates updated on June 6, 2020. Based on observed takeup, the estimated cost of the CERB increased from $35 to $60 billion.
HOW CANADA’S RESPONSE COMPARES WITH THE RESPONSES OF OTHER JURISDICTIONS: AN OVERVIEW

According to the PBO, the federal government’s deficit could reach more than $252 billion in 2020-21, or 12.7 percent of gross domestic product (GDP), up nearly 12 percentage points since the previous projection. In many countries, public deficits are at historic levels. The Italian government estimates its deficit at 10.4 percent of GDP. In the United Kingdom, public-sector net borrowing is estimated at 15.2 percent of GDP for 2020-21, while in the United States, the federal deficit alone could total 17.9 percent of GDP.

In Canada, the federal economic response was built around two measures designed to support workers’ income: the CERB, for individuals who had lost most of their income, and the CEWS, to provide support to businesses suffering from revenue losses and help them keep their employees on the payroll. As of May 6, 2020, 34 of the OECD’s 37 member countries had implemented some form of support intended for employees or self-employed workers facing income losses, and 22 had offered wage subsidies for businesses.

Brunswick, the government expects the deficit to reach $299.2 million in 2020-21; in March 2019, a provincial budget surplus of $92.4 million was projected. The pandemic and containment measures will result in an estimated $291.4 million drop in the province’s revenues, as well as an estimated $100.2 million increase in spending, of which $39.5 million will be offset by increased federal transfers. New Brunswick, Department of Finance and Treasury Board, Fiscal and Economic Update, May 2020 (https://www2.gnb.ca/content/dam/gnb/Departments/fin/pdf/Publications/FiscalAndEconomicUpdateMay2020.pdf).


However, the CERB, a made-in-Canada response to the crisis, is almost unique. Many countries that already had an [un]employment insurance system achieved a similar result to the CERB by changing their existing rules. The main objectives of the changes were to

- temporarily extend eligibility to self-employed workers,
- relax the insurable hours criteria or their equivalent,
- eliminate the waiting period,
- increase the maximum benefit level,
- exclude the crisis period from the duration of regular benefits or extend the benefit period, and
- eliminate the criterion of active job search during the crisis.

In short, many other countries did what Canada could have done if its EI system had been able to deal with an explosion of claims.

Some countries opted for a lump-sum payment or a specific program for self-employed workers rather than extending EI. A few countries, such as the United States, paid lump sums to taxpayers who had suffered a loss of income or to all individuals below a certain income threshold.

The CEWS, which targets companies facing revenue losses, is comparable to measures implemented in a handful of OECD countries. In Australia and New Zealand, subsidies were fixed. In the United States, Ireland, and the Netherlands, they are based on compensation paid, as is the case in Canada.

Sixteen OECD countries offered other types of wage subsidies to businesses. These subsidies specifically targeted employees who contracted COVID-19, provided compensation related to the payment for hours not worked, or provided support based on revenue losses and payroll.

Canada’s federal government has also enhanced existing transfer programs (GST, the CCB, OAS, and GIS) to provide direct support to their beneficiaries, whether they have experienced a loss of income or not. This practice does not appear to be widespread in other OECD countries, but Australia and the United Kingdom have made additional payments to individuals and families already receiving certain benefits.

The vast majority of OECD countries have adopted tax relief measures. Thirty countries, including Canada, have deferred the production or payment of personal

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Businesses have benefited from a wider range of easing measures. Of the 37 OECD member countries, 34 have allowed a deferral of corporate income tax payments. Also, 18 countries, including Canada, have granted a delay in the payment of consumption taxes. In addition, 20 countries have offered relief measures for the payment of payroll taxes. Some countries have announced the acceleration of direct or indirect tax refunds by implementing new mechanisms or by allowing changes to the reporting schedule.

Finally, in OECD countries where property taxes account for the lion’s share of local government revenues, the response of those governments has taken the form of deferred property tax payments, as in numerous Canadian cities. Other major actions generally resulted from funding from another level of government.

**CONCLUSION**

The economic response of Canadian governments to the COVID-19 crisis unfolded in two phases, first to deal with the health emergency and then to respond to the shutdown of the economy. The analysis in this article shows that Canadian governments have acted quite rapidly and that, by expanding emergency measures, they have tried to help just about everyone. More often than not, the interventions of both levels of government were complementary, but some contradictions arose.

Overall, Canada’s response is consistent with the trends observed in most OECD countries. The information available on the costs remains fragmented, and these will have to be better documented at the time of the final assessment. However, the importance of this aid is undeniable. On April 30, 2020, the PBO estimated that federal spending alone in response to COVID-19 was over $150 billion, or 7.7 percent of GDP. That figure does not take into account the expenditures announced since then or those made by the provinces. Additional spending will be needed for economic recovery, and also to prepare for a possible second wave of the virus.

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87 In one of the remaining countries, the date was in March; in three others, the taxes are due in October. Australia and the United States have also allowed the withdrawal of pension funds without penalty.

88 Data from “Analyse comparative des mesures d’assouplissement des taxes et impôts pour les entreprises [Comparative Analysis of Business Tax Easing Measures],” updated May 1, 2020, available on the website of the Chaire de recherche en fiscalité et en finances publiques, supra note 85.

89 The finding comes from “Analyse comparative des mesures municipales d’aide aux entreprises [Comparative Analysis of Municipal Business Assistance Measures],” updated May 1, 2020, available on the website of the Chaire de recherche en fiscalité et en finances publiques, supra note 85.

90 An analysis of the response to COVID-19 from subnational governments in federal states would certainly be useful to compare the response of Canadian provinces, but currently the available data are too fragmented to provide a clear picture of the situation.
On May 15, 2020, when Finance Minister William Morneau announced the extension of the CEWS, he indicated that all upcoming adjustments would aim to “promote jobs, promote growth.”\textsuperscript{91} Future actions must send a clear message about the need to gradually return to a more “normal” pace, with everyone’s participation. The support measures that will inevitably remain in place will need to be better targeted.

Finally, governments must eventually review the interventions implemented to respond to the emergency in order to identify what went well and what did not. They also have to carry out audits to make sure that the money went where it was supposed to go. Learning from this unprecedented situation will be critical to improving the resilience of the fiscal system and ensuring that we do better next time. By summarizing the governments’ response, this article can serve as a basis for the upcoming review.

The COVID-19 pandemic has brought unprecedented challenges to individuals, businesses, and society as a whole. Unlike past crises, this crisis, which is likely to continue until a vaccine is found, requires people to stay home and suspend their regular activities in order to minimize infections and avoid crashing the health-care system. The staying-home (or social-distancing) strategy means no income for workers (except for those who can work from home), and no revenue for businesses that must close down. To help businesses restart after this policy-induced “coma,” and to ensure that individuals have money to spend at these businesses, many countries have introduced economic emergency response measures. For example, Canada has introduced the Canada Emergency Response Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS) programs, among other similar measures. The United States has introduced the Families First Coronavirus Responses Act (FFCRA), which includes paid sick leave, tax credits for paid sick leave, free COVID-19 testing, and a supplemental nutritional assistance program; and the Coronavirus Aid, Relief, and Economic Security (CARES) Act, which includes a monthly US$1,200 support payment to individuals (known as “recovery rebates”), and COVID-19-related loss carryback rules for businesses. The two papers under review here discuss the US measures.
Hafiz et al. identify three, potentially conflicting policy priorities: (1) providing a social insurance and social safety net to individuals and families in need; (2) managing systemic economic and financial risk; and (3) encouraging social behaviours, with respect to physical space, that are critical to containing the spread of the virus. The authors argue that the need to manage all three priorities is unprecedented. They propose an analytical framework for conceptualizing the crisis as a regulatory challenge with a distinctive underlying behavioural agenda that is crucial but (it is hoped) temporary. Because the three priorities may come to be in tension with one another and because these policy decisions must be made during a pandemic, it is necessary to consider innovative and wide-ranging policy solutions. The existing theoretical paradigms of economic and tax policy are insufficient for responding to the current public health and economic crisis. For example, the theory of institutional choice suggests that social insurance should be delivered directly (for example, through food stamps) or indirectly (for example, through tax expenditures). This theory may not be nuanced enough in a time of critically necessary spatio-behavioural constraints and supply-side demands, when some spending (on rent and necessaries) is supported while other spending, which would be irreprouachable during normal times, is not supported—for example, spending on the kinds of consumption that compromise social distancing efforts.

Hafiz et al. use the proposed framework to assess the FFCRA. The authors consider that this act’s tax relief measures—which include mandatory paid sick leave or family leave for workers, and tax credits for the employers that provide those wages—have responded to the three policy priorities: providing social insurance for workers, preventing widespread market distress and the collapse of many businesses, and encouraging good spatio-behavioural practices. In the authors’ view, however, the package provides more robust benefits to employers than to employees, which suggests that market concerns or “moral hazard” concerns have been given priority over social insurance and spatio-behavioural goals. The authors note the subsequent rebalancing by policy makers.

The authors of “Cares Act Gimmicks” discuss the provisions of the CARES Act that provide financial relief to individuals through the direct sending of money (recovery rebates), the payment of enhanced unemployment benefits, and the augmented regime of paid sick leave. The authors are critical of the design and delivery of the Recovery Rebates program. One design issue the authors raise is program eligibility. Eligibility is based on the adjusted gross income in an individual’s most recently filed tax return. An individual or couple who did not file a tax return must use the 2019 Social Security statement filed by their employer. An individual who reported over US$75,000 (or US$150,000, for married couples) would see the standard $1,200 monthly amount scaled back to nil if his or her income exceeds $99,000 ($203,000, for a married couple). Also, the delivery of the payments is tied to previously filed tax returns, and the payments are administered by the Internal Revenue Service (IRS). The first support payment was released on April 10, 2020, two weeks after the US Congress passed the CARES Act. The US Treasury Department is
required to send a notice to a recipient’s last-known address within 15 days of distributing the payment. According to the authors of this paper, many Americans may not have filed their 2019 returns, and it is likely that about 15 percent of electronic payments by the IRS went to closed bank accounts or accounts not controlled by the taxpayer. Further, the authors claim that the amount of the payment is simply “not enough” for people living in major urban centres. The authors recommend that the US Congress pass subsequent legislation that focuses on minimizing human suffering by ensuring access to shelter, utilities, food, and health care.

J.L.


New technologies, such as robots, artificial intelligence (AI), and blockchain, may prove to be a double-edged sword for tax administrations, increasing not only tax compliance but also its converse—tax non-compliance. In the near future, which of these two effects will dominate? What can governments do to ensure that the new technologies improve tax compliance? These three works offer some insights.

Alm et al. provide an excellent overview of the problem of the US “tax gap,” and they explore both the reasons for non-compliance and the 20th century’s major non-compliance strategies. They also succinctly review recent technological advances that serve to enhance (or subvert) tax compliance, and they describe three main reform options. The paper notes that the tax gap, as measured by the “voluntary compliance rate” (VCR), was reported by the IRS to be 81 to 83 percent in the 1970s and 1980s, and 83.6 percent for the tax years 2011-2013. The amount of uncollected taxes in 2011-2013 is estimated to be US$441 billion annually—an amount that, if collected, would almost balance the US annual federal budget deficit.

In part II of the paper, the authors canvass the theories and empirical research in the academic literature on tax compliance. Among their 12 basic findings are the following:

- Both the level and the type of audit matter—a lot.
- Fines have small deterrent effects.
- Tax rates affect compliance (but the effects are nuanced).
- Positive inducements improve compliance.
The information that tax authorities have on income sources is an essential component of a compliance strategy.

Demographics matter (for example, non-compliance tends to be higher for younger, single, self-employed male taxpayers).

Individuals are motivated by factors beyond narrow financial self-interest.

Tax-enforcement strategies have shifted from the traditional “enforcement paradigm,” which emphasizes the repression of illegal behavior through frequent audits and stiff penalties; to a “service paradigm,” which emphasizes the provision of services to tax-paying citizens; to, finally, a “trust paradigm,” which emphasizes the promotion of public trust in the tax administration’s quality, credibility, and reliability.

Among the main conditions that facilitate non-compliance are lack of effective oversight, high tax rates, taxpayers’ perception of equity (or lack thereof), taxpayers’ proclivity for greed, the assistance of skilled advisers, and a lack of diversity in tax-compliance measures. In the 20th century, taxpayers used three major non-compliance strategies: not reporting cash payments and receipts; using sophisticated tax shelters to manufacture non-economic losses; and hiding money in offshore accounts.

In part III of the paper, the authors discuss three new technologies that can be used to improve tax compliance—namely, data mining, AI, and public-key cryptography. Data mining can assist tax administration with fraud-detection capabilities. For example, the IRS can use data-mining techniques to tap into the vast amount of information provided through tax returns and third-party tax information reporting, with a view to detecting areas of non-compliance. When AI is fed appropriate data and supplied with various algorithms, it can anticipate particular modes of tax evasion. Public-key cryptography can be used to prevent fraudulent tax refund claims that use fake or falsified social security numbers. Such frauds cost the government billions of dollars of lost revenue annually. They can be stopped if taxpayers use a designated key to submit tax returns. Moreover, new technologies also help curtail the use of traditional non-compliance strategies. Digital commerce reduces cash usage, for example, thereby reducing the non-compliance that occurs through the non-reporting of cash transactions. The global information exchanges facilitated by new technologies give the IRS access to information on taxpayers’ use of offshore accounts.

In part IV of the paper, the authors explain how technological advances may open up new doors to tax non-compliance, and what reform options are available. For example, blockchain technology and smart contracts essentially create private regulatory frameworks, eliminate traditionally trustworthy intermediaries (such as financial institutions), enable users to have a high level of anonymity, and are tamper-resistant. This combination of disintermediation and anonymity has led to the characterization of blockchain applications as “super tax havens.” The growth
of the digital economy and the gig economy challenges the fundamental design of most tax systems and facilitates non-compliance. For example, multinational corporations use technology-driven business developments to shift taxable profits out of both the residence country and the source country, and tax non-compliance has become a ubiquitous feature of the gig economy.

The authors recommend reducing non-compliance through the reform of tax laws applicable to (1) blockchain, (2) transactions in a cross-border setting, and (3) the gig economy. For example, the government could impose new sales taxes on blockchain transactions when these transactions intersect with the tangible economy, and it could use the new technology as an enforcement tool. To address the challenges arising from the digital economy, Congress could join forces with the IRS to address tax compliance through ensuring that the IRS has sufficient funding to maintain a tactical advantage in the battle against tax evasion and multinational corporations’ aggressive tax-avoidance schemes, and the government could participate in international efforts to reform the international tax rules. Tax laws applicable to the gig economy could include (1) a simplified deduction allowance instead of actual expenses, (2) augmented third-party reporting, and (3) the use of technology to enhance taxpayer education and tax enforcement.

In “When Do Tax Compliance Robots Follow the Law?” Morse describes algorithmic tax-compliance robots, such as TurboTax and H & R Block Online, and she argues that these robots sometimes follow the law and sometimes break the law. Because they make centralized legal decisions without the direct control of users, Morse maintains that these robots generally follow the government’s interpretation of the substantive law and thus minimize the risk of audit for users. At the same time, they appear to break other laws that protect taxpayer confidentiality and taxpayer data. In general, these robots “do little to encourage taxpayer honesty.”2 For example, some features of the tax-compliance software systems, such as the constant display of a “tax due” bar, may encourage taxpayers to lie by overstating business expenses or understating cash income. At the same time, these robots may assist enforcement by revealing an error that is repeated across many returns. The author suggests that tax-compliance robots and the wider application of AI in future tax compliance “presents a special opportunity for the law”3 to shape and direct the centralized legal decisions made by such robots. The law should encourage taxpayer honesty by increasing tax-compliance robots’ responsibility for user honesty, and it should impose penalties if the users persist in lying. With respect to applying substantive tax law, the author suggests that tax-compliance robots, for market reasons (that is, maximizing sales and users through the minimization of tax audits by the government), sometimes take a conservative, risk-averse approach to the implementation of tax law, causing taxpayers to pay too much in tax. In such cases, the author

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2 At 279.
3 At 282.
suggests, “the law may face the counterintuitive task of encouraging a robot to produce returns that report less tax liability—not more.”4

In “Taxation in the Age of Smart Contracts: The CryptoKitty Conundrum,” Allison Christians explains the use of smart contracts, which is one of the latest developments in AI technology, and its implications for tax law and tax compliance. Through the example of CryptoKitty, which is a type of smart contract, Christians shows the conundrum faced by regulators and tax administrations. CryptoKitties are digital assets traded on the Ethereum network.5 Their unique properties allow them to be propagated into new, unique digital assets through “digital breeding.”6 “The owner of two CryptoKitties,” Christians says,

[snip]

This phenomenon presents a dilemma for tax authorities. Because smart contracts have economic impacts on investors and consumers, their implications for tax law cannot be ignored. The application of existing laws to this new phenomenon is unlikely to be adequate; no clearly adequate approach exists. Christians suggests three possible approaches: the adoption of new measures to enforce existing law (for example, identifying a third-party information-reporting and tax-withholding intermediary); insertion of the government into private contract ordering (for example, the government requiring that there be a link between tax authorities and taxpayers and that transactions be inserted into the smart contracting process); or the creation of a rival platform to facilitate digital transactions according to the government’s own terms (for example, using blockchain to implement electronic invoice platforms for collecting value-added taxes [VATs], or having the government create a platform to replace private platforms). Christians suggests that the “most likely scenario is the road taken to date, which is to narrowly address the worst tax system abuses with familiar safeguards to the best ability of the tax administrator, subject to resource constraints as well as legal barriers.”8 She anticipates that this “quixotic fight,” as she calls it, “will be fought until some other political equilibrium emerges.”9

J.L.

4 At 304–5.
5 At 97, Christians describes the Ethereum network as the one that “largely popularized the smart contract phenomenon,” but she also notes other networks where smart contracts can be traded, such as NEO, Chainlink, EOS, and Straitis.
6 At 96.
7 At 96–97 (footnote omitted).
8 At 113.
9 Ibid.
The international tax system was created in the 1920s to address the problem of international double taxation. Through bilateral tax agreements that are based on model conventions, countries agree to distribute taxing rights according to the principles of residence-based taxation and source-based taxation, and according to the arm’s-length principle. The deficiencies in this system have been exposed by the globalization of the world economy and the new business models facilitated by new technologies. These deficiencies have led to the problem of base erosion and profit shifting (BEPS)—that is, the erosion of the tax base of the high-tax countries where economic activities take place, and the shifting of profits to low-tax jurisdictions. The Group of Twenty/Organisation for Economic Co-operation and Development (G20/OECD) BEPS project sought to address these deficiencies by ensuring that profits are taxed where economic activities take place, but it sought to do so without changing the basic distribution of taxing rights among countries. Recently, because the existing rules do not produce satisfactory outcomes for most nations, academic debates and international efforts have focused on the possibility of new rules for distributing taxing rights in respect of income arising from the digital economy. The three articles reviewed below contribute to these debates and offer insights into how taxing rights should be re-imagined. In “The Transformation of International Tax,” Mason provides an excellent overview of the BEPS project, identifies the ways in which the project has transformed the international tax system, and offers a framework for thinking about a reallocation of taxing rights under BEPS 2.0. Unlike the many academic commentators who regard the BEPS project merely as a technical fix of loopholes to prevent tax avoidance, Mason views the project as having reflected and, to a significant extent, operationalized “meaningful changes in the participants, agenda, institutions, norms, and legal instruments of international tax.” For example, she notes that the participants in the project have expanded—from a small club of mostly rich countries, under the auspices of the OECD, to members of the G20 that have the perspectives of emerging economies. Also, she regards BEPS as having changed the 20th-century norm of “no double taxation” (the principle that income should not be taxed twice) to a new norm of “full taxation” (the principle that income should not escape tax). Most

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10 At 3.
11 At 25.
interestingly, Mason credits the BEPS project with creating (1) new legal instruments, such as the multilateral instrument, for updating participating countries’ bilateral tax treaties; (2) new forms of soft law, such as the minimum standards; and (3) institutional structures, such as the BEPS Inclusive Framework. With this “new apparatus of international tax policymaking,” governments immediately started to tackle the issue of the allocation among countries of the entitlement to tax income from international digital commerce.

As to the future of international tax, Mason points out that the principle of “full taxation” implies that income should not go untaxed, but it does not specify where that income should be taxed—whether at source, residence, or in some third state that lacks a tax entitlement under the current rules. BEPS 2.0 confronts this allocation question. Mason describes BEPS 2.0 as a negotiation that involves three major issues: (1) how to redefine the permanent establishment (PE) threshold for the digital economy; (2) how to attribute income to such redefined PEs; and (3) how to curb tax competition among nations by adopting minimum tax rates. Mason maintains that although national self-interest will be the most important motivator of any resolution on allocation, it will be efficiency, fairness, and administrability concerns that drive the formulation of any resulting rules. The allocation issue has always been settled through bargaining, but the changing politics of international tax (such as the rise of China and India, the rupture between the United States and Europe, and growing tax unilateralism and other governance and political changes within the United States) makes it difficult to predict what the future will be. Now is a crucial moment for international tax.

In “Taxing Tech: The Future of Digital Taxation,” Faulhaber states that if countries cannot agree to real international tax reform, the international tax system will face many more years of unilateralism—that is, countries’ imposing a cascade of inconsistent and overlapping digital tax measures on tech companies (such as the digital services tax in France and the United Kingdom). She acknowledges that an international solution faces serious challenges because many countries now benefit from the existing system of allocating taxation rights. After examining the digital tax measures and the pros and cons of unilateral approaches, Faulhaber identifies some general themes: (1) the threshold for source-country taxation should be expanded to allow countries to tax companies that have significant economic ties with them even when the companies have no physical connection to the countries; (2) changes are most important for large multinational corporations because small domestic companies are less likely to have economic ties with countries in which they are not located; and (3) at least some countries want to discuss tax rates in order to ensure that large multinational corporations are not able to avoid taxation entirely. It remains unclear, however, whether the over 130 countries participating in the BEPS Inclusive Framework can reach a solution because, among other challenges, the

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12 At 3.
13 At 192.
details on which they disagree raise significant legal and technical issues and make it difficult to reach a consensus.

In “Tax Wars: How To End the Conflict Over Taxing Global Digital Commerce,” Cockfield describes the unilateral digital tax measures as “wars” among governments, and he warns that these wars could stifle new business models or even impede the spread of the global digital economy. Cockfield suggests that these wars reflect a growing dissatisfaction with existing methods of taxing the value associated with global transactions. He proposes an economic presence test (a “quantitative economic presence permanent establishment” test) as a jurisdictional threshold, and a “residual profit split by income” method to replace the existing arm’s-length principle in allocating income between countries.

J.L.


There exists a body of literature on the income taxation of incorporated small businesses, which is a fascinating area of study for students of taxation. In the context of basic tax system design, such study concerns the extent to which (and the time at which) income earned through a legal fiction should be recognized as income at the individual shareholder level in order to ensure progressive taxation of the income. In the context of instruments for subsidizing small businesses for societal benefits, this area concerns the determination of the right types of small-business activities and the right level of subsidy, as well as the means of preventing abuse. Ultimately, tax rules tend to reflect an attempt to balance various competing concerns through a democratic process.

Duff’s paper is a chapter in a volume honouring Professor Judith Freedman—a leading scholar on the taxation of small businesses. The paper reviews Freedman’s work, including a co-authored report titled “Small Business Taxation” in Dimensions of Tax Design: The Mirrlees Review, and it highlights Freedman’s concerns about structural tax differentials and tax preferences. According to Duff, Freedman’s central argument is that the taxation of similar economic activities that are carried on through different legal forms is best addressed not by creating new classifications for differential treatment and using complex anti-avoidance rules to discourage tax-motivated choices among different legal forms, but by reducing or eliminating tax differences based on legal forms. Referring to the Canadian system of the taxation of private companies and their shareholders, including the changes introduced in

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2017 and 2018, Duff shows how Freedman’s concerns play out in the Canadian context. He also explains why Freedman’s contributions to tax law and policy in this area are so convincing. He argues that Canada would have been better served if it had heeded Freedman’s advice.

Through reviewing Freedman’s work and applying her thinking to the Canadian context, Duff advances our notions of how to reform the Canadian taxation of small business. That is a real contribution to the literature.

J.L.


Organisation for Economic Co-operation and Development, OECD Secretariat

Analysis of Tax Treaties and the Impact of the COVID-19 Crisis (April 3, 2020)

During the COVID-19 pandemic, most non-essential workers have been unable to work at their employer’s physical premises and have thus become telecommuters, working from home. Cross-border telecommuting raises interjurisdictional tax issues.

Zelinsky discusses the implications of New York State income tax for telecommuting employees who are employed in the state while living outside it because of the pandemic. Under existing law, New York taxes non-resident telecommuters on the days they work at home according to the “convenience of the employer” test. Zelinsky argues that the governor of New York, Andrew Cuomo, should instruct New York’s tax collectors to stop enforcing this law, for several reasons. First, these employees work at home because the government has asked (in some cases, required) them to do so during the COVID-19 pandemic. Second, if both New York State and the telecommuters’ state of residence tax the individual’s income, double taxation will likely result: not many US states allow a credit for New York State taxes. Third, and most importantly, New York has no legitimate right to tax these telecommuters when they do not use New York public services. Zelinsky asks that Congress stop New York from taxing out-of-state telecommuters if the governor of New York will not remove this tax voluntarily.

The OECD Secretariat provides clarification on tax treaty issues arising from telecommuting, such as the creation of PEs for the employer, the impact on the residence status of a company under the “place of effective management and control” test, and the source of income received by an employee from the employer under a government’s COVID-19 relief programs. On the PE issue, the OECD Secretariat explains that the COVID-19 situation is unlikely to create any changes to a PE determination, because the change of employment location caused by the pandemic is exceptional and temporary. On the possible impact of the COVID-19 crisis on the residence status of a company, the OECD Secretariat states that a temporary change
in location of the chief executive officers and other senior executives should not trigger a change in residence, especially once the tiebreaker rule is applied. As to the source of the income received by an employee during the COVID-19 crisis, the OECD Secretariat explains that it should be the country where the employment used to be exercised (that is, the state where telecommuters used to work, not the state where they are resident). Accordingly, under article 15 of the OECD model convention, the right to tax such income is allocated to the state where employment used to be exercised before the COVID-19 crisis.

J.L.


The status of a worker as an employee or independent contractor is important for the purposes of income tax law, labour law, torts, and regulatory laws. This article discusses the status of gig workers under a new law enacted in California: Assembly Bill 5 (A.B.5). A.B.5 broadens the coverage of Californian labour law by codifying the common-law test known as the “ABC test” for the purposes of California’s labour and unemployment insurance codes and for the purposes of the wage orders of California’s Industrial Welfare Commission. Under the ABC test, a presumption of employee status exists, and it is overcome only if all three facets of the three-pronged ABC test are affirmatively proved: that is, (1) the person for whom work is performed has neither legal nor practical control of the person performing that work; (2) the worker performs work that is outside the usual course of the hiring entity’s business; and (3) the worker is customarily engaged in an independently established trade, occupation, or business that is of the same nature as the work performed by that individual for the person who hired the worker. A.B.5 also provides a detailed and daunting list of exemptions, leaving numerous professions and occupations subject to the traditional common-law tests.

Zelinsky recognizes that some applaud A.B.5 as the dawn of a new day for the protection of gig workers, and as a precedent for simplifying and unifying the definition of employee status under different laws. Taking a different view, he makes a compelling case for continuing the “hodgepodge” approach to this area, arguing that it is the best the law can do. The basis of his position is that the term “employee” performs different roles in the tax, tort, and regulatory contexts. He maintains that when “employee” is being defined, one size does not easily fit all.

J.L.


This article reports the results of an ambitious empirical research project that compared the statutory interpretation methodologies of the IRS and the US Tax Court. The author uses a newly created dataset of all IRS publications since 1919, and an
existing dataset of court decisions. He applies natural-language processing, machine learning, and regression analysis to map methodological trends and to test whether the IRS and the courts have developed unique cultures of statutory interpretation. His main findings include the following: the IRS publications have increasingly interpreted the statute on normative policy grounds, such as fairness and efficiency; and the IRS has grown much more purposivist over time when interpreting the statute. The Tax Court, for its part, has followed the same trend toward textualism as most other US courts and over time has, in fact, become more textualist and less purposivist.

As to the possible explanations of these trends, Choi suggests that the factors in the IRS’s shift toward normative decision making may be specific to tax administration, such as the following: (1) IRS publications are drafted by tax law experts; (2) when the IRS is provided with specific grants of regulatory authority, it exercises that authority by getting it right on policy grounds; (3) the IRS has the expertise and the resources to make more sophisticated normative judgments, including the more accurate estimation of the real-world impact of particular tax policies. The Tax Court’s movement toward textualism is consistent with the movement of the US Supreme Court and the federal courts.

J.L.


This paper is about the Medicare program in the United States (US medicare), which is a government program, aimed largely at Americans age 65 and over, that covers about half of the health expenses of those enrolled. However, the problems that the paper identifies with US medicare are also present in Canada’s medicare program, and thus the paper’s analysis and recommendations are relevant to Canada.

Since US medicare was founded in 1965, two major changes have occurred: income inequality has increased, and medical technology has become more advanced and expensive. Problematically, the interaction of these two factors has caused the preferences for health coverage to differ much more strongly across income groups today than they did in the past.

Previous research has established that the willingness to pay for health care in the United States rises steeply with income. As the authors of this paper put it, “[F]or the wealthiest in society, the marginal value of another Lamborghini is low, but an additional year of good health in which to enjoy it is nearly priceless.” This pattern in the willingness to pay probably did not matter in 1965, because the possible solutions to any given medical problem were limited in number, and spending

15 At 6-7.
more money on treatment could do little to improve the quality of care. As the paper notes, the only things to spend money on in 1965 were more, or repeated, tests or procedures. But this might just make the patient worse off: repeated tests, for example, might merely generate false positives. Today, the world has changed. By way of example, the paper cites the treatment of cardiovascular disease. In 1965, bypass surgery was quite a high-risk and rare intervention, while statins, stents, and transcatheter aortic valve replacements did not exist.

On the other hand, there may be limits to the amount that lower- and middle-income groups want to spend on medical care. For example, an enhancement of social programs or more take-home pay might be more desirable to these groups than more government money spent on a medical treatment that increases the life expectancy of a small group by a month or two, at a cost of many thousands of dollars per patient.

Further, income inequality has increased sharply. When one combines this fact with (1) the finding, cited above, that the willingness to pay for medical services increases with income and (2) the fact that a greater range of expensive medical services is now available, the conclusion is that sizeable groups in the population may have different views on the optimal amount of government money to spend on health care.

Thus, governments have to make choices that will not please everyone. US medicare places few limits on the scope for coverage, even for unproven technologies. The paper cites the example of proton beam therapy for prostate cancer, which is covered by US medicare even though no evidence currently exists that it is more effective than less costly alternatives. (Canadian medicare does not cover this form of treatment.) Thus, the paper suggests that US medicare corresponds more to the preferences of higher-income groups than to those of lower-income groups. By implication, Canadian medicare is less biased in this way.

With this information as a backdrop, the paper constructs a theoretical model of the health-care system to determine the type of health-care program that maximizes social welfare. To summarize, the recommendation is a hybrid system in which a government program provides health coverage at a basic level, and higher-income households top up this coverage with privately financed plans. As medical costs rise and inequality grows, such top-up coverage is likely to become increasingly attractive even to the non-rich. On the other hand, such a divergence in the quality of care across income groups conflicts with frequently expressed public assertions that medical care is a basic human right that should be equally available to all.

A.M.

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16 Although the model in the paper is only for those aged 65 and over, the same questions arise if the government program is extended to become “medicare for all,” an extension (currently the law in Canada) currently being debated in the US political arena.

The taxation of fluctuating incomes is one of the unsolved problems with a progressive rate structure in a personal income tax system, both in Canada and around the world. Most people agree that it is unfair that a person with an income that fluctuates over the years pays more tax than a personal with a stable income. This unfairness has been shown to be not just a matter of horizontal inequity (unequal treatment of equals) but also a matter of vertical inequity (that is, in general terms, the imposition of a higher tax burden on the poor than on those with more income). Many Canadian income-averaging schemes have been introduced to solve this problem and then repealed—block-averaging, general averaging, income-averaging annuity contracts, and forward averaging.17 These schemes have generally suffered from a lack of understandability for the general public and from the unintended benefits they afforded to non-target groups.18 The last such scheme, forward averaging, was repealed in 1988 on the basis that it was no longer needed because of the flattening of the rate structure that took effect that year. Its principal unintended benefit was to perennially high-income taxpayers, who took the zero-cost gamble that top tax rates would come down, so that they would receive a benefit by having their past income taxed at the new lower rate.19

In light of these problems with previously implemented averaging schemes, researchers have investigated whether the unfairness produced by the lack of income averaging is large or small: if it is small, perhaps the tax system can do without an averaging scheme (as it does now) without major problems. Daniel Gordon and Jean-François Wen define the income fluctuation penalty for a taxpayer as (1) the excess of the actual tax liability, paid over a five- or six-year time period, over the tax that the taxpayer would have paid if he or she had been taxed on the average income over the period, divided by (2) the taxpayer’s total before-tax income over the period.

17 One such scheme, which has not been implemented anywhere and is referred to in the title of the article under review, is the one devised by William Vickrey. For discussion, see Neil H. Buchanan, “The Case Against Income Averaging” (2006) 25:4 Virginia Tax Review 1151-1218.

18 For income-averaging annuity contracts (IAACs), which were repealed in 1981, the unintended benefit was tax-deferral benefits to people whose income never fluctuated (because the otherwise-taxable amount used to purchase the IAAC was not taxable until the annuity payments were received): see Canada, Department of Finance, 1981 Budget, Supplementary Information and Notices of Ways and Means Motions on the Budget, November 12, 1981, at 16. An income-averaging annuity provision for artists currently exists in Quebec provincial personal income tax.

Gordon and Wen found that the fluctuation penalty from 1993 to 2010 was small, averaging one-third of a percentage point or less in every time period.\textsuperscript{20} However, 10 percent of taxpayers faced a fluctuation penalty of at least 1 percentage point, and 1 percent of taxpayers faced a fluctuation penalty of at least 4 percentage points.\textsuperscript{21} The fluctuation penalty was most severe for the low-income group. Owners of unincorporated businesses had higher fluctuation penalties than other taxpayers.

Since 2010, which was the end of the time period examined by the Gordon-Wen study, the federal rate structure for the personal income tax has become more progressive, with the introduction of the 33 percent rate bracket. Many provinces have followed suit with their own measures. Thus, the problem of fluctuating incomes has come to the fore again. But in the absence of a persuasive income-averaging scheme, no action has been taken. Repeating the mistakes of the past is not an attractive proposition for policy makers.

Steinerberger and Tsyvinski make a big step toward breaking this logjam by introducing a new way to think about the design of an income-averaging scheme. Presumably, the approach to creating the existing Canadian schemes was simply to look at the definition of the problem and think of a scheme that might solve it; that is the normal way to solve policy problems. The criticism of this approach is that it is ad hoc. Steinerberger and Tsyvinski introduce a different way of creating an averaging scheme, which is to specify a set of assumptions (also called “axioms”) that an averaging scheme must satisfy, and then to show that only one averaging scheme satisfies those axioms. If consensus exists that these assumptions are appropriate, then there is a strong justification for that particular averaging scheme—any other scheme must violate those assumptions.

Formally, this paper considers the taxpayer’s sequence of incomes from negative infinity to the present day.\textsuperscript{22} The problem is to decide on the weights to be applied to each income amount in order to determine the taxpayer’s average income. In principle, many different weights are possible—for example, equal weights can be given to all incomes or lower weights can be assigned to the more distant past. In order to determine an appropriate set of weights, the article makes several assumptions. The most important of these is recursivity: the taxpayer’s average income must be the same regardless of the time unit over which income is measured. Thus, the taxpayer’s measured average income for a four-year period must be the same regardless of whether the scheme determines this amount from, for example, the total income over each of the two two-year periods, the annual income for each of the four years, or the monthly income for each of the 48 months.

The key result is that the weights, as a function of income and time, can be determined from “the density of the reflected Brownian motion with a drift started at


\textsuperscript{21} Ibid., at 454.

\textsuperscript{22} For humans, who have finite lives, the starting point would presumably be birth.
the current income and moving over the past incomes.” Needless to say, this article
does not solve the policy problem of making taxpayers understand the income-
averaging scheme.23 Somewhat simpler results are produced when averaging is to
be over the short past or the long horizon.

Although the recursivity assumption seems plausible, it is not obvious that in the
tax context, the satisfaction of this condition is a “must.” In other words, should one
automatically reject an averaging scheme that does not have this property? Also, the
article does not discuss how the policy designer uses the average income, which is
determined by the weighting scheme, in the actual income-averaging scheme to be
legislated. Thus, only half of the income-averaging problem seems to have been
solved, even under the specific assumptions made.

The paper acknowledges that its main contribution is probably not the precise
results that it derives but its approach of specifying assumptions and rigorously
deriving their implications for this knotty policy problem.

A.M.

Thiess Buettner, Katharina Erbe, and Veronika Grimm, “Tax Planning
of Married Couples and Intra-Household Income Inequality” (2019)
179 Journal of Public Economics 1-13 (https://doi.org/10.1016/
j.pubeco.2019.1040480)

Do couples seek to maximize their joint after-tax income? This issue most often
arises in practice in connection with income splitting—a common planning strat-
egy that many tax practitioners recommend but that many clients choose not to
adopt because it involves transferring assets or income to other members of the
household. As one adviser has stated, “This basic tax-saving strategy is very much
underused because men, traditionally the main bread winners, have tended to be
quite territorial about their income.”24 The tendency for one member of a couple
to be reluctant to share income, even if it increases the combined resources of
the couple, has now been documented in a large-scale empirical study of German
couples who were making choices about payroll tax.

The data is a representative sample of 2004 German individual income tax files,
which include payroll tax paid. The description of the tax rules provided in the
article (and employed below) is also for 2004. The article leaves the impression that
the rules have not changed since, but empirical studies of behaviour in past years
often do not address such issues.

Married couples in Germany can choose among three different payroll-tax pos-
sibilities: tax each spouse similarly (the default treatment); assign lower tax rates to
the wife and higher tax rates to the husband; or assign higher rates to the wife and
lower rates to the husband. These options may be called, respectively, the symmetric,
the female-favouring, and the male-favouring options. A deviation from the default

23 At 1, abstract.
24 Ian Davidson, “Tax Tips for Lapsed Accountants” (June/July 1997) CA Magazine 34-36, at 35.
choice must have the explicit consent of each spouse. The choice of an option for
the upcoming year can be exercised only until the end of November.

The first step in the empirical work is to drop the few instances where the incomes
of the husband and wife are so similar that all three choices produce equal total
payroll tax payments for the couple. Next, the data are divided into two subsamples.
In subsample A, the husband has the higher earnings, and so the male-favouring
option is tax-minimizing for the couple as a whole. In subsample B, the wife has
the higher earnings, and so the female-favouring option is tax-minimizing for the
couple as a whole.

The key results are as follows. In subsample A (181,000 couples), about 80 per-
cent chose the tax-minimizing option, 0.04 percent chose a tax-increasing option,
and the rest chose the symmetric (that is, default) option. In subsample B (26,000
couples), only 23 percent chose the tax-minimizing option, 0.8 percent chose a tax-
increasing option, and the rest chose the symmetric option.

The first thing to note is that the behaviour in subsample A was largely consistent
with the maximization of family income. Only 20 percent of couples failed to
exploit tax-reducing opportunities. In contrast, the behaviour in subsample B clearly
arose from something other than tax minimization: the vast majority of couples
took the default option and paid more tax as a result.

One cannot explain this overall pattern of behaviour in the two subsamples in
terms of some people not paying attention to tax considerations. Although sub-
sample B could be explained that way (most people are making the default choice)
subsample A clearly shows conscious tax-minimizing behaviour, since 80 percent
have moved away from the default choice toward the tax-minimizing choice.

In both subsamples, the effect of the tax-minimizing choice is to increase the take-
home pay of the primary earner (the spouse with the higher earnings) by decreasing
that spouse’s payroll tax relative to the default option. Similarly, the tax-minimizing
choice decreases the take-home pay of the secondary earner (the spouse with lower
earnings) by increasing that spouse’s payroll tax. The figures cited above show that
couples appear to be willing to make this choice if the husband is the primary earner
(subsample A), but not if the husband is the secondary earner (subsample B).

Two factors appear to explain this difference in behaviour. One factor is a pattern
in the data—the gains from switching to the tax-minimizing choice are higher when
the husband is the primary earner: about Cdn $5,000 versus about Cdn $2,400
when the wife is the primary earner.25 The other factor is psychological or socio-
logical: according to a study cited by the authors, tax-minimizing behaviour in

25 At 5, table 1. For subsample A, the average is a €5,511 gain to the husband less a €2,979 loss to
the wife, for a net gain of €2,532 (in 2004 euros). For subsample B, the average is a €4,934 gain
to the wife less a €3,712 loss to the husband, for a net gain of €1,222 (again in 2004 euros).
Multiplying the €2,532 and €1,222 figures by a 2004-2020 German inflation factor of 1.254
(see How To Factor Inflation Into Any Calculation [www.lawyerdb.de/Inflationrate.aspx]) and
the current euro-to-dollar exchange factor of 1.53 produces the figures in the text (for example,
2532 × 1.254 × 1.53 = $4,858, which rounds to $5,000).
subsample B would conflict with the social norm that “a man should earn more than the wife.” The tax adviser’s words cited above, in the first paragraph of this review, seem to provide a similar explanation: “[M]en, traditionally the main bread winners, have tended to be quite territorial about their income.”

This article also uses regression analysis to explain which couples in each subsample would make the tax-minimizing choice. In each case, a primary factor discouraging use of the tax-minimizing choice is the size of the reduction of the secondary earner’s after-tax earnings (even though the family’s after-tax income is increased by making this choice). Presumably, this tax-minimizing choice is avoided because it is disheartening to the secondary earner, who already has the lower pre-tax income. For example, a couple with a male primary earner is indifferent between the default and the tax-minimizing choices when a combined tax benefit for the couple of about Cdn $2,000 produces a reduction of the wife’s (the secondary earner’s) after-tax pay of about Cdn $4,300; a higher tax benefit or a lower reduction in the wife’s after-tax pay would cause the couple (on average) to make the tax-minimizing choice. A second finding for this male-primary-earner situation is that couples with a larger age difference are more likely to cooperate and make a tax-minimizing choice.

All of the dollar or euro tax-saving figures cited in this review apparently should be interpreted as the present value of the tax saving for a lifetime, not as an annual saving that is repeated every year. In other words, a $1 tax saving is best interpreted as an indefinite deferral of the payment of $1 in tax.


Economists and business leaders frequently suggest temporary cuts in the goods and services tax/harmonized sales tax (GST/HST) at times when consumer demand for goods is weak. This was one suggestion, for example, for how the federal government should respond to COVID-19: “If the challenge is to persuade Canadians to spend, a cut in the national sales tax is a logical route.” Such a measure makes

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26 At 3.

27 The figures in 2004 euros were a tax saving of €1,000 and a loss of after-tax pay of €2,139 (at 2). These were converted to 2020 Canadian dollars in the same way as is shown in note 25, above.

28 The reason is that tax payments under the payroll tax are credited against the personal income tax (presumably at a 100 percent rate) about a year after the payroll tax payment. Thus, there is a payroll tax saving in year 1 of $1, and (every year after that) subsequent payroll tax savings of $1 per year are cancelled out by the increased payment of $1 in personal income tax. See the somewhat cryptic explanation at 2, note 2.

sense from a macro-economic stabilization point of view, as an attempt to move the economy back toward full employment and economic growth. But would this temporary cut have a permanent effect on prices in the economy?

Standard static models of tax incidence, which show the effect of tax changes on all economic agents in an economy, would predict no such effect. However, the models may be wrong, and this article’s empirical evidence concerning temporary and permanent changes in the EU VAT suggest that the models are indeed wrong. Furthermore, VAT increases are much more closely associated with price increases than VAT decreases are associated with lower prices. The implication of these results for Canada is that a temporary GST/HST cut would in the end produce higher equilibrium prices, benefiting firm owners at the expense of consumers. Clearly, this puts the desirability of such a policy in a new light.

The temporary VAT cut examined in this article arises from an unusual institutional situation. Member states in the European Union are permitted to experiment with reduced VAT rates for selected labour-intensive services, with the goal of understanding the effect of VATs on prices and employment. Under one such experiment, Finland reduced the VAT rate on hairdressing services by 14 percentage points in January 2007, and increased the rate by the same amount in January 2012.

The authors examine the degree to which prices (specifically, VAT-inclusive prices) decreased following the VAT reduction in 2007. This result is compared with the extent to which prices increased following the end of the VAT reduction in 2012. In other words, the authors examine the passthrough rate for the VAT decrease and the VAT increase. To control for the possibility that any difference in the passthrough rates may be due to differences in economic conditions at the two times (with 2007 having come just before the worldwide recession and fiscal crisis), the article also examines price changes in the context of beauty salons in the same two periods: a change in general economic conditions that caused price changes in hairdressing services would be expected also to show up in price changes in beauty salons. Thus, beauty salons serve as the control group.

The main finding is that prices respond twice as much to the 14 percentage point VAT increase as to the 14 percentage point VAT decrease. In other words, the amount of the decrease in price after the VAT decrease is less than the amount of the increase in price after the subsequent VAT increase. Prices remain at the higher level than for the control group 3.5 years after the VAT cut has ended. This is a substantial period of time, because most of the passthrough occurs in the first month after the tax decrease or increase.

The profits of firms supplying hairdressing services follow the same asymmetric pattern as prices. Firms operating at low profit margins are particularly likely to show this asymmetric response.

The context of this research makes the results particularly believable. Normally, researchers are restricted to examining tax changes that are made in response to specific economic conditions. In such situations, it is impossible to tell whether the economic conditions that led to the tax change are somehow affecting the behaviour after the tax change. In this case, however, the timing, the magnitude, and the
commodities involved were determined by the European Commission, and hence the reform can be considered to be exogenous. In other words, the tax change can be considered to be random.

Nevertheless, the fact that only two small VAT changes are examined leaves one wondering whether the results apply to VAT changes in general. Thus, the paper also examines pass-through rates for all VAT changes that occurred in EU member states from 1996 to 2015. All of these changes can be expected to be non-random in the sense described above, so various statistical techniques were used to alleviate this problem. The results of this broader study support the study’s findings with respect to the hairdressing VAT cut: prices continue to respond more to VAT increases than to VAT decreases.

There remains one question about the applicability of this research to Canada. European VATs are buried in prices, so the consumer sees only the tax-included price. Canada’s GST/HST, by contrast, is generally added to prices at the cash register. Thus, consumers in the European Union may be less aware than Canadians of how the total price they are paying has been determined. As a result, Canadian consumers may push back harder against such asymmetric responses to tax changes than European consumers would.

A.M.


Taxpayers’ compliance costs have generally been measured through surveys of individuals or corporations, but survey respondents may or may not be typical of the population. Thus, it is interesting to see an approach to this problem of compliance costs that relies not on such surveys but on inferences from observed behaviour. For the authors of this article, the challenge was to measure the compliance cost to taxpayers of the US personal income tax, and their inferences are based on the pattern of claims for the standard deduction versus the pattern of claims for itemized deductions that use schedule A—in particular, how this pattern changes with the 1988 increase in the standard deduction. The authors chose the 1988 reform for examination because it is a relatively “clean” change—that is, it is not accompanied with other changes that could affect this choice. Generally, this approach to measuring compliance costs can be used whenever taxpayers have a choice between a low-cost, low-benefit option and a high-cost, high-benefit option, so there may be possible Canadian applications of this method.

The theory behind the authors’ methodology is as follows. If compliance costs are non-existent, taxpayers should itemize if the cost of itemizing is greater than

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30 For a recent example of this type of research, see Chris Evans, Philip Lignier, and Binh Tran-Nam, “The Tax Compliance Costs of Large Corporations: An Empirical Inquiry and Comparative Analysis” (2016) 64:4 Canadian Tax Journal 751-93.
zero. With compliance costs, itemizing is worthwhile only if the saving it produces in the tax bill exceeds the cost of itemizing (which, from other evidence, has been shown to be mostly record-keeping cost). Thus, one would expect that there would be relatively few people with schedule A claims just above the standard deduction because of the cost of itemizing. Data bear out this prediction: there is indeed “missing mass” in the distribution of schedule A claims in every tax year. The graphs in the article are convincing on this point.

Further, in a year in which the standard deduction has been increased, the mass of itemizers just above the post-reform standard deduction has dropped relative to the mass of itemizers in this dollar-amount range in the previous year. This change in the missing mass from a pre-reform year to a post-reform year can be used to construct the distribution of benefits forgone through claiming the standard deduction instead of itemizing.

To extend these compliance costs to other schedules of the US personal income tax return, the authors use the IRS’s estimate of the average number of hours for each schedule. For example, suppose the measured cost of schedule A is $10, and a particular taxpayer must also file schedule X. If the IRS estimates that schedule X will take twice as many hours as schedule A, the compliance cost of schedule X is estimated to be $20.

The overall conclusion of this article is that the total compliance costs of the US personal income tax are about 1.2 percent of gross national product. For comparison, the authors note that US personal income tax revenue is about 8.8 percent of gross domestic product. In other words, compliance costs are about 14 percent of revenue.

Estimates that use survey methodology have generally produced much lower figures than this. For example, the compliance costs of the Canadian personal income tax have been estimated to be 2–3 percent of revenue.31

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31 François Vaillancourt, Édison Roy-César, and Maria Silvia Barros, *The Compliance and Administrative Costs of Taxation in Canada* (Vancouver: Fraser Institute, April 2013), at 37.