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# Current Tax Reading

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**United Kingdom, HM Treasury and HM Revenue & Customs, *Consultation on the Patent Box*** (London: HM Treasury and HM Revenue & Customs, June 2011), 48 pages, ISBN 978-1-84532-884-9 (www.hm-treasury.gov.uk/d/consult_patent_box.pdf)

The $4.5 billion paid by a group of technology companies, including Apple, Microsoft, and Research in Motion, for Nortel's patents, and Google's $12.5 billion bid to buy Motorola Mobility, have highlighted the profits that are generated by strategically important patents. But patent income is internationally mobile, and competition for this footloose tax base led several European countries—the Netherlands, Belgium, Luxembourg, and Spain—to introduce "patent boxes," which provide a low rate of corporate tax on patent income. Recently, the United Kingdom announced its intention to follow suit: the introduction of a patent box was initially proposed by the Labour government in 2009, and in November 2010, the Conservative-Lib Dem coalition government confirmed its decision to proceed with a patent box in which "relevant profits" from patents held by UK corporations will be taxed at a 10 percent rate. The June 2011 consultation paper reviewed here is a followup to the November 2010 document,[1] which outlined the broad principles for the design of the patent box.

According to the consultation paper, the stated aim of the policy is to provide "an additional incentive for companies in the UK to retain and commercialise existing patents and to develop new innovative patented products."[2] Eligible profits include income from patent licences, income from the sales of patented products, and profits generated by patents for inventions used in industrial processes. The reduced rate applies only to the residual profit over and above normal profits and does not apply to other forms of intellectual property, such as copyrights and trademarks. To qualify, the firms holding the patent must remain actively involved in exploitation

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1 United Kingdom, HM Treasury and HM Revenue & Customs, *Corporate Tax Reform: Delivering a More Competitive System* (London: HM Treasury and HM Revenue & Customs, November 2010), at 51-54.

2 Consultation paper, at 5.

of the patent. Eligibility is restricted to patents that are first commercialized after November 29, 2010, subject to certain transitional arrangements proposed in the consultation paper. HM Treasury has estimated that the tax expenditure on the patent box will be £900 million in 2015-16. To put this in perspective, the research and development (R & D) tax credit currently costs the UK Treasury about £1 billion.

Identifying the "relevant profits" that will be eligible for patent box treatment will be a herculean task, even with the adoption of a formulaic approach to reduce compliance and administration costs. The patent box could well be considered an employment stimulation measure—it will take a small army of accountants, lawyers, and economists to prepare the applications for patent box treatment and to police abuses. The cost effectiveness of the patent box in stimulating R & D and innovation is highly questionable. An Institute for Fiscal Studies (IFS) research report on the proposal argues that

> [the] policy is poorly targeted at the types of activities where government intervention is justified and gives firms little additional incentive to conduct research activities in the United Kingdom. Under a UK Patent Box, a significant amount of real activity would need to accompany newly created patent income in order to outweigh the loss in revenue.[3]

The IFS study indicates that the cut in the tax rate will not generate enough additional patent income in the United Kingdom to offset the reduced tax rate, resulting in an overall reduction in tax revenues.

The introduction and spread of patent boxes seems to confirm the worst fears of many economists that international tax competition will generate a race to the bottom for tax rates on internationally mobile sources of income.

B.D.

**Reuven S. Avi-Yonah, Nicola Sartori, and Omri Marian, *Global Perspectives on Income Taxation Law*** (New York: Oxford University Press, 2011), 181 pages, ISBN 978-0-19-532136-4

**Carlo Garbarino, "Tax Transplants and Circulation of Corporate Tax Models"** [2011] no. 2 *British Tax Review* 159-87

There has long been a deep body of comparative tax literature, consisting of books and articles that examine a particular policy issue and draw on country experiences to illustrate a range of possible rule choices. In the past 10 to 15 years, however, we have seen two new forms of comparative tax law emerge that may perhaps be described as more self-conscious and comprehensive. One form, which tends to be

3 Rachel Griffith, Helen Miller, and Martin O'Connell, *Corporate Taxes and Intellectual Property: Simulating the Effect of Patent Boxes*, IFS Briefing Note 112 (London: Institute for Fiscal Studies, 2010), at 1.

textbook in style, surveys country experience across the entire range of core rule choices under a tax system; it is broad in the coverage of country practices but not necessarily deep in the analysis of particular issues. Another form examines comparative tax law from a more explicit methodological perspective found in comparative legal studies generally; it emphasizes common features that lead to convergence or divergence of tax law across countries.

The brief monograph by Avi-Yonah, Sartori, and Marian is clearly within the survey/textbook form of comparative income tax law.[4] Indeed, the format of the monograph is similar to the portion of the Ault and Arnold text[5] in which a particular policy issue is described briefly and the relevant practices in selected countries are then surveyed. Unlike the Ault and Arnold text, however, Avi-Yonah et al. do not provide separate and independent descriptions of the income tax law in the countries that are selected for comparison. Instead, they organize the design issues consistent with what they see as the standard organization of topics in a basic income tax course in a US law school, and draw on selected country practices to illustrate a range of possible rule choices. In this respect, the monograph moves through issues associated with the definition of taxable income, the deductibility of expenses, the choice of the individual or household as the tax unit, tax accounting, capital gains and losses, tax avoidance, the corporate income tax, and international taxation. Practices in selected countries are drawn on as points of comparison with the design choices reflected in the US income tax. As with the Ault and Arnold text, illustrative country practices are drawn primarily from eight particular countries—Australia, Canada, France, Germany, Japan, the Netherlands, Sweden, and the United Kingdom—with the US practice as the benchmark; however, Avi-Yonah et al. extend the range of comparison to include Italy, Israel, and some developing countries.

Because the survey of country practices replicates much of the Ault and Arnold text, the contribution of this monograph to the literature is difficult to see. In fact, this type of comparative tax literature is similar to casebooks, treatises, and textbooks on the tax law in a particular country. Although they cover the same ground, there is room for any number of them because of slightly different styles, approaches, and formats. The goal is not to make an original contribution to the literature in the sense of reconceptualizing a subject or presenting a new empirical finding; the intellectual value added takes the form of different syntheses of the law in a traditional treatise style. The more interesting part of the monograph may arguably be found in the brief description in chapter 1 of different methodological approaches to comparative tax law.

4 Other texts include Hugh J. Ault and Brian J. Arnold, *Comparative Income Taxation: A Structural Analysis*, 3d ed. (The Hague: Kluwer Law International, 2010); Victor Thuronyi, *Comparative Tax Law* (The Hague: Kluwer Law International, 2003); and Victor Thuronyi, ed., *Tax Law Design and Drafting*, vols. 1 and 2 (Washington, DC: International Monetary Fund, 1996 and 1998).

5 Ault and Arnold, supra note 4.

Avi-Yonah et al. observe that a comparative approach to tax law, like any other area of law, is useful only to the extent that it provides fresh insights. They suggest that a comparative researcher must go beyond a description of the law in selected countries and adopt an explicit methodological approach as a means of revealing fresh insights. Four such approaches are surveyed in chapter 1: (1) the functional approach, (2) the cultural approach, (3) the critical approach, and (4) the economic approach.[6] The functional approach, which is characterized as "probably the most widely adopted,"[7] emphasizes the common issues among countries and the tendency to convergence of rule choice as best practices are uncovered through experience and are transplanted. The cultural approach emphasizes differences in institutions and rule choice as the outcome of differences in the social and economic environment. The critical approach emphasizes the way in which vested interests shape rule choice. Finally, the economic approach is a form of functionalism that emphasizes the efficiency properties of various rule choices. The descriptive chapters of the text follow this survey of methodological approaches with fleeting hints of the kinds of insights that these methodologies may produce. The survey format, however, constrains the analytical depth that might otherwise be provided through a fuller application of these methodological approaches, leaving the reader with what is predominantly a description of the rule choices made in the selected countries.

The article by Garbarino is an example of the application of the functional approach to comparative tax research. Building on the conceptual framework developed in a previous article,[8] the author develops in more detail what he labels an "evolutionary analysis . . . [of] corporate tax reforms."[9] He argues that such reforms are the outcome of tax competition in the sense of the development of competing tax models or rule choices that are adopted, not necessarily as a means of attracting investment, but as a solution to issues that are independent of that particular goal. He describes, at a broad conceptual level, why and how solutions circulate and are adopted by countries, which then form clusters around the associated rule choice. The adoption of a particular solution often involves modification to account for local considerations, which can in turn become the basis for alteration of the relevant tax model. Garbarino also distinguishes between spontaneous tax-policy convergence and convergence that is the outcome of explicit transfer from one country to another. In contrast with the latter, the former occurs when common policy approaches are adopted without any explicit policy transfer. Although the article is framed in terms of corporate tax reforms, there is very little in the way of detailed discussion of specific rule choices. Garbarino draws instead on selected

6 For a full discussion of these approaches, see Omri Y. Marian, "The Discursive Failure in Comparative Tax Law" (2010) 58:2 *American Journal of Comparative Law* 415-70.

7 Avi-Yonah et al., at 4.

8 Carlo Garbarino, "An Evolutionary Approach to Comparative Taxation: Methods and Agenda for Research" (2009) 57:3 *American Journal of Comparative Law* 677-709.

9 Garbarino (2011), at 159.

features of corporate income tax systems to illustrate various aspects of his evolutionary analysis. He does, however, suggest some lines of empirical research that would presumably focus in more detail on specific rule choices as illustrative of the suggested conceptual framework.

T.E.

**Organisation for Economic Co-operation and Development, *Tackling Aggressive Tax Planning Through Improved Transparency and Disclosure: Report on Disclosure Initiatives*** (Paris: OECD, February 2011), 21 pages (www.oecd.org/dataoecd/13/55/48322860.pdf)

**United States, Government Accountability Office, *Abusive Tax Avoidance Transactions: IRS Needs Better Data To Inform Decisions About Transactions***, GAO-11-493 (Washington, DC: GAO, May 2011), 48 pages (www.gao.gov/products/GAO-11-493)

**Ilya A. Lipin, "Uncertain Tax Positions and the New Tax Policy of Disclosure Through Schedule UTP"** (2011) 30:4 *Virginia Tax Review* 663-713

In the March 4, 2010 budget, Canada's Department of Finance announced its intention, following a consultative process, to adopt an information-reporting regime for targeted tax-avoidance transactions.[10] The announcement appeared to be motivated by the adoption of similar regimes in the United States, the United Kingdom, and Quebec,[11] and was followed up on May 7, 2010 with the release of proposed reporting provisions.[12] In general, "reportable transactions" would be those that bear two of the following three hallmarks:

1. A promoter or tax adviser in respect of the transaction is entitled to fees that are contingent on the amount or availability of a tax benefit or the number of participating taxpayers.
2. A promoter or tax adviser requires confidential protection with respect to the transaction.
3. A taxpayer obtains contractual protection in respect of the transaction.

The reporting obligation would be imposed on the taxpayer, promoter, and tax adviser, with a failure to comply resulting in the denial of the relevant tax benefit or the imposition of a late-filing penalty.

10 Canada, Department of Finance, 2010 Budget, Budget Plan, March 4, 2010, at 382-84.

11 See Finances Québec, *Aggressive Tax Planning*, Working Paper (Quebec: Finances Québec, January 2009), reviewed in this feature (2009) 57:2 *Canadian Tax Journal* 397-418, at 397-99.

12 Canada, Department of Finance, "Government of Canada Seeks Public Input on Proposals To Require Information Reporting of Tax Avoidance Transactions," *News Release* 2010-043, May 7, 2010 and accompanying Backgrounder.

In the first of the three publications listed above, the Organisation for Economic Co-operation and Development (OECD) cites the Canadian proposals as an example of one particular set of disclosure initiatives referred to as "mandatory disclosure." The report was prepared by the Aggressive Tax Planning Steering Group of Working Party No. 10 on Exchange of Information and Tax Compliance. It begins with a cursory review of the standard rationales for disclosure initiatives, which is followed by an overview of particular disclosure initiatives in Canada and other selected member countries. These include (1) mandatory disclosure regimes for tax-avoidance transactions, (2) reporting obligations that focus on differences in tax and financial accounting, (3) the use of questionnaires focused on certain taxpayers or particular areas of risk, (4) cooperative compliance programs, (5) product rulings, and (6) penalty-linked disclosure rules.

Perhaps not surprisingly, the report suggests that country experience supports the proposition that the various disclosure initiatives have been effective in realizing the standard rationales for such initiatives. The report, however, includes very little empirical data as evidence for this proposition. Some relatively coarse-grained descriptive data are presented regarding the experience in the United Kingdom, which adopted a mandatory disclosure regime for tax-avoidance transactions in 2004. The data suggest that the number of transactions subject to disclosure has declined over the period 2004-2009. The report also indicates that the disclosure regime has prompted the introduction of 49 anti-avoidance measures.

The report by the US Government Accountability Office (GAO) provides the results of an audit of the Internal Revenue Service's (IRS) implementation of the amendments to the tax-shelter reporting rules to extend information reporting, as well as associated penalties for non-compliance, to a wider range of tax-avoidance transactions. These amendments, which were enacted by the American Jobs Creation Act of 2004, apply to "reportable transactions," defined to include "listed transactions" and "non-listed transactions." The former category consists of transactions that are the same as, or substantially similar to, one of the types of transactions that the IRS has determined to be a tax-avoidance transaction and identified by notice, regulation, or other published guidance. Non-listed reportable transactions consist of certain loss transactions and other transactions that are not listed but prompt avoidance concerns, as evidenced by the fact that they are offered to a taxpayer under conditions of confidentiality, with the taxpayer paying an adviser a minimum fee. A disclosure statement describing a reportable transaction must be filed by a taxpayer who participates in such a transaction and by an adviser who makes a tax statement regarding a reportable transaction and receives a minimum fee. An adviser is also required to maintain an investor list, which the IRS may request as part of an investigation.

The GAO report provides some evidence of the logistical difficulties that are often encountered by a tax administration in ensuring that the required disclosure is made and, more importantly, that disclosed information is used effectively for enforcement purposes. The GAO report finds, for example, that more information is needed regarding the results of the IRS's enforcement efforts, including why some investigations were closed without penalties or injunctions. The report also observes that consistency and accuracy of the tracking of investigations require improvement, while more could be done to ensure compliance with disclosure requirements and to acquire investor lists in a timely manner.

As part of its audit, the GAO interviewed a number of current and former IRS officials and certain unspecified "others well-known in the tax community." On the basis of these interviews, the report concludes that "abusive" tax avoidance remains a major concern, with the nature of the transactions changing. More particularly, there is a notable decline in mass-marketed transactions and a migration to more sophisticated and internationally focused transactions.

The article by Lipin provides an overview of the recent IRS initiative to require corporate taxpayers to disclose uncertain tax positions (UTPs) on a schedule to their income tax return. Conceptually, the requirement is the tax analogue to the financial accounting requirement to identify and quantify UTPs for financial statement purposes. However, for US income tax purposes, far more detail is required to be provided regarding the details of the relevant transactions that are the source of a UTP. The article provides an accessible account of the background leading to the IRS announcement of this particular information-reporting initiative, the details of the reporting requirement, and its financial accounting analogue. There is also some discussion of the contentiousness surrounding the IRS initiative, particularly the potential effect on the right of privilege for certain tax work product.

T.E.

**Jonathan R. Kesselman, "Consumer Impacts of BC's Harmonized Sales Tax: Tax Grab or Pass-Through?"** (2011) 37:2 *Canadian Public Policy* 139-62

On July 1, 2010, British Columbia replaced the provincial retail sales tax (RST) with the harmonized sales tax (HST). Kesselman's article was published before the announcement, on August 26, 2011, that 54.7 percent of the 1.6 million British Columbians who voted in a provincial referendum had voted to get rid of the HST. Kesselman's analysis of the impact on consumer prices of replacing the RST with the HST, and studies by other economists of the impact on investment and employment,[13] failed to convince enough BC voters that the switch was in their interest. Although the HST will now be withdrawn, these studies are still relevant because they measure the lost opportunities for the BC economy and the likely impact of returning to a provincial RST.

From an economist's perspective, the key difference between the HST and the RST is that the latter taxes a broad range of business inputs, leading to hidden taxes embedded in many goods and some services. Under the RST, "about $2.5 billion annually or 48 percent of total RST revenues took the form of these hidden, embedded taxes."[14] However, from the consumer's perspective, the biggest change resulting

13 See, for example, Jack Mintz, "British Columbia's Harmonized Sales Tax: A Giant Leap in the Province's Competitiveness" (2010) 3:4 *SPP Briefing Papers* 1-13.

14 Kesselman, at 142.

from the adoption of the HST was that some services that had previously been tax-exempt became taxable at a 7 percent rate, and there was widespread skepticism that the elimination of the taxation of business inputs would be passed on to consumers through lower prices. The extension of the tax to previously untaxed goods and services combined with the effect of the elimination of embedded taxes on the pricing of many of those goods and services makes the analysis of the price impacts of the switch difficult to forecast by economists and consumers alike. This is why Kesselman's analysis is so valuable.

First, Kesselman notes that 29 percent of consumer expenditures, including a wide range of goods and a number of services, that had been taxable under the RST remained taxable under the HST. While the combined federal and provincial statutory tax rates on these goods and services remained at 12 percent, the effective tax rates may have been reduced with the elimination of the RST on business inputs. Other interesting results from his analysis include the observations that the price of food purchased from restaurants rose by 6.5 percent (less than the new 7 percent tax rate); the price of personal care and recreation services, categories that contained many newly taxed services, rose by only 1.9 and 0.1 percent, respectively; and three categories of consumer goods—clothing and footwear, rented accommodation, and homeowners' maintenance and repairs—experienced price reductions ranging from 0.2 to 1.5 percent.

Overall, Kesselman found that the introduction of the HST raised the cost of living in British Columbia by 0.5 to 0.6 percent, which is consistent with businesses having passed through to consumers all of their tax savings related to in-province sales. In my view, this small consumer impact was a small price to pay for the improvement in the competitiveness of BC firms and their ability to generate new investment, improve productivity, and pay higher wages to workers. Kesselman's article made the case for the HST especially compelling because his analysis indicates that the introduction of the HST credit and the accompanying increase in the personal income tax allowance made individuals and families with incomes of less than $30,000 per year net gainers under the HST.

B.D.

**Marc Lee, Iglika Ivanova, and Seth Klein, *BC's Regressive Tax Shift: A Decade of Diminishing Tax Fairness, 2000 to 2010*** (Vancouver: Canadian Centre for Policy Alternatives, BC Office, June 2011), 12 pages, ISBN 978-1-926888-67-5 (www.policyalternatives.ca)

This brief study documents the regressive shift in the tax mix in British Columbia during the decade 2000-2010, which probably had an impact on the public's perception of the HST. The study examines the trend in the total provincial tax rate, defined as the total tax bill as a share of household income. The total tax bill consists of income taxes, sales taxes, property taxes, and health-care premiums in the form of the medical services plan (MSP) premium. The authors find that in 2000, most households in the province paid about the same total tax rate, although households at the highest income levels (the top 10 percent) paid slightly higher rates. However, by 2010, the BC tax system had become more regressive, with the richest 20 percent of households paying a lower rate than the other 80 percent. The principal cause of the shift in household incidence is the combination of reductions in personal income tax rates, which disproportionately benefited higher-income households, and a heavier reliance on regressive taxes such as sales taxes, MSP premiums, and the carbon tax.

T.E.

**Alexander Edwards and Terry Shevlin, "The Value of a Flow-Through Entity in an Integrated Corporate Tax System"**
(2011) 101:2 *Journal of Financial Economics* 473-91

This article provides empirical evidence of the extent to which the tax benefit associated with the income trust structure was capitalized in the price of investment interests. As the subject of an event study, the authors select the Department of Finance's announcement on October 31, 2006 of its intention to adopt the specified investment flowthrough (SIFT) trust and partnership legislation.[15] The tax clientele for the flowthrough result realized by the income trust structure was tax-exempt pension plans, registered retirement savings plans, and non-residents who do not receive the benefit of the dividend tax credit. The benefit attributable to flowthrough treatment was greatest for these investors such that the tax clientele effect was only further deepened with the proposal in November 2005 to introduce an enhanced dividend tax credit for taxable resident individuals holding shares of public corporations.[16] The enhanced credit was intended to eliminate demand for the income trust structure by providing full corporate-shareholder integration of distributed income for these investors. Demand for the income trust structure by tax-exempts and non-residents remained strong, however, and led to the introduction of the SIFT trust and partnership rules to ensure consistency of treatment with the corporate form for these investors. The authors observe that the unanticipated introduction of the SIFT rules provides a unique environment for their event study.

The authors first calculate a theoretical maximum expected price change of income trust units as a result of the tax rule change, on the assumption that the marginal investors setting trust unit prices are tax-exempts and non-residents who attribute no value to the dividend tax credit. They then compute three-day abnormal returns around the announcement of this change for 170 actively traded income trust units. They document a mean price decline of 13.4 percent and a negative price effect for all but one income trust in their sample, resulting in an $18.5 billion

15 Canada, Department of Finance, "Canada's New Government Announces Tax Fairness Plan," *News Release* 2006-061, October 31, 2006 and accompanying Backgrounder and Notice of Ways and Means Motion To Amend the Income Tax Act.

16 Canada, Department of Finance, "Minister of Finance Acts on Income Trust Issue," *News Release* 2005-082, November 23, 2005 and accompanying Backgrounder. The proposal was implemented in legislation effective for dividends paid after 2005.

decrease in market capitalization. They also examine cross-sectional variation in announcement period returns. In this respect, they use certain proxies for income trusts most likely to be held by tax-exempts. Real estate investment trusts being excluded from the SIFT trust and partnership legislation provide a necessary control group. The significant tax capitalization of the benefit of the income trust structure suggests that tax-exempts and non-resident investors were both the inframarginal and price-setting marginal investors. The extent of the tax capitalization effect also suggests that these investors are not able to effectively access dividend credits through dividend rental and other tax credit trading transactions.

T.E.

**Mihir A. Desai, C. Fritz Foley, and James R. Hines Jr., *Tax Policy and the Efficiency of U.S. Direct Investment Abroad***, NBER Working Paper no. 17202 (Cambridge, MA: National Bureau of Economic Research, July 2011)

Reforming the US corporate income tax will be a prominent policy issue in the coming years as the federal government grapples with its deficit and the slow economic recovery from the Great Recession. Some claim that the US statutory corporate tax rate, now among the highest for developed countries, is inhibiting investment and employment. Others point to provisions that "favour" foreign investment by US multinationals. The ability of US multinationals to defer taxation of profits earned by their foreign subsidiaries has resulted in their holding substantial investments offshore, as highlighted by Microsoft's use of $8.5 billion in offshore cash to buy Skype, the online telecommunications service, earlier this year.

Desai et al. try to evaluate the claim that the US tax system "subsidizes" foreign investment by determining whether foreign investment by US multinationals has been "dynamically inefficient," which, roughly speaking, means that the return on foreign investment has been less than the growth rate of the US economy. They use a procedure for testing for dynamic inefficiency that Abel et al.[17] developed for evaluating the efficiency of domestic investment. In an international context, if foreign investment outflows exceed the flow of interest and dividend payments from foreign investment, then foreign investment is dynamically inefficient in the sense that a reduction in the stock of foreign investment would improve the consumption possibilities in the domestic economy. Desai et al. find that over the period 1950-2010, interest payments and earnings from foreign affiliates of US corporations exceeded investment outflows in 49 of the 61 years. In present value terms, using the US growth rate as a discount rate, the inflows exceeded the outflows by

17 Andrew B. Abel, N. Gregory Mankiw, Lawrence H. Summers, and Richard J. Zeckhauser, "Assessing Dynamic Efficiency: Theory and Evidence" (1989) 56:1 *Review of Economic Studies* 1-19.

$2.114 trillion in 2010 dollars, a surplus of 163 percent of net debt and equity investment abroad. Consequently, the study results indicate that US direct investment abroad is dynamically efficient, although the authors caution that "[t]he finding that direct investment abroad is dynamically efficient should not be interpreted either as an endorsement of current U.S. tax policy or a claim that current policy is efficient in all respects."[18]

While the focus of their study is the dynamic efficiency of US investment abroad, Desai et al. also perform similar calculations for foreign investments in the US economy, and these calculations indicate that foreign investment inflows to the United States have generally exceeded the outflows of interest and dividend payments. The "dynamic inefficiency" of foreign investment in the US economy is puzzling, and it would be interesting to see whether Canadian foreign direct investment to the United States and other countries has been dynamically efficient.

B.D.

**Jarle Møen, Dirk Schindler, Guttorm Schjelderup, and Julia Tropina,**
***International Debt Shifting: Do Multinationals Shift Internal or External Debt?*** CESifo Working Paper no. 3519 (Munich: Center for Economic Studies and Ifo Institute for Economic Research, July 2011), 45 pages (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1891843)

This paper adds to a growing list of studies that indicate that the debt placement of multinational corporations is influenced by differences in tax rates across countries. The main contribution of this study is to carefully model the difference between the tax factors that affect, respectively, internal debt placement (interaffiliate lending and borrowing) and external debt placement (borrowing from external sources). The authors' model predicts that an affiliate's total debt-to-asset ratio will be higher when the corporate tax rate in the country in which it operates is higher, in order to take advantage of the debt shield provided by interest deductions. An affiliate's external debt-to-asset ratio will be higher when the weighted average of the difference between the local tax rate and the tax rate facing all other affiliates in the group is higher, where the weights are the asset shares of each of the affiliates in the total assets of the corporate group. An affiliate's internal debt-to-asset ratio will be positively related to the difference between the local tax rate and the tax rate in the lowest-taxed affiliate within the group. (In other words, in the absence of adjustment costs and other factors, all of the interaffiliate lending should be concentrated in the affiliate with the lowest tax rate.)

Møen et al. test the predictions of the model using firm-level data from the Midi database on German-owned corporations, developed by the Deutsche Bundesbank, and tax rate data from the University of Toronto's international tax program. Their

18 Desai et al., at 20.

data set consists of 33,857 firm-year observations on foreign affiliates of German-owned corporations from 1996 to 2006. For the full sample of countries, the average debt-to-asset ratio is 0.62, the average external debt-to-asset ratio is 0.431, and the average internal debt-to-asset ratio is 0.189.

The dependent variables in the regression equations are the total debt-to-asset ratio, the external debt-to-asset ratio, and the internal debt-to-asset ratio of the affiliates, and the econometric results are generally consistent with the predictions of the tax-motivated debt placement model. In particular, the authors' model indicates that the internal debt-to-asset ratio increases by 0.243 percentage points when the maximum tax rate differential between the affiliate and the lowest-taxed affiliate in the group increases by 1 percentage point.

To illustrate the economic impact of international corporate rate differentials, Møen et al. use their econometric results to compute the effect of a 10 percentage point increase in the tax rate in one country on the debt in a multinational enterprise consisting of two affiliates of equal size. Their model predicts that the debt-to-asset ratio of the affiliate in the low-tax country will decline by 1.4 percentage points and the debt-to-asset ratio of the affiliate in the high-tax country will increase by 4.6 percentage points. About 40 percent of the debt increase in the debt of the affiliate in the high-tax country is driven by the increase in the tax shield, while 60 percent is due to international debt shifting.

B.D.

**Graeme Cooper, *Predicting the Past—The Problem of Finding a Counterfactual in Part IVA***, Sydney Law School Legal Studies Research Paper no. 11/49 (Sydney: University of Sydney Law School, August 2011), 22 pages (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1910990) (also published in (2011) 40:3 *Australian Tax Review* 185-200)

**Australia, Treasury Department, *Improving the Operation of the Anti-Avoidance Provisions in the Income Tax Law***, Discussion Paper (Canberra: Treasury Department, November 2010), 42 pages, ISBN 978-0-642-74647-4 (www.treasury.gov.au/documents/1901/PDF/dp_anti_avoidance_provisions.pdf)

The subject of the article by Graeme Cooper (of the Faculty of Law at the University of Sydney) is the flurry of recent cases under the Australian general anti-avoidance rule (GAAR). Cooper identifies three broad trends in this latest line of Australian GAAR case law. One trend is the apparent inclination of the Australian Taxation Office (ATO) to challenge a transaction under the GAAR whenever there is a sizable substantive issue, even though there may be none of the usual hallmarks of an avoidance transaction. Cooper observes that, with one exception, none of these recent cases involve marketed tax-avoidance transactions or income splitting, which had been the prior focus of the ATO's GAAR assessments. Another trend is the continued contentiousness surrounding the scope of the relevant transaction providing a tax benefit.

Unlike the Canadian GAAR (section 245 of the Income Tax Act),[19] the Australian GAAR does not require a finding that an impugned transaction constitutes a misuse or abuse. Instead, a transaction is to be struck down if it is considered to provide a tax benefit, was entered into with a sole or dominant purpose to access the tax benefit, and is not specifically excepted as a tax benefit intended by the legislature. This potentially broader application of the Australian GAAR has led taxpayers to characterize the relevant transaction as widely as possible to include various purposes, such that it can be considered to be entered into without the requisite tax-avoidance purposes.

As Cooper observes, the focus of the recent case law on the determination of the scope of the relevant transaction is well-trodden conceptual ground. The new trend that he emphasizes is a focus on the need to find a counterfactual as the basis for a determination that the relevant transaction resulted in a tax benefit. This requirement appears to follow from the definition of a tax benefit, which is premised on a need to posit "an analogous transaction and to impose on the taxpayer the tax outcome that it would have generated."[20] Although this requirement was the subject of some consideration in the early Australian GAAR case law, it was ignored for 20 years until this recent line of cases. In fact, the same requirement appears to be implicit in the Canadian definition of a "tax benefit" in subsection 245(1), but similar to the Australian experience, after some initial consideration it has been largely ignored. The presence of subsection 245(4) and its requirement that a tax-avoidance transaction be characterized as a misuse or abuse has also tended to turn the focus of the Canadian GAAR case law away from a perceived need to identify the scope of the relevant transaction and determine its predominant purpose.

The second publication listed above is the result of a government promise made in Australia's 2009-10 budget to review the operation of the anti-avoidance provisions in the income tax. The discussion paper does not consider the trends in the recent GAAR case law, but instead is centred on two principal issues: the definition of a "tax benefit" under the Australian GAAR; and the consolidation, streamlining, and improvement of the operation of specific anti-avoidance rules. With respect to the former, the discussion paper reviews the use of a list-based approach versus a comprehensive generalized definition modelled on the Canadian, New Zealand, South African, and Irish GAARs. The broad contours of each of these GAARs are set out in an appendix to the discussion paper. The discussion of specific anti-avoidance rules is necessarily focused on the unique rules in the Australian legislation, although there is some familiar discussion of the general relationship between specific anti-avoidance rules and a GAAR.

T.E.

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

20 Cooper, at 13.

**Rita de la Feria and Stefan Vogenauer, eds., *Prohibition of Abuse of Law: A New General Principle of EU Law?*** Studies of the Oxford Institute of European and Comparative Law (Oxford: Hart Publishing, 2011), 636 pages, ISBN 978-1-84113-938-8

This large volume consists of a set of papers exploring the concept of "abuse of law" as a principle of EU law that prohibits a range of transactions, behaviour, or activity. The papers are the result of a two-day symposium held at Oxford University in October 2008.

As many readers may be aware, the abuse of law concept as a principle of EU law was articulated most recently and categorically in a handful of tax-avoidance cases decided by the European Court of Justice.[21] The volume therefore includes several papers exploring the content and application of the abuse of law concept in the context of both the value-added tax (VAT) and the corporate and personal income taxes. The tax law papers are, however, suitably embedded within other papers that explore the origins and development of the abuse of law concept as a principle of EU law in a non-tax context focused on the foundational rights of the free movement of goods and services and the freedom of establishment. Although certainly of value to those familiar with EU law, the volume should be especially instructive for readers unfamiliar with what often seems to be the impenetrable opacity of that law.

T.E.

**Scott Ollivierre, "The Influence of Taxation on Capital Structure in Venture Capital Investments in Canada and the United States"**
(2010) 68:1 *University of Toronto Faculty of Law Review* 9-38

In an article published in 2003, Gilson and Schizer argued that the explanation for the use of convertible preferred shares as the dominant form of financing by venture capitalists of startup firms was the US income tax treatment of share-based compensation.[22] More particularly, they argued that overvaluation of convertible preferred shares received by venture capitalists is used as a means to ensure undervaluation of common shares that are the subject of share-based compensation for employees of startup firms. Undervaluation lowers the taxation of such compensation taken as direct share grants or as non-qualified stock options. Alternatively, undervaluation ensures that share options are treated as incentive stock options taxed on exercise at capital gains tax rates. The resulting tax benefit, which depends on lax enforcement of the valuation of convertible preferred share financing by the IRS, would normally be shared between employees of startup firms and venture capitalists through pricing arrangements.

21 See, in particular, *Halifax plc*, *Leeds Permanent Development Services Ltd.*, *Country Wide Property Investments Ltd. v. Commissioners of Customs & Excise*, Case C-255/02; [2006] ECR II-1609.

22 Ronald J. Gilson and David M. Schizer, "Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock" (2003) 116:3 *Harvard Law Review* 874-916.

The author of this article suggests that the Gilson and Schizer tax explanation does not have the same power in the Canadian venture capital industry, primarily because of the generous treatment of employee-stock options granted by Canadian-controlled private corporations (CCPCs). More particularly, Canadian startup firms, which commonly qualify as CCPCs, can issue employee stock options and access capital gains tax rates for the associated benefit on sale of the relevant shares without any requirement that the options be at- or out-of-the-money on issue. There is thus no tax-based need to use convertible preferred share financing by venture capitalists in the same way as there is in the United States. Furthermore, the ability to access other tax benefits associated with CCPC status dictates the use of debt or non-convertible preferred share financing. Given this very different tax environment, the author suggests that is not surprising that the Canadian venture capital industry is characterized by the use of a much wider range of financing structures than the US industry.

T.E.

**Ed Morgan, "International Tax as a Ponzi Scheme"**
(2011) 34:1 *Suffolk Transnational Law Review* 69-115

This article explores a question that is the subject of a considerable legal literature: Is there a body of international tax law that is distinct from the exercise of sovereign taxing authority and that acts as a constraint on such authority? Unlike much of the existing literature, this article explores the question from the perspective of public international law, given that the author is a non-tax academic with an apparent passing interest in tax.

Morgan begins the article with a brief review of the body of law supporting the accepted proposition that there are no domestic or public international law constraints on the taxing power of sovereign governments. He recognizes, however, that the well-developed bilateral tax treaty network, based on the OECD model treaty, operates as the functional equivalent of a multilateral treaty ostensibly constraining the otherwise unfettered sovereign taxing power. The remainder of the article focuses on three particular examples in which treaty constraints are seen to be ignored through an emphasis on domestic tax law or policy considerations. The first is the Canadian treaty-shopping tax case *MIL (Investments) SA v. The Queen*.[23] The second is the US tax case *William D. Jamieson*,[24] involving a treaty override in the form of a domestically mandated reduction of the foreign tax credit for alternative minimum tax purposes. The third example is the OECD initiative to promote enhanced bilateral taxpayer information exchange in the face of country behaviour that attempts to circumvent such exchange while acknowledging its positive attributes. On the basis of these examples, Morgan characterizes international tax law as a Ponzi scheme, not in the conventional sense of a financial fraud, but rather in a conceptual sense. In effect, what appears to be a discrete body of law constraining sovereign

23 2006 TCC 460; aff'd. 2007 FCA 236.

24 95 TCM 1430 (2008).

taxing authority is really only a function of the exercise of that authority and is ultimately subject to it.

T.E.

**Australia, Board of Taxation, *Review of the Taxation Treatment of Islamic Finance*, Discussion Paper (Canberra: Board of Taxation, October 2010), 76 pages, ISBN 978-0-642-74640-5**

This discussion paper provides an accessible account of Islamic finance transactions and, more particularly, the taxation issues—income tax, goods and services tax (GST), and stamp duty—presented by these transactions. After providing an overview of the principles of Islamic finance and Australia's finance taxation framework, the discussion paper analyzes the treatment of particular Islamic finance transactions under that framework. The analysis is intended to identify the issues associated with Australia's current approach to the taxation of Islamic finance transactions, with the ultimate goal of ensuring consistency of treatment with conventional financial products assessed in terms of their economic substance rather than their legal form. A final chapter concludes with an overview of the approach to Islamic finance transactions under the tax systems of the United Kingdom, Ireland, South Korea, France, Singapore, Malaysia, and Indonesia.

The discussion paper is intended to provide the basis for a consultative process that will ultimately determine whether consistency of tax treatment can be adequately realized by adjusting existing tax frameworks. The alternative, which is apparently considered less desirable, is the adoption of specific tax provisions tailored to Islamic finance transactions. Although Australia has comprehensive legislation addressing the income tax treatment of financial instruments, including debt-equity classification rules, the issues raised by Islamic finance transactions are much the same as those for other countries with less developed legislative regimes. As a result, readers should find the case studies of Islamic finance transactions instructive, even though they are focused on the application of the Australian system.

T.E.

**Marco Da Rin, Marina Di Giacomo, and Alessandro Sembenelli, "Entrepreneurship, Firm Entry, and the Taxation of Corporate Income: Evidence from Europe"** (2011) 95:9-10 *Journal of Public Economics* 1048-66

In this article, Da Rin et al. study the effects of corporate income tax (CIT) on the rate at which new corporations entered 39 manufacturing and business service industries in 17 European countries between 1997 and 2004, based on the Amadeus data set published by Bureau van Dijk Electronic Publishing. Building on the theoretical model of Cullen and Gordon,[25] the authors note that a lower CIT rate

25 Julie Berry Cullen and Roger H. Gordon, "Taxes and Entrepreneurial Activity: Theory and Evidence for the U.S." (2007) 91:7-8 *Journal of Public Economics* 1479-1505.

has two offsetting effects on the incentive to form new corporations. First, a lower CIT rate encourages entry when income generated in a corporation is taxed at a lower rate than personal income (the income-shifting effect), but discourages formation of corporations because a lower rate reduces risk sharing with the government (the risk-sharing effect). Da Rin et al. argue that this means that changes in the CIT rate will have non-linear effects on the entry rate of new firms and that the risk-sharing effect may dominate the income-shifting effect at high CIT rates.

To assess the impact of the European countries' CIT rates on the entry rates of new firms, Da Rin et al. use the average effective tax rate measure developed by Devereux and Griffith.[26] The data indicate that Austria, Denmark, and the United Kingdom have had consistently high entry rates, while Italy, Luxembourg, the Netherlands, and Portugal have had consistently low entry rates. The econometric results, based on panel data with 4,805 observations, confirm Cullen and Gordon's hypothesis that the effect of the CIT rate on entry is non-linear. For example, Da Rin et al. find that

> [a] reduction of the corporate tax rate from the median (30.04%) to the first quartile (27.57%) implies a 0.880 percentage point increase in the entry rate. A reduction from the third quartile (33.44) to the median implies a 0.270 percentage point increase in the entry rate.[27]

Another interesting observation that emerges from their study is that a reduction in the CIT rate produces a larger increase in the entry rate in countries with "good" accounting standards (such as Austria, France, and the United Kingdom) than in countries with "bad" accounting standards (such as Portugal, Italy, and Greece). They attribute this result to the fact that CIT rate reductions are of less benefit in countries "where it is easier to avoid the tax burden through the manipulation of accounting books."[28]

Canada, presumably, is a country with "good" accounting standards, and therefore CIT rate reductions should be effective in promoting entry. This has been confirmed in unpublished working papers by Beaulieu, McKenzie, and Wen at the University of Calgary[29] and Miyamoto at Queen's University.[30] While most economists emphasize the effect of the positive effect of CIT rate reductions on investment by existing firms, the impact of the recent reductions in federal and provincial CIT rates on entry rates should not be overlooked because the entry of new firms has been found to be very important in promoting improvements in competition, innovation, and productivity.

B.D.

26 Michael P. Devereux and Rachel Griffith, "Taxes and the Location of Production: Evidence from a Panel of US Multinationals" (1998) 68:3 *Journal of Public Economics* 335-67.

27 Da Rin et al., at 1059.

28 Ibid., at 1061.

29 Eugene Beaulieu, Kenneth J. McKenzie, and Jean-Francois Wen, "Factor Taxes and Business Location" (Department of Economics, University of Calgary).

30 Kazuko Miyamoto, *Corporate Tax Rates and the Entry and Exit Decisions of Canadian Firms*, Working Paper (Kingston, ON: Queen's University, Department of Economics, June 2011).

**Roger Colinvaux, "Charity in the 21st Century: Trending Toward Decay"** (2011) 11:1 *Florida Tax Review* 1-71

**Kerrie Sadiq and Catherine Richardson, "Tax Concessions for Charities: Competitive Neutrality, the Tax Base and 'Public Goods' Choice"** (2010) 25:4 *Australian Tax Forum* 597-612

Despite some academic criticism, tax preferences for the charitable sector have always seemed to enjoy broad public support as a means to promote a range of public goods and services that would not otherwise be provided directly by government. Abuse of those tax concessions has historically tended to focus on private foundations and the undertaking of commercial activities directly competing with the for-profit sector. Recent experience in many countries, however, suggests that many of the same abusive practices in the context of private foundations are migrating to the public charitable sector. In-kind contributions and leveraged donations are just one soul-destroying example of this migration, along with a range of governance issues in many public charities.

Colinvaux's article provides an extensive account of recent abuses of charitable status in the United States and the attempts by the IRS and Congress to address some of those abuses. Colinvaux argues that the result has been "a sustained challenge to the longstanding way in which charity is perceived, and ultimately, regulated."[31] With respect to the latter, he suggests that the traditional framework, based on the application of a broad standard for charitable status and a distinction between public charities and private foundations, must be re-examined. Moreover, different regulatory regimes need to be tailored for different tax and non-tax preferences, rather than conferring a range of such preferences on an all-or-nothing basis. For example, quite different standards might be applied for exempt status and tax relief for qualified gifts. Along with an extensive discussion of recent abuses, reform initiatives, and possible directions for future reform, the article provides a fascinating exposition of the historical development of tax preferences in the United States, which Colinvaux characterizes as "open-ended growth."

The Sadiq and Richardson article focuses on the longstanding issue of the participation of charitable organizations in commercial activities competing with the for-profit sector. Unlike the United States and consistent with Canada, Australia does not have an unrelated business income tax that carves out such activities from tax-exempt charitable status. In the absence of such a tax, the issue becomes whether participation in commercial activities taints the charitable purposes of an organization sufficiently to revoke its charitable status. As Sadiq and Richardson observe, this issue has gained particular notoriety in Australia, where, for example, a charitable organization has a 25 percent share of the domestic market for breakfast cereal. They argue that the issue has been incorrectly framed as one of unfair (that is, tax-advantaged) competition by charitable organizations engaged in commercial

31 At 7.

activities. They suggest instead that, given the all-or-nothing consequences associated with an assessment of the relative mix of commercial and non-commercial activities, policy makers should approach the question of charitable status mindful of a necessary balance between, on the one hand, the delivery of public goods and services by the charitable sector and, on the other hand, the negative effect on revenue and the perceived integrity of the tax system itself as a public good. Sadiq and Richardson do not, however, explore the parameters of the regulatory inquiry that would otherwise be implicated by this suggested framing.

T.E.

**Kyle D. Logue and Gustavo G. Vettori, "Narrowing the Gap Through Presumptive Taxation"** (2011) 2:1 *Columbia Journal of Tax Law* 100-49

Because of relatively high administrative and compliance costs associated with the income tax, developing countries often use presumptive taxes, defined broadly as a tax imposed on a readily observable item, as a proxy for another item that is costly to observe. Presumptive taxes are especially attractive as a proxy for taxation of the income of small and medium-sized enterprises (SMEs). With this sector, in particular, any sacrifice in accuracy may be worth the reduction in administration and compliance costs.

This article explores the use of presumptive taxes focused on SMEs in the United States. A unique aspect of the article is probably the fact that Logue and Vettori explicitly borrow from the experience in developing countries to inform experience in a developed country in matters of tax policy design. Indeed, it is rare for US tax literature to examine experience in other countries generally to inform tax policy design, let alone experience in developing countries. The authors explore in some detail the case for, and the design of, an SME tax based on presumed profits not unlike the French forfeit system used in the 1960s and 1970s. Their approach would, however, supplement the traditional design of such a presumptive tax with an extension of withholding to business-to-business transactions as a means to ensure accurate reporting of gross receipts. They also consider alternatives to a presumed profits tax, including the use of presumed profits as an audit strategy of the IRS under the income tax and a VAT. Perhaps most interestingly, there is some discussion of an innovative Brazilian tax credit for consumers as a means to ensure accurate reporting of gross receipts of business-to-consumer transactions under a presumed profits tax.

T.E.

**Harry Clarke, *Some Basic Economics of Carbon Taxes***, CCEP Working Paper 4.10 (Canberra: Australian National University, Crawford School of Economics and Government, Centre for Climate Economics and Policy, October 2010), 21 pages

This paper provides a basic overview of the use of carbon taxes as an instrument in climate policy. It focuses on three issues: (1) Do carbon taxes drive economic and environmental outcomes? (2) Should carbon taxes be levied on an origin or a destination basis? (3) How do carbon taxes compare with an emissions-trading scheme? The discussion of the second topic is particularly important because the potential threat of the diversion of production of carbon-intensive products from mitigating to non-mitigating countries may inhibit countries from adopting carbon tax policies. For this reason, the author favours a destination basis for carbon taxes where exported goods would be exempt from carbon taxes, while border tax adjustments would be levied on imports to equalize their taxation with domestically produced goods. This would avoid the adverse competitive effects that mitigating countries face, and also create an incentive for non-mitigating countries to adopt carbon taxes in order to capture the tax revenues that would otherwise accrue to the importing countries with carbon taxes. In the author's view, the major disadvantage of the destination basis is that carbon-intensive products exported from mitigating to non-mitigating countries would be untaxed, while the border adjustment for exports and imports would be complex, costly to enforce, and potentially subject to abuse.

Carbon taxes and climate change policies have been displaced from the top of the policy agenda of world leaders by the slow recovery from the Great Recession, the fiscal crises in the euro zone, and concerns about the stability of the international banking system. When the international economic system returns to some degree of normality, and governments around the world turn to the problem of raising additional tax revenues to finance their higher debt levels, carbon taxes may be viewed in a more favourable light than they have been in the past.

B.D.

**New Zealand, Inland Revenue, Policy Advice Division, *GST: Business-to-Business Neutrality Across Borders: A Government Discussion Document About GST on Cross-Border Supplies Between Businesses*** (Wellington: Inland Revenue, Policy Advice Division, August 2011), 31 pages (www.ird.govt.nz)

As destination-based consumption taxes, VAT and GST systems refund the tax on inputs paid by exporters and impose the tax on the value of imports. This approach is most workable with the export and import of goods that must pass through customs. The cross-border provision of services, however, has proved more problematic, not with zero-rating of the service provider but rather with the imposition of GST on the consumer in the consumer's jurisdiction. Reverse charging has been used as a workable approach for business-to-business provision of services across borders, but has remained a festering sore with business-to-consumer transactions because of the practical problem of requiring unregistered households to self-assess and remit the tax. An issue with the provision of cross-border services that has not attracted nearly the same attention is business-to-business transactions where the consumer is not resident in the country of the service provider but the consumption of the services occurs in that country. New Zealand has been especially proactive in addressing this issue, as reflected in the release of this discussion document.

The issue with business-to-business transactions is a function of the approach to business-to-consumer transactions. New Zealand is somewhat unique in its approach to the latter, which causes an issue with the former. More particularly, New Zealand is quite comprehensive in defining its jurisdiction to tax business-to-consumer transactions on the basis of consumption occurring in New Zealand. For example, there is very limited provision of GST rebates for tourists, while the sale of tourism packages and education to non-residents outside New Zealand does not result in a loss of jurisdiction to tax if the consumption in fact occurs in New Zealand. Application of this same jurisdictional approach to non-resident businesses means that such businesses incur GST on inputs and may not receive input credits if they have little or no taxable business activity in New Zealand. To the extent that the non-creditable GST cannot be shifted forward to consumers of the non-resident business, the tax on inputs is borne by the business, which may respond by purchasing equivalent inputs in a country other than New Zealand. As the discussion document notes, this behavioural response may be muted by the deduction of the embedded GST as an expense for income tax purposes, but the precise dimensions of such an effect are unknown. An illustrative example cited in the discussion document is the delivery of pilot-training services in New Zealand to a non-resident business where the business does not have significant taxable activities in New Zealand that could otherwise absorb input credits.

As a means to free up input tax credits, the discussion document proposes the introduction of a modified registration system that would not require an affected non-resident business to be making taxable supplies in New Zealand. This policy option is preferred over either a system of zero-rating or the provision of direct refunds. There is considerable discussion of the reasons for this preference and the kinds of integrity measures that would be required to ensure that the looser provision of input credits is not abused.

T.E.

**Yariv Brauner, "Brain Drain Taxation as Development Policy,"**
*St. Louis University Law Journal* (forthcoming)

This article revisits the idea of a tax on the migration of individuals from developing to developed countries first proposed by the trade economist Jagdish Bhagwati almost 40 years ago. Given the contentiousness in the economic literature over the dimensions of the migration pattern and its associated properties, Brauner asserts that a tax focused on the brain drain can be defended as a tool of development policy. The article begins with a review of both the relevant empirical literature and the subsequent literature developing Bhagwati's original idea for such a tax. Brauner then describes the broad design features of his version of the tax, which involve host countries agreeing to cede tax jurisdiction to home countries and providing collection and enforcement services. Perhaps most importantly, he links the imposition of the tax with its use by developing countries. In particular, he argues that an earmarked tax delivered in support of micro projects at the local level would be consistent with the new development policy agenda.

T.E.

**Ross Finnie and Ian Irvine, "The Redistributional Impact of Canada's Employment Insurance Program, 1992-2002"**
(2011) 37:2 *Canadian Public Policy* 201-18

During the last decade, Canada's employment insurance (EI) program has not been at the top of the policy agenda, in part because the unemployment rate declined from an average of 9.45 percent in the 1980s and 1990s to 6.9 percent over the 2000-2007 period. However, the increase in the unemployment rate during the Great Recession and the potential for slower growth and higher unemployment rates in the coming decade make the reassessment of the EI program especially timely. Finnie and Irvine focus on the distributional impact of the changes to eligibility, benefits, and contributions to the EI program in 1992, 1996, and 2002, using Statistics Canada's Longitudinal Administrative Database (LAD), which is based on a 20 percent sample of Canadian tax filers.

The authors' analysis indicates that the EI program has been an important component of Canada's social safety net, although the program has benefited a lower proportion of Canadian workers over time. Between 1992 and 2002, the share of the adult population receiving EI benefits declined from 26.0 percent to 16.3 percent. (Part of this decline was due to the reduction in the unemployment rate.) Overall, the EI program has been redistributive, with 44 percent of the EI benefits going to the 20 percent of individuals with the lowest annual incomes, and the top three deciles contributing 50 percent of the premiums. However, the EI program has become somewhat less redistributive over time. In 1992, benefits exceeded contributions (including the employer contribution) for families in the first six deciles of the income distribution. By 2002, benefits exceeded contributions only in the bottom three deciles, and the families in the sixth decile made a net contribution of $428 million. The reduction in the number of net beneficiaries was mainly due to the excess of contributions over benefits, with the EI fund running a surplus.

The overall impact of the EI program has been broadly redistributive, reducing income inequality by 1.5 percent in 1992; but by 2002, its contribution to the reduction in income inequality had declined to 0.5 percent. Part of the decline in the redistributive impact of the program was due to the freezing of the maximum insurable earnings at $39,000 from 1996 to 2002, combined with the decline in contribution rates. As a result, the share of total contributions made by the top three income deciles declined from 52 percent in 1992 to 46 percent in 2002. These changes in the redistributive impact of EI may be interpreted as moving it more toward an insurance-based program, with less emphasis on its role as an income redistribution program.

Now that the LAD database has been updated to 2008, it is hoped that Finnie and Irvine or other researchers can provide more recent measures of the redistributive impact of the EI program.

B.D.