Robin Boadway and Jean-François Tremblay, Corporate Tax Reform: Issues and Prospects for Canada (Toronto: University of Toronto, School of Public Policy & Governance, Mowat Centre, April 2014), 63 pages

The authors of this monograph provide a masterful survey of the fundamental economic issues of the corporate income tax, with particular reference to Canada. Boadway and Tremblay build on their analysis to propose a new type of corporate tax that would have as the tax base economic rents: profits that exceed the normal rate of return in the economy. Numerical examples clearly illustrate the possible versions of this tax.1

The advantage of this new form of tax base, according to the authors, is that it is as neutral as possible; firms have no incentive to change their behaviour in response to the tax. Such a tax base contrasts with the present corporate income tax, which is notorious for its encouragement of tax-motivated behaviour.

The authors begin with a review of the purposes of the corporate income tax. Particular attention is given to the backstop argument: a corporate tax is needed to prevent shareholders from accumulating income tax-free in corporations. The authors then review the corporate tax proposals of two UK policy reviews, the Meade report2 in 1978 and the Mirrlees review3 in 2011, and discuss who bears the corporate income tax.

The authors then return to the backstop argument, noting that it implies that corporate tax revenues should be interpreted as taxes levied indirectly on shareholders, and hence shareholders should be given credit for taxes paid at the corporate level (through the dividend tax credit). They challenge this sacred cow, noting that

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1 See Boadway and Tremblay’s appendix 2.


the after-corporate-tax return to shareholder investment is largely determined on a worldwide basis in international capital markets. Thus, there is no need to compensate shareholders for a tax largely borne by others (such as workers, through lower wages). Boadway and Tremblay thus oppose the integration of corporate and personal taxes on the basis that this simply subsidizes savings and lightens the personal taxation of capital income, rather than removing double taxation. Although this material is not new, Boadway and Tremblay display a gift for making these complex arguments understandable.

Boadway and Tremblay conclude that the backstop rationale for the corporate income tax is not a good one, and they propose instead a rent tax rationale, with the main tax policy goal of neutrality. The benefits to be achieved through a rent tax are explained in chapter 6, which sets out in detail the non-neutralities of the present corporate income tax with respect to investment decisions, leverage, profit shifting, and discrimination against new firms and risky firms.

The monograph concludes with a chapter that reviews alternative approaches to reforming corporate taxation, followed by a chapter that sets out recommendations. Boadway and Tremblay propose a combination of corporate tax and personal tax reforms.

Regarding reforms at the corporate level, the authors note that the simplest form of a rent tax is a cash flow tax, but it is administratively and politically unacceptable because it would require refundability of all losses (that is, a system of payments to firms with losses, instead of the present loss carryover system). Thus, they appear to favour a cash flow equivalent tax known as the “allowance for corporate equity” model, which would be similar to the present corporate income tax, except that it would add a deduction for the imputed cost of equity finance. The authors express the hope that this similarity might result in foreign governments continuing to give foreign tax credits to their corporations operating in Canada.

Boadway and Tremblay’s more controversial recommendations, at least among economists, arise at the personal level. Their preferred option is to eliminate both the dividend tax credit and the preferential tax treatment of capital gains (to move to a 100 percent inclusion rate). They considered a special lower inclusion rate for corporate shares to recognize tax paid at the corporate level on retained earnings, but decided against such an exception on several grounds, including fairness and simplicity.

Boadway and Tremblay show their practical side by taking the rare step of estimating the federal revenue implications of their proposals. If the corporate tax rate is kept the same, revenues would decline by 19 percent, or $6 billion. The dividend and capital gains tax changes would each raise about $4 billion, more than making up for the lost revenues at the corporate level.

Two common misconceptions about economists’ policy recommendations are that they are limited to suggesting a reduction in corporate tax rates and that they would reduce the fairness of the tax system. Neither criticism appears to apply to Boadway and Tremblay’s recommendations. The fact that their vision goes beyond simple rate reduction is clear. As for fairness, the authors argue in the monograph’s
final chapter that the reduction in corporate taxes would largely benefit workers because they bear the burden of the present corporate income tax through lower wages. In addition, the reforms to the taxation of dividends and capital gains would make the tax system more progressive, restoring, in their view, some of the fairness that has been eroded in recent years.

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“The international tax world is facing a defining moment.”4 The fundamental flaws of the existing system have been known to insiders of the system, such as tax practitioners, tax policy makers, law makers, and tax academics. Thanks to the recent media coverage of the base erosion and profit-shifting (BEPS) project,5 which is led by the Organisation for Economic Co-operation and Development (OECD) and mandated by the G20, everyone seems to know that the system fails to tax the world’s profitable multinational enterprises (MNEs). Developed economies represented by the OECD, emerging economies such as the BRICS countries (Brazil, Russia, India, China, and South Africa), as well as developing countries, all seem to claim that their tax base has been eroded. MNEs have been pilloried for “artificially” creating “homeless” or “stateless” income and for not paying a “fair” share of taxes in the countries in which their profits were earned. There appears to be a wide consensus that the current international tax regime is irrevocably broken. There is not yet any consensus about how to fix the system.

Each of the four papers reviewed below offers some ideas that are worthy of further exploration. Wells and Lowell suggest a return to the profit split (or formula apportionment) idea considered by the International Chamber of Commerce

4 Rosenzweig, at 79.
5 For current coverage of the BEPS project, see the OECD website at www.oecd.org/ctp/ieps.htm.
(ICC) before the League of Nations published the 1923 report on double taxation by four economists that laid the foundation for the current system.⁶ Avi-Yonah suggests that MNEs should just say no to aggressive tax planning. Rosenzweig suggests establishing an institutional framework to enable one country to retaliate against another country if the latter country does not conform to the new global tax regime. Blair-Stanek ventures outside tax law and introduces an entirely new solution: change intellectual property law to counter BEPS.

Wells and Lowell begin their paper by asking why MNEs are so publicly criticized if they just follow the law. They identify five basic elements (or principles) of tax treaty policy, which can be traced to the work of the League of Nations in the 1920s and 1930s:

1. Source country should tax local operations, including property or other pertinent matters.
2. Residual income should be taxed by the country of residence, which provides the knowledge, capital, and global markets for the business.
3. Presence of an interim holding company should be treated as a residence Country.
4. Subsidiaries should not be treated as a permanent establishment (PE).
5. TP [transfer pricing] is to be evaluated on a separate account basis (i.e., one-sided TP principles).⁷

According to Wells and Lowell, the above principles encourage MNEs to engage in BEPS. What is missing in the current BEPS debate is the fact that no country seems to like the existing treaty rules that guide the allocation of income between countries, but there is no movement to update these fundamental rules to reflect the economy of the 21st century. Therefore, MNEs have simply become the “villains for these failures.”⁸ To move forward, Wells and Lowell suggest that the flawed foundational premise must be addressed to meet the needs of both countries with divergent interest and MNEs. They maintain that the original ICC recommendation should be given fair consideration.

The ICC draft 1923 resolution contains the following principles:

- If a company does business in more than one country, the profits should be taxed in each country in proportion to the profit realized therein.
- If the countries cannot agree, then the allocation is presumed to be proportional to sales (turnover).

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⁷ Wells and Lowell, at 27.
⁸ Ibid., at 5.
These proportions cannot exceed the total fixed by the “competent authority in the country of domicile.”

The ICC proposal was rejected by the League of Nations economic experts’ report on the ground that “the methodology has no fundamental basis in economic theory which is capable of easy application.”

Wells and Lowell did an excellent job in documenting the work of the ICC and the League of Nations that planted the seeds of the modern international tax system. They remind readers how little has changed in international tax thinking in the face of dramatic changes in world politics, economics, and business practices. To solve the problems of the 21st century, however, it may be wise to review history, which has taught us that tax revenues will follow treaty policy design. To redesign treaty policy, the residence country paradigm may need to be replaced with a profit split (formulary apportionment) paradigm.

In Just Say No: Corporate Taxation and Corporate Social Responsibility, Avi-Yonah describes the Caterpillar profit-shifting strategy, discusses why shy corporations should pay tax, and examines the three main views on corporations and their implications for corporate social responsibility (CSR) and corporate tax.

The Caterpillar profit-shifting strategy involves “artificially” relocating approximately $2.4 billion in profits from the United States to Switzerland through the use of a hybrid entity in Switzerland (an entity treated as a corporation for Swiss tax purposes but as a partnership for US tax purposes), and creating a “virtual inventory,” which has no resemblance to the physical movement of any product sold by Caterpillar. The tax plan was proposed by one of the big four accounting firms. Avi-Yonah considers the plan to have no economic substance because the profits would have been earned without the transactions.

Assuming that governments want to tax corporations, for whatever reasons, Avi-Yonah discusses whether corporations should cooperate and pay the tax, or engage in “strategic” tax behaviour designed to minimize or eliminate their corporate tax burden. He summarizes the debates on CSR and concludes that the scope of CSR depends on one’s view of the corporation. One view is that a corporation is an “artificial entity,” which is primarily a creature of the state. Another view is that a corporation is a “real entity,” separate from both the state and from its shareholders. A third view is that a corporation is an “aggregate” or “nexus of contracts,” which is merely an aggregate of its individuals members or shareholders. Each of the views has different implications for the payment of tax and CSR. Under the artificial entity view, engaging in some forms of CSR is part of the corporation’s mission, and paying corporate tax is one way of fulfilling the corporation’s CSR obligations. Under the

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10 Supra note 6, at 46, quoted in Wells and Lowell, at 22.
real entity view, the corporation is similar to an individual citizen, is legally required to pay taxes, and is expected not to engage in overly aggressive tax planning to minimize its tax obligations. Under the aggregate view, which dominates contemporary CSR scholarship, CSR is an illegitimate attempt by managers to tax shareholders without their consent, and managers have an obligation to maximize shareholder profits by minimizing corporate taxes. Avi-Yonah argues that the last view, when taken to its extreme, is misguided and self-defeating because “it could mean that neither corporations nor the government can fulfill their responsibilities to society.” He concludes that “strategic tax behavior seems to be inconsistent with any view of the corporation.”

Avi-Yonah also addresses the competitiveness argument often used by corporations: “everyone does it, especially our foreign competitors.” He points out that US corporations were competitive until the 1990s, when they did not engage in aggressive tax strategies. Today, it is rare to find a US-based multinational that does not declare on its website that it is committed to CSR. In the end, he believes that the only real solution is to change the attitude of US corporations. A tax director of a major corporation, when presented with an aggressive tax plan, should just say no.

In “An Antigua Gambling Model for the International Tax Regime,” Rosenzweig investigates a “sticky” problem in international tax law: the lack of a mechanism for resolving policy differences among countries. This type of dispute differs from the disputes between taxpayers and governments, which are currently resolved through mutual agreement procedures. He imagines that the problem of intercountry tax policy disputes will worsen in any new multinational framework emerging from BEPS or similar projects. Without a workable institutional mechanism for resolving these disputes, it would be difficult to implement the new multilateral framework or norms. He suggests that the recent experience of the World Trade Organization (WTO) in the Antigua Gambling case can be used as a model for the new international tax regime.

In the Antigua Gambling case, the dispute was between Antigua and Barbuda, the smallest member country of the WTO, and the United States. Antigua and Barbuda hosted popular online gambling sites directed primarily at US gamblers. In 2006, the United States enacted a law that makes it illegal to offer online gambling in the United States. Antigua and Barbuda brought a claim in the WTO that the United States was impermissibly restraining international trade in services in violation of the general agreement on trade in services (GATS). It won the case. The typical remedy for a violation of GATS is permitting the aggrieved country (Antigua and Barbuda) to retaliate by enacting restraints or tariffs on services from the other country.

11 Avi-Yonah, at 12.
12 Ibid., at 30 (emphasis in original).
13 Ibid., at 32.
14 United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services, WT/DS285/AB/R.
However, since there were virtually no services provided by the United States in Antigua and Barbuda, the usual remedy was meaningless. Antigua and Barbuda was permitted by the WTO to retaliate against the United States, not under GATS, but under another WTO agreement: the agreement on trade-related aspects of intellectual property rights. In July 2013, Antigua and Barbuda declared its intention to begin selling copyrighted songs, movies, and other material directly to US consumers, without paying royalties.

What are the implications of the Antigua Gambling model for international tax law? One idea is to build a dispute settlement mechanism into the BEPS project that permits a form of cross-retaliation, such as that used in the WTO. This matter is important because there are disparate incentives between some developed and developing countries that have led to a breakdown in the international tax order (for example, some countries choose to be tax havens, and other countries enact unilateral laws against tax havens). There is no direct retaliation possible in the tax system. If the WTO-style cross-retaliation were introduced, it would increase the cost of non-compliance because the “aggrieved” country can use tax or non-tax measures to retaliate against the other country.

Rosenzweig suggests several interesting alternatives for translating the Antigua Gambling model for international tax law, including incorporating BEPS into the WTO. He raises an important issue and provides some interesting ideas about tackling it.

In “Intellectual Property Law Solutions to Tax Avoidance,” Blair-Stanek suggests an intellectual property (IP) law solution to the problem of BEPS. He recognizes the fact that MNEs’ tax-avoidance strategies rely on undervaluing their IP. He proposes IP law reforms to make it harder for MNEs to litigate or to license the IP if they use low valuations in transferring the IP to an offshore entity. For example, transferring a patent for a low price to a subsidiary in a tax haven should make it harder for an MNE to demonstrate the patent’s validity (to qualify for patent registration), a competitor’s infringement, or entitlement to any injunctions. The low transfer price may also be used in determining the amount of damages. Blair-Stanek suggests that these adverse impacts under IP law would deter multinationals from using IP to avoid taxes.

J.L.
of ‘US multinationals,’ what do we mean by ‘US’? More specifically, to what extent are these ‘US’ corporations owned by non-US investors?\textsuperscript{15}

According to the author, this question plays an important role in the current policy discussion regarding the taxation of large US MNEs. It relates, for example, to such concerns as whether the tax benefits now available to large US multinationals should be retained, enhanced, or limited; the competitiveness of US businesses; and the propriety of offering a tax holiday for “repatriated profits.”

The author first examines the literature on “home country bias” in equity ownership (that is, investors holding a disproportionate share of their equity portfolio in home country stocks). He finds that the literature does not separate large US MNEs from other companies and does not help answer the question posed earlier. Scanchirico then looks at the data on cross-border securities holdings, including foreign holdings of US stocks in the Treasury International Capital system, reporting on “institutional investment managers” under the Securities Exchange Act, disclosures under the Investment Company Act and the Investment Advisers Act, reporting related to US withholding tax, and the companies themselves. The preliminary conclusion is that data are not available to answer the question.

However, the author reports some interesting findings. For example, the percentage of foreign ownership of US equity increased from less than 4 percent in 1974 to about 5 percent in 1984 and over 13.5 percent in 2012.\textsuperscript{16} It is not possible to determine who owns Google because of reporting gaps and opacity of intermediaries and institutional investors, even though the data indicate that its shareholders include FMR LLC, the American arm of the Fidelity investment management complex; The Vanguard Group, Inc.; State Street Corporation; Barclays Global Investors UK Holdings Limited; JPMorgan Chase & Co.; Capital World Investors; Capital Research Global Investors; The Bank of New York Mellon Corporation; and Invesco Ltd. Data concerning US withholding tax show that the percentage of US corporations’ dividends paid to foreign payees (as reported on forms 1042-S, 2011) is 4 percent in Australia, Cayman Islands, and Switzerland respectively; 8 percent in Canada; and 16 percent in the United Kingdom.\textsuperscript{17}

In conclusion, the author notes that the existing constellation of disclosures and reports about the ownership of US equity reveals almost nothing about the foreign ownership share of large US MNEs. Therefore, “in the current debate over how large US multinationals are taxed—based as it must be on the current state of knowledge—assertions that rest, explicitly or implicitly, on the supposition of US ownership, rest on very little indeed.”\textsuperscript{18}

J.L.

\textsuperscript{15} At 4.

\textsuperscript{16} Ibid., at 22.

\textsuperscript{17} These data do not seem to support the widespread use of treaty shopping involving the outbound payments of dividends.

\textsuperscript{18} At 58.
In these two papers, the authors discuss the treatment of gains from indirect transfers. The notion of “indirect transfers” refers to the transfers of shares of an offshore company whose value is derived directly or indirectly from the value of shares of an onshore company. Often, the transferor and transferee are both non-residents of the country in which the onshore company is located. A well-known example is the transaction in the Indian Vodafone case. In this case, a Dutch subsidiary of Vodafone (a UK-based multinational telecommunications company) acquired the shares of a Cayman Island’s company from Hutchinson (a company based in Hong Kong) for the purpose of acquiring the Indian telecommunications businesses indirectly owned by the Cayman Islands company. The gains from the sale of the Cayman Islands company shares were considered not to be taxable in India under the existing Indian legislation, which has since been amended to tax these gains.

In “The Relationship Between China’s Tax Treaties and Indirect Transfer Anti-avoidance Rules,” Zhou investigates whether the position articulated in circular 698 issued by the Chinese state tax administration (SAT) is consistent with China’s treaty obligations. Under Chinese tax law, gains realized by a non-resident from the transfer of shares or other equity interest in a Chinese-resident company are sourced in China, and thus subject to a 10 percent withholding tax. The Chinese general anti-avoidance rule (GAAR) empowers the tax administration to reassess transactions that lack any reasonable commercial purpose. Circular 698 states that pursuant to GAAR, SAT will disregard the offshore company and redetermine the facts as the transfer of shares in a Chinese-resident company if the arrangement lacks reasonable commercial purpose or economic substance.

The author provides a good overview of the approaches to interpreting tax treaties. Many Chinese tax treaties contain article 13(5) of the United Nations model convention, which allows the source country (that is, the residence country of the

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19 Vodafone International Holdings BV v. Union of India & Anr. (2012), 14 ITLR 431 (India SC).
company whose assets give rise to the value of the offshore company shares that are transferred) to gain from indirect transfers. A small number of Chinese treaties contain a general anti-abuse rule and explicitly permit the application of the domestic GAAR to treaties.\(^{23}\) After discussing the general principles of treaty interpretation under Chinese domestic law and the Vienna Convention on the Law of Treaties,\(^ {24}\) the author concludes that in the event of a conflict between China’s treaty obligations and circular 698, the treaty provisions should prevail.

The relationship between circular 698 and China’s treaty obligations is discussed separately, depending on whether a treaty contains UN model article 13(5). The author does not discuss the application of the domestic GAAR or whether a treaty explicitly incorporates the domestic GAAR. Zhou draws two conclusions. First, SAT’s substance-over-form approach to characterizing transactions is incompatible with the form-over-substance approach that should be applied in interpreting article 13(5). Second, when a treaty contains a general anti-abuse rule or allows the application of the domestic GAAR, such as the China–Hong Kong Arrangement, “Circular 698 is arguably in line with the arrangement [or treaty].”\(^ {25}\)

In “Taxing Indirect Transfers: Improving an Instrument for Stemming Tax and Legal Base Erosion,” Cui argues that taxing gains from indirect transfers can have vital policy significance in countries where foreign inbound investments are actively traded in offshore markets, such as China and India. This taxation not only protects the tax base but also protects the “legal base” of these countries by discouraging offshore transfers, thereby encouraging the use of legal mechanisms in onshore markets. However, after reviewing the existing instruments for taxing indirect transfers, including those adopted by countries with otherwise sophisticated tax and legal systems, such as Canada and the United States, the author concludes that the instruments remain “remarkably crude.”\(^ {26}\) Cui classifies the instruments as “ex ante” rules (such as the charging rule under paragraph 2(3)(c) and the definition of “taxable Canadian property” under subsection 248(1) of the Canadian Income Tax Act)\(^ {27}\) and “ex post” rules (such as GAAR). Cui proposes to improve the taxation of indirect transfers by striking a better balance between ex ante and ex post law-making, and consistently treating taxable indirect transfers as sales of underlying target companies (by allowing conforming adjustments in tax basis).

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\(^{23}\) As of May 2014, 13 Chinese tax treaties explicitly allow the application of the domestic GAAR. These are treaties with Mexico (2005), Hong Kong (2006), Singapore (2007), the Czech Republic (2009), Belgium (2009), Malta (2010), the United Kingdom (2011), Botswana (2012), Denmark (2012), the Netherlands (2013), France (2013), Switzerland (2013), and Germany (2014).


\(^{25}\) Zhou, at 563.

\(^{26}\) Cui, at 652.

\(^{27}\) Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”).
The author provides an interesting discussion about why the issue of indirect transfers does not arise more often, suggesting that possible explanations include enforcement difficulty and the fact that many countries do not tax foreign investors on capital gains from direct transfers. In terms of tax policy, however, the author maintains that there is no reason why indirect transfers should not be taxed. Such taxation can be justified as the taxation of economic rent. In many developing countries, “the appreciation of foreigners’ investments in domestic companies has to do with special opportunities in the local economy,” and thus taxing the gains from indirect transfers can be justified as taxing “location-specific rent.”

Why do indirect transfers for tax-avoidance purposes occur? Cui suggests that the answer may not be tax rules, but rather other factors. In the case of China, these factors may be “unfriendly (and easily avoidable) domestic regulatory regimes and undeveloped law for M&A [mergers and acquisitions], as well as comparatively lower quantities of domestic parties in the onshore M&A market.” According to Cui, the US Foreign Investment in Real Property Tax Act rules do not tax indirect transfers, but an offshore market for equity interest in US real estate companies is nearly nonexistent as a result of US tax and non-tax regimes. Cui notes, without commenting, that Australia, Canada, and Japan, which have a similar level of sophistication in tax administration, have enacted rules for taxing indirect transfers of real property. However, China has active offshore markets for equity investments in Chinese companies and is currently trying to tax indirect transfers through GAAR.

As for the design of the appropriate instrument for taxing indirect transfers, Cui suggests that ex ante, more specific rules, and ex post standards (such as GAAR) are necessary to encourage voluntary compliance while preventing abuse. Existing ex ante rules, such as those in Canada and article 13(5) of the UN model convention are, in essence, “source rules” because they regard any capital gain from the indirect transfers as having a domestic source. The ex post rule adopted in China’s circular 698 adopts a lookthrough approach, under which indirect transfers are not taxable per se. What is taxable per se is the direct transfer of shares of resident companies because Chinese tax law does not specifically speak to indirect transfers. Indirect transfers become taxable only after they have been determined by the tax authorities to be, in economic substance, direct transfers under GAAR. Cui suggests that well-designed ex ante lookthrough rules (with basis adjustments) can better target tax avoidance, provide certainty for taxpayers, and generate market incentives that facilitate compliance.

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28 Cui, at 659.
29 Ibid., at 666.

Kahng claims that this paper is the first to analyze and assess the taxation of intellectual capital within a broad interdisciplinary landscape that includes knowledge management, financial accounting, and national accounting. Kahng defines “intellectual capital” to include non-physical sources of value, such as patents and copyrights, computer software, organizational processes, and knowhow. She notes that after a long history of being undervalued and excluded from measures of economic productivity and wealth, intellectual capital has finally gained wide recognition as being of central significance in economic productivity and growth. For example, in 2013, the US Bureau of Economic Analysis included for the first time research and development (R & D) as well as artistic creations, such as films, music, and books, in its measures of national economic productivity and wealth, adding $569 billion to the size of the US economy.31

Kahng provides an excellent review of intellectual capital research, findings, and reform proposals in the fields of knowledge management, financial accounting, and national accounting. She observes that scholars in these fields make a theoretically persuasive claim that intellectual capital results in economic productivity, which has been poorly understood and inaccurately measured. These scholars also have developed new methodologies for identifying and measuring intellectual capital. Kahng argues that advances in these fields have major implications for the tax treatment of intellectual capital.

Currently, intellectual capital is generally deducted rather than capitalized. Therefore, the tax system incorrectly measures the income from intellectual capital. Kahng claims that the current deduction “has the effect of imposing a zero rate of tax [on] the returns on intellectual capital,”32 which amounts to undertaxation of income from intellectual capital. This undertaxation “results in an enormous loss of tax revenues” and “creates an incentive to overinvest in intellectual capital relative to other types of capital, which results in the misallocation of economic resources.”33

Drawing on research in other fields, Kahng argues that the deduction system is flawed and should be reformed. She proposes to capitalize and amortize over five years a broad array of intellectual capital investments, including R & D, advertising, worker training, and strategic planning. It is too early to say if such a proposal will receive much attention in the United States. The idea of capitalizing capital expenditures makes perfect sense. The challenge remains in defining what these expenditures are.

J.L.

31 At 6.
32 Ibid., at 41.
33 Ibid.
The debates on BEPS and transfer pricing presuppose that the “source” of profit may reliably be determined. “Routine” profits earned by MNEs can be sourced to the place of economic activities with a reasonable level of certainty. However, the source of income attributable to “intangibles” (or super profit) is elusive. There is no consensus on what intangibles mean beyond the scope of intellectual property, such as patents, copyrights, and trademarks. The OECD intangibles report (2013) suggests that intangibles include something of value that can be controlled or owned for use in commercial activities. China and India suggest that intangibles may include something of value that cannot be owned or controlled by any specific corporation, such as country-specific advantages—namely, location savings or market premium. In this article, Wilkie provides an interesting way of thinking about intangibles in the context of transfer pricing and BEPS.

Wilkie suggests that the letter “i” in intangibles can be “i” or “I.” “I”ntangibles are things of value and capable of being the objects of transactions (that is, capable of being owned and transferred), whereas “i”ntangibles have a much broader meaning. “Location benefits” are not “I”ntangibles, but can be considered as “i”ntangibles. Location benefits include location savings and “other benefits arising from purposely and purposefully organizing business operations in a particular territory.” Customer base or local market features are not seen by the OECD as “I”ntangibles, but should be treated as “i”ntangibles. Wilkie makes the following insightful observation:

“[A]side from considerations associated with discernible features of “ownership” and “control” that are hallmarks of “I”ntangibles, it might be asked why these “intangibles” are any less significant than “I”ntangibles for measuring and sharing the relative advantage and opportunities multinational or global businesses seek to capture by exploiting their unique features and opportunities and that are not available or sustainable in an uncontrolled setting. A functional analysis based on facts and circumstances would seem to be appropriate for these intangible features of business as well as “I”ntangibles.”

Further, Wilkie notes that “I”ntangibles and “i”ntangibles converge in contributing to the profit of global businesses. In transfer-pricing analysis, finding reliable comparators for either type of intangibles may be difficult. Therefore, the result may inevitably be a profit-oriented approach.

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36 At 355.

37 Ibid., at 357.
Wilkie also discusses the challenges in achieving the objectives of BEPS action 8, such as the recognition of intangibles in private law and/or tax law and the legal significance of the OECD transfer-pricing guidelines and BEPS measures. He suggests that a constructive, reliable, and sustainable response to BEPS action 8 should avoid approaches that require changes to law, avoid creating parallel quasi-transactional regimes for “intangibles” that are not property in the legal sense but effectively operate as if they were, and adopt an approach that recognizes and can use, in the relevant analysis, the possible depth and textures of “global” business, informed possibly by a more expansive economic analysis that takes account of considerations enlightened by an awareness of the study of economic geography, but is not constrained by any particular inferred quasi-legal or accounting constructs.38

J.L.


The authors review four 2012 tax decisions of the Supreme Court of Canada: Canada v. Craig,39 Fundy Settlement v. Canada (also known as “Garron Family Trust”),40 Canada v. GlaxoSmithKline Inc.,41 and Calgary (City) v. Canada.42 They render their verdict on these decisions at the beginning of the article:

[W]e take the position that over the years the Court has done a disservice to the aspirations of our tax system in its interpretation of the Act and other tax legislation. There is little question, in our view, that the Canadian income tax system is less fair, more distortionary, more complex and more incoherent than it ought to be because of the Court’s tax decisions and because of the approach it has taken to tax cases. . . .

By engaging in and encouraging a most arid legal formalism when dealing with tax cases, the Supreme Court has made it almost impossible for the others involved in the tax law-making process to compensate for its uninspired performance.43

In addition, they reiterate their praise of Bowman CJ’s approach:

He did not purport to deduce answers to complex cases based on the supposed plain meaning of words or phrases. He stated goals, weighed consequences, and chose appropriate results based on notions of policy, common sense, professional values, and

38 Ibid., at 359.
39 2012 SCC 43.
40 2012 SCC 14.
41 2012 SCC 52.
42 2012 SCC 20.
43 At 267-68 and 269.
sensitivity to relevant tax principles. . . . He always tried hard to reach the best results as he understood them.\footnote{Ibid., at 272, quoting Neil Brooks and Kim Brooks, “Going for the Jugular: Justice Bowman’s Approach to the Craft of Judging” (2010) 58, special supp. Canadian Tax Journal 5-28, at 27.}

After mounting a forceful argument about the role of courts in the development of tax law and a failure of leadership on the part of the Supreme Court of Canada, the authors review each of the four cases to illustrate how the court still holds doggedly to a formalistic approach. They have refused to take seriously the purposes of the provisions they are interpreting, the consequences of their decisions in terms of tax principles, or the most sensible and appropriate result among the alternative interpretations that were open to them.\footnote{At 272.}

According to the authors, Canada v. Craig reflects the staggering failure of the court’s formalism. The court reached a “perverse” result that effectively read a longstanding section (section 31) out of the Act, even though the section reflects sound tax policy principles and important tax expenditure considerations. The court’s interpretation of section 31 ignores the purpose of the provision, is based on a misreading of the history of the provision, and is contrary to the court’s own stated approach to statutory interpretation (that is, textual, contextual, and purposive). Further, the Supreme Court overruled a unanimous decision that it had handed down over 35 years earlier (in Moldowan v. The Queen\footnote{[1978] 1 SCR 480, at 485.} on the ground that the earlier court had not followed the plain meaning of the words in section 31. To demonstrate how miserably the Supreme Court failed in interpreting the purpose of section 31, the authors provide an excellent overview of the purposes and history of this provision.

The Fundy Settlement v. Canada decision is “short and adds nothing to the analysis in the lower courts.”\footnote{At 299.} It held that the corporate test for the location of central management and control was the appropriate test for trusts for essentially the same two reasons given by Woods J in the Tax Court: (1) trusts and corporations are similar in many respects; and (2) adopting the same test would promote consistency, predictability, and fairness in the application of the tax law. The authors are disappointed with the Supreme Court’s decision:

Instead of assuming the role of pragmatic tax policy analysts and formulating a residency test that would preserve the purpose that residency requirements serve in an income tax system by, for example, making tax avoidance more difficult, the Court resolved the issue formally by resorting to an argument by analogy with corporations.\footnote{Ibid., at 273.}
In the authors’ view, “Fundy represents a missed opportunity to develop a test for the residency of trusts based on the legal, political and economic benefits the trust might be deriving from Canada and on the need to have tax rules that are difficult to manipulate.”

The GlaxoSmithKline decision is the Supreme Court of Canada’s first case on transfer pricing. According to the authors, transfer pricing provides a striking example of what is wrong with the tax rules that apply to MNEs. The facts of this case vividly illustrate how transfer pricing offers no answer to the problem of fairly allocating multinationals’ profits to the countries in which they operate. In fact, the decision makes things worse. The court did not settle any general proposition of law in this case. In applying the comparable uncontrolled price method under the arm’s-length principle, it is indisputable that all economically relevant circumstances must be considered in ensuring that the comparator arm’s-length transaction is sufficiently comparable to the contested non-arm’s-length transaction. The authors maintain that the judgment can be read as suggesting that in almost all cases the business and economic circumstances surrounding a taxpayer that is a member of an MNE group distinguishes its transactions with related corporations from arm’s-length transfers. If this is the case, they argue that it would be almost impossible for tax departments to regulate transfer prices.

More specifically, the authors believe that the ruling (that the licence agreement with Glaxo Canada’s parent corporation and the supply agreement with its sister corporation were relevant in arriving at a realistic picture of the profits of Glaxo Canada) cannot be correct for several reasons. For example, the two agreements exist between different corporations in two different countries. Why would the payments for intangibles owned by the parent corporation be made to the sister corporation? Whether the licensing agreement was a relevant consideration in determining the reasonableness of the transfer price that Glaxo Canada paid to the sister corporation is a factual question that requires a careful review of all the facts and circumstances. Rip ACJ of the Tax Court (as he then was) carefully and exhaustively reviewed all of the facts and circumstances of the case. Instead of finding that the licence agreement was not relevant, Rip ACJ stated that he was bound by Singleton and did not consider the licence agreement. The Supreme Court found that by relying on Singleton he committed an error in law. The authors regard this error to be “beside the point” in light of the general findings by Rip ACJ. In their view, “[i]n sending the matter back to the trial court for a redetermination of the reasonableness of the taxpayer’s transfer prices, the Court imposed a test of reasonableness that will make it even easier for multinationals to manipulate their transfer prices to avoid tax.”

49 Ibid., at 304.
51 At 273.
Calgary (City) v. Canada does not illustrate the Supreme Court’s formalism because it did not raise any interpretive issues. The authors wonder why the court granted leave to appeal in this case.

With the typical forcefulness and intellectual rigour that distinguish Brooks’s writings, this article exposes the court’s failure to follow its own textual, contextual, and purposive approach to statutory interpretation. The authors argue that the court did “not even allude to the purpose of the legislation or the consequences of alternative holdings, let alone take these matters seriously or struggle explicitly with them.” They urge the court to play a positive role in developing tax law and make a concession to common sense.

J.L.


The author of this article, which is part of a book on the charitable and not-for-profit sector, has two goals: (1) to assess alternative rationales for tax recognition of charitable gifts and the forms of incentives that flow from each and (2) to assess the Canadian experience in light of these rationales.

Duff begins by reviewing the arguments that charitable gifts should be deductible on the basis that they reduce the ability to pay and calls them a poor rationale for tax recognition. Duff then turns to the arguments that charitable gifts should be subsidized, and finds them to have more substance, but notes that they support a tax credit that does not vary according to the donor’s level of income and that is refundable if the donor’s income is low enough to exempt the donor from paying tax.

Duff analyzes the aggregate data on donations by individuals and concludes that total donation amounts are quite responsive to incentives. In particular, the 1987 change from a deduction to a two-tiered tax credit achieved its goal of shifting the distribution of charitable giving to include more low-income donors. Similarly, the movements since 2006 to reduce (and now delete) the capital gain on donations of certain appreciated capital property have partially undone the effects of the switch to a credit and tilted donations toward upper-income donors. Duff expresses his concern about this trend. He also notes that neither reform addresses the long-term decline in the percentage of taxpayers in all income classes who report contributions to charitable organizations.

A.M.

52 Ibid., at 325.

The authors of this paper report on the results of a set of semistructured in-person interviews with experts on the taxation of capital gains in Canada, Australia, and the United States. Two issues concerning capital gains for individual taxpayers were addressed: (1) the advantages and disadvantages of having an inclusion rate of less than 100 percent, and (2) the general question concerning how to reform this part of the tax system in the country in which the interviewee is based. There were 24 interviewees, including 8 from Canada. Interviewees from each country were selected in geographical clusters (for example, the Toronto area) to minimize travel costs. Two-thirds of the interviewees were from academia, and the remainder were divided evenly between tax practice and “government advisory type” roles.

The article contains many direct quotes and paraphrases from the responses of the individual participants, which is quite helpful in demonstrating the diversity of opinion in this controversial area. Nevertheless, there were two areas of consensus (but not unanimity): an accrual-based capital gains tax is not feasible, and a 100 percent inclusion rate is preferred.

For each country, the authors separately report the responses to the questions about the needed reforms to the taxation of capital gains in that country. Two pages are devoted to Canada. The Canadian respondents appear to have been more inclined than respondents from other countries to mention problems with the borderline between income and capital.

Another interesting part of the paper is the comparative description of the taxation of capital gains in the three jurisdictions. Canada is unique among the jurisdictions in allowing the carryback of capital losses. Australia is notable for the fact that when it introduced the taxation of capital gains in 1985, it did not use a valuation day; instead, gains from assets held before September 20, 1985 were exempted forever (although future budgets could change that).


With the high level of attention currently paid to whether or not corporations are obliged to pay a “responsible” amount of tax (rather than the minimum required), the auditor general’s report on aggressive tax planning is well timed. The auditor general also has the advantage of being able to get officials to answer questions that are inconvenient for the government. The Canada Revenue Agency (CRA) appears to have been cooperative, while the Department of Finance often insisted that the information sought could not be released because it was a Cabinet confidence.

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53 At 204-5.
The four specific aggressive tax plans investigated by the auditor general are offshore insurance, registered retirement savings plan (RRSP) strips, stock dividend value shifts, and the inappropriate use of losses through “tech wrecks.” None of these plans is still operative (at least in its previous form) as a result of adverse Federal Court of Appeal decisions regarding the stock dividend planning and legislative amendments concerning the other three plans. Although the report does not focus on this point, the time required is notably long. For example, the CRA first identified RRSP strips in the late 1990s, but a business case concerning the nature and magnitude of the issue was not submitted to the Department of Finance until 10 years later, in September 2009; the 2011 budget stopped the use of these plans. Similarly, the CRA contacted the Department of Finance about tech wrecks in 2001, 2004, and 2006, but corrective budget proposals were not made until 2013. One should not conclude from this that the answers were simple and obvious but bureaucrats dragged their feet; rather, the persistence of these issues indicates the difficulties surrounding this policy area.

The report is quite specific in discussing the process within the CRA of addressing aggressive tax plans, including the operation of the GAAR committee, the national risk assessment model, the training of auditors, the application of third-party penalties, and the CRA’s methods of measuring its own success in dealing with aggressive tax planning.

A.M.


Frequent flyer points earned through business expenses incurred by employees (and later reimbursed by employers) may be redeemed by employees for personal travel. There is little doubt that tax policy goals dictate that these points form part of the economic income of employees, even though the governments of the United States, Canada, and Australia have made little attempt to find a practical way to tax them. Zelenak finds this to be strange because the amount of forgone revenue is significant—he estimates it to be approximately $1.5 billion annually in the United States.

Zelenak canvasses each country’s tax history concerning this fringe benefit, finding little that deserves praise: “After more than three decades, the results could hardly be more discouraging. Virtually no tax on frequent flyer benefits is collected anywhere, and respect for the rule of law (on the part of both taxpayers and the agencies themselves) has been eroded.”

Zelenak appears to believe that points (rather than the rewards actually received) should be taxed and subject to information reporting, but he is uncertain whether

54 At 3.
the information-reporting obligation should be placed on employers or airlines (or other sponsors of loyalty programs, of which frequent flyer points are just one type). The twin advantages of placing the reporting obligation on employers are that withholding from salary becomes possible, and points earned personally could be excluded from the calculation. The advantage of placing the reporting obligation on airlines is that reporting would be less onerous because airlines possess all the information needed to comply. In the end, Zelenak concludes that the better approach is to place the burden on airlines and other issuers, both to minimize the number of businesses required to report and to avoid requiring employers to obtain points information from their employees.

Applying Zelenak’s idea about airline reporting would be significantly less practical in Canada than in the United States. Canadians book many flights on foreign airlines, and inducing these airlines to comply with Canadian information-reporting laws might be difficult. Zelenak does not consider this issue.

A.M.