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Current Tax Reading

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Jennifer Robson and Saul Schwartz, "Who Doesn't File a Tax Return: A Portrait of Non-Filers" (2020) 46:3 *Canadian Public Policy* 323-39 (https://doi.org/10.3138/cpp.2019-063)

This article provides empirical data on the size of the non-filing population, the determinants of non-filing, and the value of social benefits forgone because of non-filing.

The situations of people who do not file personal tax returns vary, but these people may be said to fall into two categories. The first category includes people who still owe taxes after their taxes are withheld at source or are paid through instalments. Such non-filing could be an intentional act by these people, who seek to avoid being forced to pay the outstanding balance—in which case, tax evasion has occurred. (One reason to study non-filers is to identify a class of tax evaders.) The second category of non-filers includes those who owe no tax at all after their tax payments have been made. A large majority of these people are probably eligible to receive government benefits. A second reason for studying non-filers is to measure the effectiveness of social programs (for example, the Canada child benefit) at reaching people in need.

A main focus of this article is the size of the non-filing population. Although there are many hypotheses about what causes people not to file, aggregate data is not well suited to answering questions about individual motivation. Individual-level data on the direct and indirect costs of tax filing would be required to study this issue.

An approach to identifying non-filers that requires only publicly available data is to compare, on the basis of statistical data, the number of Canada's population aged 15 and over with the number of tax returns filed. Using this approach, the authors produce a national non-filing rate of 9.3 percent for 2016.

A second approach to identifying non-filers is to examine data produced as a by-product of Statistics Canada's survey work. Statistics Canada has an ongoing

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program that involves matching its survey respondents with their tax returns for the purpose of determining income amounts. Income data are obtained by gaining people's permission to access their tax return data rather than by asking them to identify these amounts themselves (either from memory or by consulting their own personal files). The data thus obtained are both more accurate and less burdensome for the respondents to provide. This is an effective approach: the vast majority of people (98 percent, according to one survey) agree to provide such access.[1] Thus, Statistics Canada runs an extensive matching program, and the group of people whom Statistics Canada has failed to match with a tax return can be considered to be non-filers. By this measure—according to the sample of approximately 24,000 people reached by Statistics Canada as part of the 2016 Survey of Consumer Finances (SFS)—13.7 percent of the population aged 15 or over are non-filers. However, given that the SFS is not completely representative of population subgroups, the better estimate is that 12.3 percent (2.4 million/19.5 million) of Canada's working-age population in 2016 were non-filers.

There appear to be two sources of error in this figure of 12.3 percent. First, the article notes that returns filed more than approximately one year late are not included in the matching. This exclusion would cause the figure to be on the high side, although previous research suggests that this inaccuracy may not be significant. Second, the data used for matching include name, address, date of birth, current age, labour force status, and a general estimate of total annual income as reported in the interview—but not social insurance number. Since failure to find a match does not mean that a match does not exist, this exclusion would seem to be a second reason for the 12.3 percent figure to be too high. The article's only comment in this regard, however, is that matching is subject to error that cannot be observed or reasonably estimated, and no direction for the error is suggested.

In addition to measuring the non-filing rate for the population as a whole, the authors also attempt to separate out the factors that contribute to non-filing. This is done through the estimation of two logistic regression models, one for women and one for men. (Non-filing rates are higher for men than for women—13.6 percent as opposed to 11.3 percent—and, as noted below, have different determinants.) In brief, the findings are that higher non-filing rates are associated with the following characteristics: Ontario residence; single status (for men only); having children 18 and over (for women only); and having self-employment as the main source of income (for men only).[2]

Finally, the article attempts to measure the value of government benefits lost to Canadians because of non-filing. The results are reported for families rather than for individual taxpayers; government benefits are generally paid according to family income. The authors disaggregate the results into six family types and into three types of government benefits—the goods and services tax/harmonized sales

1 See note 8 in the article.

2 Table 3.

tax (GST/HST) credit, the working income tax benefit,[3] and federal and provincial child benefits. The value of the benefits forgone because of non-filing was highest for single parents and couples with children (averaging about $3,000-$4,000), while singles living alone and couples with no children had much smaller losses (averaging $200-$250).[4] In terms of the cost to the federal and provincial fisc, this added up to $1.7 billion for the 2017 benefit year.[5]

The study poses many questions for future research to address. In particular, how many people are non-filers for tax evasion purposes? The income reported on the survey could be suspect, in the case of such people, and thus the calculations of forgone government benefits would be incorrect. Also, if we assume, instead, that the income numbers are correct, why would so many people be missing out on such large amounts of government benefits? And are the study's single-year forgone benefit amounts consistent over time? In other words, are the same people missing out on these government benefits year after year?

A.M.

Florian Scheuer and Joel Slemrod, "Taxing Our Wealth,"
Journal of Economic Perspectives (forthcoming)

This is a succinct and accessible analysis of proposals for an annual wealth tax. A primary aim of such a tax is to shift the tax burden to the more affluent members of society. In this article, the notion that inequality of income and wealth has been rising over the past four decades is viewed as beyond dispute. Wealth, much more than income, is concentrated in a small group, so wealth is an attractive tax base for attacking inequality.

The authors begin by briefly discussing issues related to the base and rate of a wealth tax. First, according to standard models, a wealth tax at rate t is equivalent to a tax rate of t/r on capital income, where r is the interest rate. Thus, for an asset whose rate of return is 8 percent, a 4 percent wealth tax corresponds to an annual 50 percent tax on capital income. Thus, tax rates that might sound low in an income-tax or sales-tax context are effectively much higher when considered in a wealth tax context. Second, and finally, a wealth tax is not sensitive to the amount of income actually generated from that wealth; the wealth tax applies even if the rate of return on that wealth is zero or negative.

Next, the article turns to a description of existing and proposed wealth taxes. Much attention is paid to Switzerland. The Swiss wealth tax raises by far the most revenue as a share of total tax revenue, and it is comparable in that regard to wealth tax proposals made recently by US presidential candidates Elizabeth Warren and Bernie Sanders. Notable differences between the Swiss wealth tax and the proposed

3 The recasting of this as the Canada workers benefit occurred in 2019, after the year studied.

4 Table 4.

5 Table 5.

US tax are the exemption levels (US$55,000 to US$250,000, depending on the Swiss canton, as compared with $50 million and $32 million, respectively, for the Warren and Sanders plans) and the top marginal rates (0.1 percent to 1.1 percent, depending on the Swiss canton, as compared with 6 percent and 8 percent for the Warren and Sanders plans). Wealth taxes in other European countries are even more different from the US proposals. Thus, evidence about the effects of European wealth taxes may be of little use when it comes to evaluating current wealth tax proposals.

The article also compares wealth taxes with property taxes, estate and inheritances taxes, and capital gains taxes. A property tax applies to only one component of wealth, and that particular component amounts to less in the wealth of the richest people than it does in the wealth of upper-middle class people. The effective rate of tax on asset value varies widely, but it averages about 1.1 percent.

Regarding the possible evasion of a wealth tax, the authors note that studies of European wealth tax indicate high rates of evasion, but they also observe that evasion may be increasing in difficulty as a result of the Foreign Account Tax Compliance Act (FATCA) and the growth—which FATCA largely spawned—in the international exchange of information. Also, regarding comparisons between the wealth tax and the US estate tax, the high rates of avoidance and evasion for the latter may not extend to a wealth tax because the higher frequency of reporting (annually instead of just once) make it much harder to systematically conceal wealth.

The article also discusses normative questions, beginning with the Atkinson-Stiglitz result in respect of a wealth tax: any tax on capital income is undesirable, according to this theorem, because it is Pareto-inefficient. The authors describe this result as being useful as a conceptual baseline but not as a guide to policy action, because it holds true only for unrealistic assumptions. After developing new mathematical propositions based on more appropriate assumptions, the authors conclude that the modern theory of optimal taxation lends support, after all, to the imposition of such an annual wealth tax.

The article concludes by addressing issues that extend far beyond economic questions, into questions of political economy. Will the growing inequality of income and wealth lead to adverse political outcomes? At one extreme is a concern that excessive inequality may allow the rich to tilt the political system in their favour. At the other extreme is a concern that an increase in the concentration of wealth could lead to instability in the political system and, possibly, to revolution and radical redistribution. But is a wealth tax the appropriate tool for addressing these two concerns?

A.M.

Florian Scheuer and Joel Slemrod, "Taxation and the Superrich" (2020) 12 *Annual Review of Economics* 189-211. Also available as **Florian Scheuer and Joel Slemrod, *Taxation and the Superrich*, National Bureau of Economic Research Working Paper no. 26207** (Cambridge, MA: NBER, August 2019)

This paper surveys what is known about the taxation of the super-rich, with a focus on the United States. The minimum qualification for this group, commonly defined as "the Forbes 400," is wealth of US$2.1 billion. The article focuses on normative questions—that is, how this group should be taxed.

Realized capital gains form 60 percent of total adjusted gross income for the 400 Americans with the highest adjusted gross income.[6] This statistic is important because much of the capital gains reported by this group may in fact be disguised compensation for labour—especially the sale of stock that was founded by the taxpayer or by a relative of the taxpayer (often called "founders' stock"). An additional issue is the step-up in basis on death, which can cause a large amount of capital gains in the US tax system to escape tax forever—a non-problem in Canada, where we have a deemed disposition on death rather than a step-up in basis. Thus, the article concludes that, with different kinds of income being taxed at different rates and with the tax law in some cases allowing income not to be taxed at all, a big issue is the "plasticity" (that is, malleability) of the tax base for the super-rich.

Much of the paper is devoted to incorporating into the standard economic (Mirrlees) model of optimal taxation a richer modelling of labour markets, especially superstar effects (that is, when a few people with slightly superior skills reap disproportionate economic rewards). This modelling produces few policy conclusions, although it does produce a clear agenda for future research.

A.M.

Arun Advani, Emma Chamberlain, and Andy Summers, *A Wealth Tax for the UK, Final Report* (Wealth Tax Commission, 2020)

The Wealth Tax Commission published its final report, *A Wealth Tax for the UK*, which recommends the levy of a one-off wealth tax to raise revenues to address the financial pressure caused in the United Kingdom by the COVID-19 pandemic, and by inequality. The report has generated public debates, and its proposals were discussed at the House of Commons Treasury Committee's inquiry into tax after coronavirus.[7] It should be noted, however, that this so-called commission was not appointed by the government; it consisted of an independent group of academics and practitioners brought together by the London School of Economics and Political Science (LSE) and the University of Warwick. The authors of the report are

6 At 7.

7 See Hamant Verma, "Could a UK Wealth Tax Work? MPs Question Experts," *Chartered Institute of Taxation*, November 25, 2020 (www.tax.org.uk/media-centre/blog/media-and-politics/could-uk-wealth-tax-work-mps-question-experts).

Arun Advani (assistant professor in economics at Warwick), Emma Chamberlain (a barrister), and Andy Summers (associate professor at LSE).

The report comprises six chapters, an appendix on the taxation of trusts and non-residents, and glossary terms. A foreword was penned by Lord Gus O'Donnell, cabinet secretary and head of the civil service (2005-2011) and former permanent secretary to HM Treasury. Chapters 1 to 3 provide an introduction and an overview of what a wealth tax is and why a wealth tax is needed. Chapter 4 proposes a one-off wealth tax and lays out the principles of such a tax (revenue, efficiency, fairness, avoidance, and alternatives); design issues (for example, who and what is taxed, how to value assets, and how to address the liquidity challenge of "wealth-rich and cash-poor" taxpayers); administrative matters; the design of thresholds and rates; and the delivery of the new tax. Chapter 5 considers the annual wealth tax in terms of principles, design features, and delivery. Chapter 6 offers conclusions and recommendations.

The report draws on research papers—written by a network of "world-leading experts on tax policy"—that represent, according to the report's three authors, "the largest repository of evidence on wealth taxes globally to date."[8] But the report's recommendations are the authors' own. The report avoids recommending the rates or thresholds that should apply under a wealth tax, which are considered to be "archetypal matters of political judgement and democratic deliberation."[9] It recommends a one-off wealth tax as opposed to an annual wealth tax, mainly because the former (1) can raise substantial revenue (£260 billion if all individual wealth above £500,000 is taxed at the flat rate of 5 percent or £80 billion revenue if the threshold is £2 million); (2) is better than the possible alternatives (for example, increasing the income tax rate by 9 percent or the value-added tax by 6 percent); and (3) does not distort behaviour and therefore would be economically efficient. The report suggests that the COVID-19 crisis would help increase public support for the one-off tax and that the new technological facilities and enhanced requirements with respect to the disclosure of offshore wealth would enable the administration of a wealth tax.

It is no secret that countries need to find ways of raising revenues to pay for the expensive COVID-19 relief programs and to finance the post-COVID-19 economic recovery. Also, the COVID-19 pandemic has highlighted wealth inequality as a social condition that needs to be addressed. Taxing wealth seems like a good idea. Argentina, for one, has just passed legislation to levy a one-off wealth tax.[10]

For tax policy makers and students of taxation, the report itself and the background papers are worth reading.

J.L.

8 At 6.

9 Ibid.

10 See Sebastian Boyd, "Argentina To Hit the Rich with Wealth Tax as Covid-19 Costs Rise," *Bloomberg*, December 5, 2020 (www.bloomberg.com/news/articles/2020-12-05/argentina-to-hit-the-rich-with-wealth-tax-as-covid-19-costs-rise).

Ian Irvine and Miles Light, "The Tax Consequences of Legal Cannabis" (2020) 46:3 *Canadian Public Policy* 305-322 (https://doi.org/10.3138/cpp.2019-062)

This article simulates the effect of the legalization of cannabis within a demand model for alcohol, tobacco, cannabis (sourced legally or illegally), and other recreational goods. Market parameters, such as the various elasticities of demand, are obtained from previous research. The cannabis market is assumed to be in a condition of long-run equilibrium, so outlets are plentiful, prices are set by vendors, and consumers purchase according to their preferences. The legalization of cannabis is treated as having caused a large decrease in the legal-market price, from essentially infinity to the new price. This price is assumed to be 88 percent higher than the illegal-market price.[11] Legalization is assumed to have caused a 10 percent increase in the volume of cannabis consumed. Since many of the parameters of the model are subject to some uncertainty, a variety of outcomes are presented.

The key result of the model is that sales tax revenues and excise tax revenues from legal cannabis may be fully offset by reduced revenues from alcohol and tobacco. This is not all that surprising, perhaps, given that consumers' incomes do not rise with the legalization of goods: household budgets remain fixed, and thus the move to purchases of cannabis in the legal market necessarily implies a decreased consumption of other goods. Some of this decrease will be in the consumption of untaxed illegal cannabis, but much of it will be in the consumption of alcohol and tobacco, which generally have higher tax rates than legal cannabis. This difference in tax rates was a deliberate choice by governments seeking to reduce the size of the illegal cannabis market as much as possible.

A second result of the model is that new revenue will accrue from personal income tax and corporate income tax: it is assumed that people producing and selling cannabis in the illegal market do not pay tax but that income from legal-market cannabis activities is fully taxed. This is personal income tax for employees in the industry, and corporate income tax for cannabis businesses. With legalization, the result of the model is that two-thirds of sales now come from the legal market.

A.M.

Gretchen Lawrie and Yang Zhang, "KPMG Canada's Isle of Man Offshore Company Tax Strategy" (2018) 4 *Journal of Case Research and Inquiry* 48-64

This is a case prepared for class discussion that summarizes the Isle of Man offshore company structure marketed by a Canadian accounting firm to some of its clients in the 2000s. The case also discusses the development and marketing of the structure, and the structure's consequences for some of the clients involved and for the accounting firm itself. Several original documents are cited. The case also provides introductory discussions of relevant provisions of Canadian tax law and US tax law;

11 Appendix A.

the case appears to be intended for classroom use by American students beginning their tax studies. An instructor's manual is available. Coverage of developments appears to end in mid-2016; the late-2016 decision in *Canada (National Revenue) v. KPMG LLP* is not discussed.[12]

A.M.

Adil Sayeed, "COVID-19 Blunts Alberta Challenge to Federal-Provincial Income Tax" (2020) 46:S3 *Canadian Public Policy* S300-6 (https://doi.org/10.3138/cpp.2020-073)

This article points out a little-known aspect of the present tax collection agreement (TCA) structure: when an economic downturn occurs, provinces receive a cash flow benefit. This benefit, according to the article, may be huge in 2020. In particular, the TCA system provides that federal instalment payments for 2020 personal income tax revenue were based on pre-COVID-19 forecasts of economic growth, even though personal income tax revenue for the 2020-21 fiscal year was at one point expected to be 14 percent lower than in the previous year.[13]

If that same percentage drop applied to the revenue of Alberta, the province would have been paid over $1 billion more under the TCA system than the province's actual revenue would have merited. Furthermore, generous repayment terms built into the TCA provide that Alberta would not have to repay the excess until 2024-25, and no interest would be charged in the interim.[14] Perhaps this provision of the TCA is reasonable; the article notes that the government of Canada can borrow funds at better rates than any province can.

Updated figures issued on November 30, 2020 (not available when the article was written) suggest that personal income tax revenue for 2020-21 dropped only 3.3 percent relative to the previous year, rather than the 14 percent projected in July 2020.[15] Thus, the TCA system's benefit to provinces may turn out to be less significant than described.

Other portions of the article discuss Alberta's flirtation with pulling out of the TCA system. The article argues that, because of the pandemic, this is unlikely to happen for some time, given the cash flow benefit discussed above and the general

12 See 2016 FC 1322; Henry Shew and Jody Wong, "MNR v. KPMG: Professional Duty Overruled" (2017) 7:1 *Canadian Tax Focus* 7-8; and Daniel Bourgeois, Cheryl Gibson, and Martha MacDonald, "Current Cases," in *Report of Proceedings of the Sixty-Ninth Tax Conference*, 2017 Conference Report (Toronto: Canadian Tax Foundation, 2018), 1:1-22.

13 Canada, Department of Finance, *Economic and Fiscal Snapshot* (Ottawa: Department of Finance, July 8, 2020). This forecast is for federal revenue, which is probably a reasonable forecast for provincial revenues in the aggregate. Individual provinces could be higher or lower.

14 At S303.

15 The drop is projected to be from $167.6 billion to $162.1 billion: see Canada, Department of Finance, Fall Economic Statement 2020, Supporting Canadians and Fighting Covid-19, November 30, 2020, at 127.

unwillingness of provinces to spend money on new projects not related to public health or economic recovery.[16]

A.M.

Ben Eisen and Milagros Palacios, *The Great Convergence: Measuring the Fiscal Capacity Gap Between "Have" and "Have-Not" Provinces* (Vancouver: Fraser Institute, December 2020) (www.fraserinstitute.org/sites/default/files/great-convergence-measuring-the-fiscal-capacity-gap.pdf)

Fiscal capacity—own-source revenues calculated on the assumption that tax rates are set at the national average—measures the ability of a province to generate revenue for financing expenditures. This report documents the fiscal capacity of each province from 2007-8 to 2020-21 (for the last two years, the figures are projected) and draws conclusions regarding provincial budgeting and the federal government's equalization program. For this purpose, fiscal capacity includes 100 percent of resource revenues.[17]

It is well known that fiscal capacity varies dramatically across provinces, but it is less well known that the gap in fiscal capacity between richer and poorer Canadian provinces has shrunk dramatically in recent years—an event that the report calls "the great convergence." The accompanying figure, taken from the report (reproduced by permission), demonstrates this convergence clearly.[18]

Furthermore, the rankings of provincial fiscal capacity have changed significantly. Alberta has had the highest fiscal capacity since at least 1967. In 2007-8, Alberta's fiscal capacity was 93 percent greater than the other provinces'. For 2020-21, the report estimates that this gap between Alberta and the other provinces will have fallen to 4 percent.[19] Alberta is estimated to have only a little more than half (55 percent) of the fiscal capacity per person (in 2020 dollars) that it had in 2007-8.[20] The fall in oil prices provides most of the explanation for this decline,

16 For further discussion of this TCA provision and the merits of Alberta pulling out of the TCA system, see H. Michael Dolson, "Should Alberta Collect Its Own Personal Income Tax?" (2020) 10:1 *Canadian Tax Focus* 7.

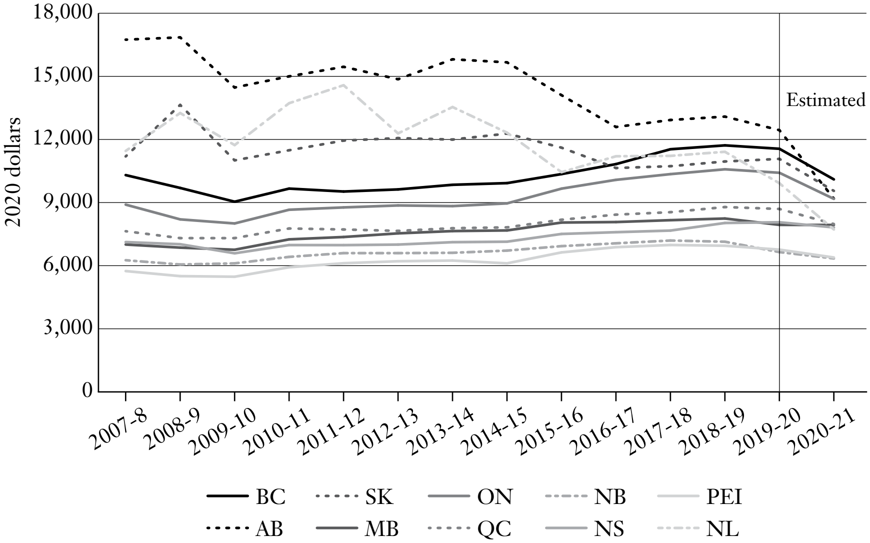
17 The authors inform me that for every year through 2018-19, the data are the fiscal capacity numbers drawn from the Finance Canada workbooks used in the calculation of equalization entitlements. For 2019-20 and 2020-21, the official numbers are not available and are estimated on the basis of data from provincial budgets and/or fiscal updates. For instance, resource fiscal capacities for 2019-20 and 2020-21 are forecasted by adjusting the last official number according to the percentage change in resource revenues presented on the budget and/or fiscal updates. Meanwhile, the non-resource fiscal capacity figures are estimated by adjusting each last official number according to the percentage change in actual non-resource revenues. Two exceptions to this procedure are described at 6-7.

18 At 3.

19 At 1.

20 At 5.

Per-Capita Fiscal Capacity (Non-Resource Revenues plus 100 Percent Resource Revenues), 2007-8 to 2020-21



Source: Ben Eisen and Milagros Palacios, *The Great Convergence: Measuring the Fiscal Capacity Gap Between "Have" and "Have-Not" Provinces* (Vancouver: Fraser Institute, December 2020), at 3, figure 1.

but the report shows that Alberta's non-resource revenues have fallen, too, from 47 percent above Ontario's revenues in 2014-15 to 3 percent below Ontario's revenues in 2020.[21]

For Alberta, the budgeting implications are stark. When the province had a big advantage in fiscal capacity over the rest of Canada (almost double in 2007-8, as noted above), it was able to have both low tax rates (for example, no sales tax) and high per-capita spending (second in per capital program spending)[22] without running large budget deficits (between 2010 and 2014, its largest deficit was 1 percent of gross domestic product).[23] The new situation was well summarized by Alberta's finance minister in 2019: "We can no longer spend like we're the rich kids on the block because, quite frankly, we're not anymore."[24] A detailed analysis of how to address this budgeting gap is said to be outside the scope of the report.

The accompanying figure shows that Alberta is the big loser in terms of fiscal capacity, while other provinces have either lost less than Alberta or have stayed

21 At 8.

22 At 6-7.

23 At 7.

24 At 8.

stable (this is currently the case, at any rate, before the effects of COVID on fiscal capacity are fully known). The report forecasts that in 2020-21 (the current budget year), Alberta will have given up its lead in fiscal capacity to British Columbia. Saskatchewan will be second, Alberta third, and Ontario fourth.[25] The lowest-ranking province will be New Brunswick, followed by Prince Edward Island and by Newfoundland and Labrador. This is a sharp fall for Newfoundland and Labrador, which had the second highest fiscal capacity in the country in 2010-11.[26]

The report observes that budgeting in equalization-receiving provinces (currently Quebec, Manitoba, and the three maritime provinces) is especially complicated, in that forecasting own-source revenue is not enough; one also has to forecast changes in the equalization payments from the federal government. The report does not attempt to forecast the amounts of these payments. Instead, it makes a number of observations about the complexity of such forecasts over the next few years. In particular, payments to existing recipients could fall with the arrival of new equalization recipients—and the report suggests that Alberta and Ontario are candidates for such payments. The report makes a plausible case that this unwelcome possibility is more or less in keeping with current trends.

A.M.

Sherra Profit, *Reaching Out: Improving the Canada Revenue Agency's Community Volunteer Income Tax Program* (Ottawa: Office of the Taxpayers' Ombudsman, June 2020), 50 pages

The Canada Revenue Agency's (CRA's) Community Volunteer Income Tax Program (CVITP), operated through partner organizations across the country, helps individuals with modest income and a simple tax situation comply with their tax-filing obligations and access the benefits and credits to which they are entitled. In the 2018-19 program year, about 835,200 returns (3 percent of all returns in Canada) were filed under the program.[27] In Quebec, the CVITP program is operated in conjunction with Revenu Québec, and volunteers prepare both federal and provincial returns. This comprehensive and thoughtful report is the result of a study requested by the minister of national revenue in connection with an increase in the CVITP's funding in the 2018 budget. The ombudsman reports on a number of obstacles that prevent the CVITP from reaching its full potential and makes numerous recommendations for improvement, only a few of which are discussed here.

The CRA's role in the CVITP program is mainly to train volunteers, provide software, and provide assistance to CVITP volunteers (such as a dedicated phone

25 At 5.

26 At 10.

27 The numerator is from page 6. The denominator of 30,346,932, for the total number of 2019 returns, is from Canada Revenue Agency, "Individual Income Tax Return Statistics for the 2020 Tax-Filing Season" (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/individual-income-tax-return-statistics.html).

number). The partner organizations do the rest, including allocating paid staff to the program (not all "volunteers" are donating their time). CRA employees do not prepare returns. The CRA does not provide or direct funding to partner organizations, so they must raise funds on their own. The ombudsman recommends that the CVITP provide program funding for partner organizations to pay their employees, noting that "[t]he CRA cannot promote the CVITP as its program and tax credit for the program's successes, while distancing itself to mitigate liability risks, and not assuming some responsibility for the cost of operating the clinics."[28] Although the CRA informed the ombudsman's office that such direct funding would require that a "grants and contributions" program be in place, the report notes that one was in place until 2011 and suggests that the CRA review and reconsider its decision not to have such a program.

The CVITP's definition of a "modest income" is $35,000 for a single individual, $45,000 for a couple, and $50,000 for a couple with two children. The CVITP considers a simple tax situation to include interest income under $1,000, employment income, pensions, support payments, scholarships, and benefits from employment insurance, disability, and social assistance.[29] Among the items that would disqualify a return from the program are self-employment income, employment expenses (presumably paragraph 8(1)(f) salespersons' expenses), and capital gains or losses.[30] However, CVITP organizations and volunteers have the ability to complete returns outside these guidelines.[31] The report recommends that these restrictions on access be reduced.

The report devotes considerable space to the difficulties of accessing services—problems caused by barriers in the CRA's authentication and authorization processes. This problem is not limited to the CVITP. The report notes: "We repeatedly hear about difficulties individuals face passing the CRA's authentication questions to validate their identity when contacting the CRA for information. These difficulties especially arise with the more vulnerable segments of the population, including those using the CVITP."[32] People facing these problems include "housing-insecure" people who move frequently and do not inform the CRA; newcomers to Canada who face language barriers in telephone communication; and people whose record-keeping practices do not allow them to provide the CRA phone agent with an

28 At 24.

29 At 7.

30 Since the report was published in May 2020, a limited exception for self-employment income has been added: income reported in box 48 of the T4A that is under $1,000 where no expenses are claimed: Canada Revenue Agency, "About Free Tax Clinics," under the heading "Eligibility Criteria" (www.canada.ca/en/revenue-agency/services/tax/individuals/community-volunteer-income-tax-program/lend-a-hand-individuals/about.html).

31 At 7. The website is stricter about the types of income, noting that training is not provided for these other types of income, and volunteers should not prepare returns that contain such items: see "About Free Tax Clinics," supra note 30, under the heading "Eligibility Criteria."

32 At 14.

amount on a particular line of a past return. The CRA's response to this concern is that "[w]hen deciding what constitutes a valid consent [for release of information], the CRA is not engaging in a service oriented risk/benefit balancing act. Rather, it is bound by law to take necessary measures not to commit a criminal offence."[33] The CRA has a point, but does that mean that there is no answer to the problem? The report does not go so far as to advocate a change in the law, perhaps because such a recommendation is outside the scope of an ombudsman report, but this is something that needs to be considered.

A.M.

Eduardo Baistrocchi, "The International Tax Regime and Global Power Shifts," *Virginia Tax Review* (forthcoming) (http://dx.doi.org/10.2139/ssrn.3744992)

This article claims that the centre of world economic power has been shifting over the past 100 years—from the United Kingdom to the United States in the 1930s, and from the United States to China in the early 21st century—and that this power shift is correlated with the evolution of the international tax regime. The author offers historical empirical evidence to support these claims. Regarding this shift's normative implications for a solution to the emerging problems of taxing the global digital economy, the article states that a multilateral rule-based resolution is unlikely to emerge because, among other reasons, no jurisdiction or group of jurisdictions has emerged so far that has influence in global international tax policy comparable with US influence. In other words, while the hegemonic influence of the United States is declining, a new hegemon has not yet emerged:

> The hegemon's role in the international tax sphere is usually to provide some underlying purpose and coherence, which the U.S. has done from 1933 until 2015 through, for example, its support for the ALP [arm's-length principle]. The hegemon, which is normally the major capital exporter, is really pursuing the interests of the hegemon's capital, and it uses the ideas and the sense of purpose, to generate consent for its hegemony.[34]

J.L.

Shafik Hebous, *Global Firms, National Corporate Taxes: An Evolution of Incompatibility*, IMF Working Paper no. WP/20/178 (Washington, DC: International Monetary Fund, September 2020)

This paper—by reviewing and synthesizing the literature on international trade, public finance, and firm market power—seeks to explain why the international corporate tax framework ("the tax framework") is increasingly difficult to apply to

33 At 16.

34 At 51.

global firms. It notes, first, that the difficulty is not distinctively new: multinational enterprises (MNEs) existed at the tax framework's inception, 100 years ago. But the "global" nature of enterprises today exacerbates the weaknesses of the tax framework, which was created with an "international" company in mind. The residence versus source distinction (including the "physical presence" requirement in the source country) and the transfer-pricing rules are increasingly incompatible with the business reality of global firms today. For example, the paper states that "the typical global firm of today produces in and for the global market, which incapacitates the notion that production and business can be easily separated by national boundaries."[35] Also, as the author says, "[t]he owners of the global firm are all over the globe, and so are its customers."[36]

This paper's contribution to the debates about reforming the tax framework is that it summarizes succinctly, through charts and figures, the incompatibility between the structure of the tax framework and the structure of global firms. It concludes that MNEs have evolved while the tax framework has not been able to, and arguably cannot, "get up to speed."[37]

J.L.

Craig Elliffe, "International Tax Frameworks: Assessing the 2020s Compromise from the Perspective of Taxing the Digital Economy in the Great Lockdown" (2020) 74:9 *Bulletin for International Taxation* 532-49

This article uses the unprecedented global economic recession triggered by the COVID-19 pandemic as a backdrop for assessing the proposals by the Group of Twenty/Organisation for Economic Co-operation and Development (G20/OECD) base erosion and profit shifting (BEPS) Inclusive Framework to reallocate taxing rights on automatic digital services (ADS) and consumer-facing businesses (the so-called pillar 1 proposal) and to impose a global minimum corporate tax on MNEs (the so-called pillar 2 proposal). The author characterizes these proposals as the "2020s compromise," aimed at addressing seven problems with the "1920s compromise" that was created after the First World War as the foundation of the existing international tax framework. Among the seven problems identified by the author are the vanishing ability to tax business profits that arise from the exploitation of intangibles, especially marketing intangibles and data generated by users; the failure of transfer pricing to deal with the effects of integration and synergies of MNEs; and tax competition among states. In the author's view, the 2020s compromise represents "the most far-reaching international tax reforms for 100 years"[38] and involves

35 At 5.

36 At 22.

37 Ibid.

38 At 548.

issues that are "highly contentious, politically and intellectually."[39] Overall, the proposed solution "is a very positive step on the journey to a new international tax consensus that is much-needed for the 2020s and beyond."[40] The author hopes that if the "significant worldwide deficits"[41] arising from the First World War helped forge the 1920s compromise, the fiscal challenges created by the great lockdown caused by COVID-19 might help forge the 2020s compromise.

J.L.

Mindy Herzfeld, "Are Pillars 1 and 2 Compatible with Sovereignty and Democracy?" (2020) 169:10 *Tax Notes* 1557-62

The OECD/G20 BEPS Inclusive Framework published, on October 12, 2020, reports on the pillar 1 and pillar 2 blueprints. Pillar 1 proposes to allocate new taxing rights to market jurisdictions in respect of automated digital services and consumer-facing businesses. Pillar 2 proposes anti-avoidance measures to ensure a minimum corporate tax on an MNE group's profit. The Inclusive Framework invited the public to submit comments on various technical issues by December 14, 2020.[42] The stated aim is to bring the process to a successful conclusion by mid-2021 through a resolution of the remaining technical issues, many of which require a still non-existent political consensus, and through the development, as needed, of model draft legislation, guidelines, international rules, and processes.

Herzfeld comments on the legitimacy of the project and the implications for sovereignty and democracy. Drawing on Dani Rodrik's[43] theories regarding the political trilemma of the world economy—in particular, the notion that "it's impossible to simultaneously pursue democracy, national sovereignty, and economic hyperglobalization"[44]—Herzfeld argues that the push for uniform tax rules in pillar 1 and pillar 2 puts pressure on democracy and sovereignty. She identifies some key areas in pillar 1 (such as the determination of the tax base) that would involve "the OECD usurping the role of elected lawmakers who answer directly to their citizens."[45] Herzfeld recognizes the need for more multilateral coordination on international tax rules to address the challenges of taxing digital economic and

39 At 549.

40 At 534.

41 At 549.

42 See Organisation for Economic Co-operation and Development, "OECD/G20 Inclusive Framework on BEPS Invites Public Input on the Reports on Pillar One and Pillar Two Blueprints" (www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm).

43 Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: Norton, 2011).

44 At 1557.

45 At 1559.

profit shifting by MNEs, but she argues that the pillar 1 measures "appear to go too far in requiring countries to give away their sovereignty, which inevitably involves losses in their democratic processes."[46] She suggests a more cautious and principled approach instead.

J.L.

Michael Abramowicz and Andrew Blair-Stanek, "Contractual Tax Reform"
(2020) 61:6 *William & Mary Law Review 1537-1605*

This article makes a provocative proposal—namely, to privatize tax reform through contracts. The proposal contemplates two levels of contracting: (1) a private, profit-motivated intermediary would contract with the participating taxpayers about the amount of tax to be paid according to alternative tax regimes that might better accommodate taxpayers' tax preferences; (2) the intermediary would contract with the government about the total amount of tax that participating taxpayers would otherwise pay. Under this proposal, the government would receive the same amount of tax revenue that it would otherwise collect directly from taxpayers, and it would stipulate which tax policies—for example, tax expenditures to promote certain social and economic objectives—could not be altered in the contract between the intermediary and participating taxpayers. Participating taxpayers would "profit" from this arrangement through "trading" tax preferences with one another. For example, some taxpayers might receive lower tax rates in exchange for forgoing deductions that cause the taxpayer to engage in socially wasteful behaviour. The assumption is that the proposal would reduce deadweight loss and improve efficiency because the intermediaries would design alternative tax regimes and decide which taxpayers to invite on the basis of better information generated by artificial intelligence (AI) about taxpayers.

The authors offer the following example to show that the proposal will benefit all taxpayers without reducing government tax revenues:

> [A] private intermediary called "Taxes, Inc." hires tax experts and AI experts to collaborate. The firm identifies one million candidate taxpayers to invite to opt into an alternative tax regime. Taxes, Inc. would send these taxpayers an invitation to opt in, along with disclosures about the upsides and downsides of the alternative regime. Suppose that 100,000 of the invitees agree to participate and are deemed suitable candidates after further voluntary disclosures to Taxes Inc. A randomly selected subset of these opting-in taxpayers (say, 10 percent, meaning 10,000 taxpayers) would be assigned at random to the control group. But the other 90,000 taxpayers would be bound by the alternative tax regime; the alternative tax regime would be a contract between them and Taxes Inc. If the 90,000 taxpayers—the "treatment group"—paid more than 9.0 times the taxes paid by the control group, then Taxes, Inc. would receive the excess (or some fraction thereof) as profits. But if the treatment group paid less than

46 At 1562.

9.0 times the taxes paid by the control group, Taxes Inc. would have to reimburse the government the difference (or the same fraction thereof).[47]

The proposed outsourcing of tax reform to private intermediaries may sound too radical to some, because it goes against the fundamental principles that taxation is governed by the rule of law and that the same law applies to all taxpayers. In reality, however, some taxpayers are already able, through advance pricing arrangements or the settlement of tax disputes, to "negotiate" with the tax administration about their tax liabilities. Under the pillar 1 blueprint proposed by the Inclusive Framework, large MNEs will have greater opportunities to contractually determine their tax liability in various countries, and a third party or mechanism will function as a kind of intermediary. Thus, the proposed contractual tax reform idea, although it is targeted at the US domestic context, may help us to understand the direction of international tax reform.

J.L.

Anthony Ting, "Intangibles and the Transfer Pricing Reconstruction Rules: A Case Study of *Amazon*" [2020] no. 3 *British Tax Review* 302-34

In transfer-pricing analysis, unique, hard-to-value, and foot-loose intangibles—that is, intellectual property (IP)—defy the fundamental assumption of the arm's-length principle embedded in the comparable transactional pricing methods. The migration of IP from a country in which the IP was created, often with generous tax subsidies, to a low-tax jurisdiction to which royalties or returns on the IP are paid presents a significant challenge to the tax administration of the former jurisdiction. It is this challenge that lies at the heart of the US Tax Court decision in *Amazon.com Inc. & Subsidiaries v. CIR*.[48] In this case, Amazon argued that the value of the IP that it transferred to Luxembourg was US$255 million, while the Internal Revenue Services (IRS) argued for a value of US$3.5 billion. The court determined that the arm's-length valuation should be US$799 million.

In this article, the author analyzes the *Amazon* case to show the shortcomings of the traditional transfer-pricing methods and uses it as a case study to discuss and evaluate the Australian reconstruction rules that were introduced in 2003. The analysis is relevant to the understanding of paragraphs 247(2)(b) and (d) of the Canadian Income Tax Act,[49] which empower the minister of national revenue to recharacterize taxpayers' transactions and which were considered in the *Cameco Corp* case.[50]

47 At 1543-44.

48 148 TC no.8 (2017) (https://casetext.com/case/amazoncom-inc-v-commr-2).

49 RSC 1985, c. 1 (5th Supp.), as amended.

50 *Canada v. Cameco Corporation*, 2020 FCA 112; aff'g 2018 TCC 195.

The author explains that the reconstruction or recharacterization rules are a response to a major structural flaw in the current transfer-pricing rules on the freedom of contract of associated corporations. Under the structure in the *Amazon* case, Amazon US transferred its IP to a wholly owned subsidiary in Luxembourg pursuant to several agreements. These agreements included (1) a license agreement to permit the subsidiary to use the IP related to Amazon's website technology; (2) an assignment agreement that granted the subsidiary the rights to use marketing intangibles (for example, trademarks, trade names, website contents, and domain names related to the European business); and (3) a cost-sharing agreement, under which the subsidiary would make an annual cost-sharing payment toward the costs of the ongoing IP development. The amount of buy-in payment under the license agreement and assignment agreement was the key issue before the court. At the time of the agreement, the value of the IP was difficult to determine: Amazon's own operational staff could not produce financial projections for more than 18 months ahead owing to the rapidly changing digital world, and Amazon asked its tax department to come up with the projections.[51] Amazon's valuation was accepted by the court, in principle. Accordingly, the *Amazon* case shows the importance of having "reconstruction rules" whereby an intragroup contractual price does not have the fundamental economic attributes of arrangements between unrelated parties.

The article then discusses a spectrum of alternatives for disregarding the actual transaction, including (1) adjusting the price of an actual transaction on the basis of hypothetical contractual terms and (2) substituting a different transaction for actual transactions. It explains that the domestic transfer-pricing law of some countries may not allow the actual transaction to be disregarded. In the *Amazon* case, for example, the court rejected the IRS's argument that the taxpayer would not have entered into a similar transaction with an independent party.[52] The article then reproduces the explicit permission for disregarding actual transactions in the 2017 version of the OECD transfer-pricing guidelines:

> The transaction as accurately delineated may be disregarded, and if appropriate, replaced by an alternative transaction, where the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction. It is also a relevant pointer to consider whether the MNE group as a whole is left worse off on a pre-tax basis since this may be an indicator that the transaction . . . lacks the commercial rationality of arrangements between unrelated parties.[53]

51 At 308.

52 This seems to be the approach taken in the *Cameco* case.

53 Organisation for Economic Co-operation and Development, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, July 2017), at paragraph 1.122 (https://dx.doi.org/10.1787/tpg-2017-en).

In other words, a consideration of the "commercial rationality of arrangements between unrelated parties" involves answering three main questions: (1) Is the price acceptable to both parties? (2) Are there realistically available options for each party? (3) Is the MNE group in a worse pre-tax position? The use of ex post evidence on valuing hard-to-value intangibles was also permitted.

The article then discusses Australia's statutory reconstruction rules, which empower the Australian Tax Office (ATO) to reconstruct an actual transaction in three situations:

> 1. when the form of the actual commercial or financial relations is inconsistent with the substance of those relations (Rule 1); 2. when independent entities in comparable circumstances would have entered into different commercial or financial relations (Rule 2); and when independent entities in comparable circumstances would not have entered into any commercial or financial relations (Rule 3).[54]

For Canadian readers, rule 2 might be more relevant. The article describes the following example, used by the ATO to illustrate the application of rule 2:

> [A]n Australian manufacturer sells goods to a foreign controlled distributor which assumes all the manufacturing warranty risk in return for a fee equal to 1 per cent of gross sales. However, evidence shows that, among other things, the distributor does not have "the financial capacity to bear the warranty risk nor any ability to control or mitigate it." Rule 2 would apply to remove the warranty clauses from the intra-group contract.[55]

Can the transactions in the *Amazon* case be reconstructed under these rules? Probably so. There is evidence to suggest that for Amazon US, the best of the realistic and available options is not to transfer its IP to a third party, and that the transactions may not be commercially rational. The article concludes that the Australian reconstruction rules provide a direct path for the ATO and the courts to disregard an intra-group transaction and are largely in alignment with the OECD transfer-pricing guidelines.

J.L.

Glen Loutzenhiser and Rita de la Feria, *Dynamics of Taxation: Essays in Honour of Judith Freedman* (Oxford, UK: Hart Publishing, 2020), 384 pages

This is a collection of essays in honour of Judith Freedman. The essays examine areas of tax scholarship in which the honouree has made significant contributions: issues in (1) the taxation of small and medium enterprises and individuals, (2) tax avoidance, (3) tax administration, and (4) taxpayers' rights and procedures.

54 At 327.

55 At 329.

John Avery Jones wrote the foreword for the collection; Philip Baker a tribute ("Judith Freedman as a Colleague 1982-2020"); and Heather Self the afterword ("Professor Judith Freedman: A Short Appreciation from Women in Tax"). David Duff wrote an essay on the taxation of small business, which was previously reviewed in this feature.[56] Other essays include

- "Geoffrey and Elspeth Howe and the Path Towards Independent Taxation of Husbands and Wives: 1968-1980," by Glen Loutzenhiser;
- "Does an Inheritance Tax Have a Future? Practical Options to Consider," by Emma Chamberlain;
- "Should the Suggestion That Ownership Is a 'Myth' Have Any Implications for the Structure of Tax Law?" by Edwin Simpson;
- "Dependent Contractors in Tax and Employment Law," by Hugh Collins;
- "Tackling Tax Avoidance: The Use and Growth of Statutory 'Avoidance' Language," by Malcolm Gammie;
- "EU General Anti-(Tax) Avoidance Mechanisms," by Rita de la Feria;
- "The Concept of Abuse of Law in European Taxation: A Methodological and Constitutional Perspective," by Wolfgang Schön;
- "Fiscal Jurisdiction and Multinational Groups. A Perspective from 'Political Right,'" by John Snape;
- "Reflections on the Allowance for Corporate Equity After Three Decades," by Michael P. Devereux and John Vella;
- "The Changing Patterns of EU Direct Tax Integration," by Anzhela Cédelle;
- "The Origins, Development and Future of Zero-Rating in the UK," by Geoffrey Morse;
- "Drawing the Boundaries of HMRC's Discretion," by Stephen Daly;
- "Trends in Tax Administration," by Michael Walpole; and
- "True and Fair View and Tax Accounting," by Andrés Báez Moreno.

J.L.

Organisation for Economic Co-operation and Development,
Taxation and Philanthropy (Paris: OECD, 2020)
(https://doi.org/10.1787/df434a77-en)

This report provides a comprehensive review of the tax treatment accorded to philanthropic entities and philanthropic giving in 40 OECD member and participating countries. It draws on national responses to a questionnaire on taxation and philanthropy by national delegates to Working Party no. 2 on Tax Policy Analysis and Tax Statistics of the Committee on Fiscal Affairs of the OECD. It is part of a collaboration between the OECD and the Geneva Centre for Philanthropy.

56 "Current Tax Reading" (2020) 68:3 *Canadian Tax Journal* 909-29, at 917-18.

According to the report, most countries have tax preferences for philanthropic entities (typically in the form of tax exemptions) and for philanthropic giving by individuals or corporations (typically in the form of tax deductions or tax credits). These tax measures have not been updated, however, to reflect significant changes, such as (1) the growth of the philanthropic sector; (2) the significant new reliance, by many large philanthropic entities, on self-generated income, including business and investment income; (3) the new prevalence of large philanthropic entities, which gives large donors greater influence on the use of taxpayer funds; and (4) the increasingly global nature of many policy challenges (for example, the COVID-19 pandemic and climate change), which raises questions about the tax treatment of cross-border giving. Countries are urged to ensure that the design of their tax preferences for philanthropic giving is consistent with their underlying policy goals. For example, countries should reassess the merits of exempting from taxation a philanthropic entity's commercial income and consider how such income is taxed in domestic and cross-border contexts.

Canada is not singled out as a country where tax reform is urgent, but the policy recommendations seem pertinent to Canada. It is perhaps time for Canada to review the tax exemption of registered charities and the preferential tax treatment given to donors, with a view to assessing whether the billions of dollars in tax expenditures are achieving the desired policy objectives.

J.L.