
EDITOR'S INTRODUCTION: THE DEVELOPING DEBATE ON THE TAXATION OF BUSINESS INCOME

An important function served by the *Canadian Tax Journal* is to encourage and inform timely debate about important tax issues of the day. As our readers will (we hope) have noticed, we have been attempting to facilitate discussion of this sort in a number of areas, through thematic articles and Policy Forum commentaries.

Recent issues of the journal have included analyses and commentaries intended to help frame and explore important questions engendered by the use of income trusts to achieve a degree of transparency in the taxation of business income. Contributions by Jack Mintz and Stephen Richardson, Bev Dahlby, and Kenneth McKenzie¹ have offered insights into the complex matrix of tax and economic policy issues that arise in this area.

In previous comments on the debate over income trusts,² I observed that the income trust phenomenon provokes consideration of fundamental questions about how business income should be taxed; in particular, to what extent should the legal constructions within which business income is earned affect the kind and degree of taxation to which that income and its economic owners are subject? It seems that the present tax policy is that Canadian domestic business income should be taxed in the same fashion regardless of the legal arrangements framing how the income is earned. In essence, this is the gist of the "SIFT"—"specified investment flow-through"—legislation.

There are, of course, other ways, apart from the intervention of trusts and partnerships, to effect transparency in the taxation of business income and, more pointedly, to shift the actual incidence of corporate-level taxation. As has been evident in much of the less academic discussion concerning income trusts, Canada is not the only tax jurisdiction to have experience with arrangements designed to effect high degrees of practical integration of the taxation of business income between corporate "earners" and direct or indirect "economic owners," either as shareholders of corporations or in some instances as creditors. In this issue of the journal, Reuven Avi-Yonah, Tim Edgar, and Fadi Shaheen extend the income trust debate by exploring the current Canadian experience with reference to its antecedent in US tax practice and legislation. Their article touches on the equivalence of various ways to achieve degrees of integration

1 See Jack M. Mintz and Stephen R. Richardson, "Income Trusts and Integration of Business and Investor Taxes: A Policy Analysis and Proposal" (2006) vol. 54, no. 2 *Canadian Tax Journal* 359-402; "Commentary by Bev Dahlby on the Mintz-Richardson Proposal for Integrating Corporate and Personal Income Taxes" (2006) vol. 54, no. 2 *Canadian Tax Journal* 403-6; and Kenneth J. McKenzie, "Income Taxes, Integration, and Income Trusts" (2006) vol. 54, no. 3 *Canadian Tax Journal* 633-56. Also see Jack M. Mintz, "Policy Forum: Income Trust Conversions—Estimated Federal and Provincial Revenue Effects" (2006) vol. 54, no. 3 *Canadian Tax Journal* 687-90.

2 See Scott Wilkie, "Editor's Introduction: Income Trust Conversions" (2006) vol. 54, no. 3 *Canadian Tax Journal* 685-86.

with respect to the taxation of business income that are functionally equivalent to the outcome associated with income trusts. The authors also provide a unique perspective by employing this comparative insight to comment on the Canadian legislative response to income trusts.

In forthcoming issues of the journal, we expect to extend the inquiry into the taxation of business income further into the international realm. Concurrently with the introduction of fundamental changes to the taxation of Canadian business income with reference to income trusts, Canadian tax policy makers are grappling with the taxation of foreign business income earned by foreign affiliates of Canadian taxpayers. Debate in this area, of course, has become much more vigorous and focused as a result of the March 19, 2007 federal budget and the ensuing announcements by the minister of finance about the tax policy and legislative directions that are meant to be served by the budget proposals. While these recent policy developments can be construed and perceived in very limited or refined technical ways—in the income trust area, as being primarily concerned with the taxation of flowthrough legal constructions, and in the international area, as being (at least for the moment) mainly about interest deductibility—there is a common underlying theme: how legal constructions do or should affect the taxation of business income.

In the income trust area, with the adoption of a proxy corporate tax regime, evidently the tax policy conclusion is that the legal form in which business income is earned should not affect either the kind or the degree of taxation to which that income is subject. On the other hand and, interestingly, at the same time, a clear distinction is preserved between earning foreign business income in incorporated form, where it is expected to be generally exempt from Canadian taxation, and earning the same income in the same circumstances in “branch” form, where it is taxable currently and subject to credit for foreign tax (no doubt reflecting a variety of other features of the tax system targeted to the taxation of international income). Consequently, if business income is earned in branch form, all expenses, including interest, associated with earning that income will remain, it seems, fully deductible in computing income from all sources of a Canadian taxpayer. These charges may affect the degree of foreign tax credit, but not the general income computation. However, to the extent that income is earned by a foreign affiliate, interest and other charges that are incurred by a Canadian taxpayer and associated with earning the foreign income may not be deductible, or at least their deductibility may be more limited than under the present law. It is interesting to observe, then, that the international taxation proposals not only recognize, but in a manner of speaking entrench, the significance of legal form for how foreign business income is taxed, while the taxation of SIFT income seemingly reflects an institutional indifference to the form of business organization as a factor affecting how business income is taxed.

These developments provide a rich opportunity to consider a variety of important tax issues and the legislative framework for comprehensive tax policy. In this issue of the journal, then, we continue to explore fundamental issues concerning the taxation of business income, and anticipate an expansion of this inquiry shortly with respect to international business income.

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