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# Current Tax Reading

Co-Editors: Bev Dahlby, Tim Edgar, Jinyan Li, and Alan Macnaughton*

**Samuel D. Brunson, *The U.S. as Tax Haven? Aiding Developing Countries by Revoking the Revenue Rule*, Loyola University Chicago School of Law, Public Law & Legal Theory Research Paper no. 2013-013** (Chicago: Loyola University Chicago, November 2013), 51 pages (papers.ssrn.com/sol3/papers.cfm?abstract_id=2351562)

The author of this paper describes the United States as a tax haven and challenges it to help developing countries by ceasing to be one.

According the author, several tax rules make the United States an attractive place for foreigners to invest and hide their money. These rules include the zero withholding tax rate on portfolio interest payments to non-residents and the non-taxation of capital gains realized by non-residents who dispose of financial assets in the United States. But the principal rule is the revenue rule, which prohibits the United States from recognizing and enforcing foreign tax judgments. Under this rule, if a foreigner hides money in the United States and fails to pay taxes at home, her government cannot satisfy the tax debt with the taxpayer's US assets. The hidden money disparately affects developing countries. The United States has functioned as a repository for foreign assets. For example, by 2011 about $240 billion in Latin American wealth found its way into the United States, ending up primarily in Miami and New York. In 2009, the United States topped the list of countries that served as homes for private foreign deposits.[1]

The author notes an interesting phenomenon: while the United States causes foreign governments to lose tax revenue because their taxpayers use it as a tax haven, the United States is also the victim of an estimated $40 to $70 billion loss in tax revenue because American taxpayers use offshore tax havens.[2] The United States has attempted to combat the use of tax havens through unilateral measures, such as the Foreign Account Tax Compliance Act (FATCA) and bilateral information exchange agreements, and through multilateral efforts spearheaded by the Organisation for

* Bev Dahlby is a distinguished fellow, the School of Public Policy, University of Calgary. Tim Edgar is of Osgoode Hall Law School, York University, and the Faculty of Law, the University of Sydney. Jinyan Li is of Osgoode Hall Law School, York University. Alan Macnaughton is of the School of Accounting and Finance, University of Waterloo. The initials below each review identify the author of the review.

1 At 9-10.

2 At 3.

Economic Co-operation on Development (OECD), and it does not seem to mind practising economic imperialism. In contrast, the United States chose to do nothing about the fiscal damage to other countries; it does not want to enforce foreign revenue judgments because it does not want to impinge on foreign sovereignty and risk being seen as practising economic imperialism.

The author argues that the revenue rule is not grounded in any compelling policy considerations. It stands in stark contrast to the general default rule that US courts will enforce foreign final judgments. According to the author, the United States should revoke the revenue rule, both from a moral obligation to aid developing economies in becoming self-sufficient and from a practical desire to receive reciprocal aid in collecting taxes that are being held overseas.

J.L.

**Itai Grinberg, "Taxing Capital Income in Emerging Countries: Will FATCA Open the Door?"** (2013) 5:3 *World Tax Journal* 325-67

Capital income is inherently mobile. Taxing capital income is very difficult, especially for developing countries. The author of this article sees the emerging international information exchange regime, triggered by FATCA, as an opportunity for emerging countries to have the means of taxing capital income earned by their residents.

The author first provides an overview of FATCA, which was enacted by the United States to address its concerns about tax evasion by US taxpayers who hold assets in accounts with foreign financial institutions. FATCA requires foreign financial institutions to report the account balance or value of each US account and the amount of dividends, interest, other income, and gross proceeds from the sale of property credited to a US account. A US account is one held by US individuals and shell entities owned by US individuals. In order to force foreign financial institutions to disclose their US account holders or pay a steep penalty for non-disclosure, FATCA imposes a withholding tax on specified payments from US sources and the proceeds from disposing of certain US investments on foreign financial institutions that do not comply by becoming a participating foreign financial institution. The United States used the combined weight of its financial markets and the need of financial institutions to do business in the United States as leverage to ensure that foreign financial institutions comply with FATCA reporting requirements. The desire to obtain tax information from foreign financial institutions is shared by many other countries, but none has the clout enjoyed by the United States.

In part I of the article, the author explains that compliance with the unilateral law of the United States was problematic for foreign financial institutions because they had to choose between violating FATCA and violating their domestic laws that protect bank secrecy. This problem was resolved with a model intergovernmental agreement (model I IGA) developed by the United States and some EU countries (France, Germany, Italy, Spain, and the United Kingdom) on the basis of reciprocal automatic information exchange between governments. According to the article, "[a] number of technical features of the Model I IGA agreement are structured to allow FATCA to become a global model."[3] However, one of the obstacles blocking model I IGA from becoming a global model was the United States itself. The model I IGA provides for only partial reciprocity between the United States and its partners: the US obligation to report is limited to those types of accounts on which the United States has authority to collect information under current US laws and regulations, whereas its partners are required to collect information on all income earned through financial accounts that are held by the US persons specified by FATCA. Therefore, when the United States and Switzerland agreed to facilitate FATCA compliance, the reciprocal automatic information exchange between governments was modified. It provided for direct reporting by Swiss financial institutions to the Internal Revenue Service (IRS), with consenting US account holders reported on individually and non-consenting US account holders reported on an aggregate basis. Switzerland then agreed to provide information exchange on request about ascertainable groups of non-consenting US account holders. This model is referred to in the article as "Model II IGA." In part I of the article, the author argues that the recent trends in addressing offshore accounts may produce a fragmented automatic information reporting system that benefits only a limited number of developed economies.

In part II of the article, the author argues that only a uniform multilateral automatic information exchange regime can benefit emerging countries because these countries lack sufficient independent leverage over multinational financial institutions to address their offshore tax-evasion concerns. And, interestingly, such a regime also benefits financial institutions. Major multinational financial institutions have emphasized their desire for a universal model to implement FATCA, including consistent compliance requirements and reporting frameworks.

In part III, the author notes the recent global developments in creating a single global model for automatic tax information exchange and attributes them to FATCA: "FACTA is a catalyst that forces the world to search for something better than FATCA itself, which can effectively replace it while also addressing the underlying policy concerns."[4] In part III, the author maintains that a uniform multilateral automatic tax information exchange regime is a subset of international financial law. A regime that could be useful to emerging countries will materialize only if the G20 plays an agenda-setting role and the OECD provides the technical expertise. The author suggests steps that emerging countries may take in bilateral and multilateral settings to help create the requisite governance structure.

J.L.

3 At 333.

4 At 352.

**Christine Neill, *What You Don't Know Can't Help You: Lessons of Behavioural Economics for Tax-Based Student Aid*,** C.D. Howe Institute Commentary no. 393 (Toronto: C.D. Howe Institute, November 2013), 22 pages

Tuition, education, and textbook credits (student credits) are an important part of student aid. Neill's calculations show that the tax savings for a full-time university student amount to more than $2,000 per year in all provinces except Ontario and British Columbia; these savings amount to 31 to 43 percent for an average $6,000 tuition fee.[5] Neill implies that the size of these savings is fully justified by the goal of economic efficiency because of the spillover benefits of education to society and students' inability to finance their educational investments by borrowing (since investments in education, unlike investments in a house or a factory, do not result in something that can be sold). Nevertheless, Neill concludes that the current system of student credits is "one of the least effective and least equitable ways of achieving those aims."[6]

One reform would be to make these credits refundable so that they could be used immediately by the low-income students who need them the most. However, although it is well known that the major barrier to refundability is revenue cost, Neill chooses not to investigate this issue, commenting only that "[t]his cost would be fairly minor, however, and [would] only last for a few years at the most."[7]

Neill's bigger point is that behavioural economics research suggests that the whole concept of delivering student benefits through tax credits is inappropriate because it is unlikely to increase enrolment from youth in low- to middle-income families. One reason is that it is difficult to determine tuition credits net of the tax savings benefits; even tax practitioners would probably not know that the total federal and provincial tax savings from student credits is highest in Alberta ($2,596) and lowest in British Columbia ($1,843).[8] In addition, the delay in receiving the cash payment (often longer than six months after tuition fees have been paid, and much longer than that if neither the student nor the student's parents can use the credit in the current tax year) makes tax credits worth less in present value terms. Low- and middle-income students are likely to use especially high discount factors in evaluating future benefits. Further, much of the student credits go to high-income families, and students from these families are unlikely to change their education enrolment plans on the basis of the credits.

What then is the alternative? Neill looks favourably on the Quebec government's choice to reduce the tuition tax credit rate from 20 to 8 percent, with the savings going to increase provincial student aid. Neill also suggests considering having the government make direct deposits into registered educational savings plans for 14- to 17-year-old high school students.

A.M.

5 At 4, table 1.

6 At 18.

7 At 19.

8 At 4, table 1. The figures are for the 2012 tax year.

**Edward J. McCaffery, *Behavioral Economics and the Law: Tax*, Center for Law and Social Science Research Paper Series no. CLASS13-1** (Los Angeles: University of Southern California, Gould School of Law, September 2013), 36 pages (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2326772) (forthcoming in Doron Teichman and Eyal Zamir, eds., *Oxford Handbook of Behavioral Law & Economics*)

The theme of behavioural economics is that decision makers often fail to be rational in the economic sense; for example, they show biases and inconsistencies in their thought patterns. However, the effects of this non-rational behaviour are reduced in the case of privately purchased goods because the goods are purchased in competitive markets. Although it would not be difficult for an individual seller to trick many consumers into thinking that a fair price is quite a bit higher than it is in reality, competition in markets drives the price down and reduces the impact of these seller-induced biases. Effectively, markets give power to the few who are not fooled.

McCaffery emphasizes that there is no such de-biasing mechanism in tax and public finance, and therefore the lessons of behavioural economics should be more powerful in this arena than in the case of privately purchased goods. For example, one study found that consumers fail to appropriately reduce their consumption of a good that is subject to a tax imposed at the cash register, even when information about the added tax is widely available.[9]

Unfortunately, few studies currently apply the principles of behavioural economics to public finance. Thus, McCaffery devotes much of his paper to speculations about how behavioural economics could explain the self-created "fiscal cliff" crisis in the United States, and the general problem that in many countries political processes consistently lead to government revenues falling below government expenditures.

A.M.

**Joint Committee on Taxation of the Canadian Bar Association and Chartered Professional Accountants of Canada, "Re: Draft Legislative Proposal Released by the Department of Finance on June 3, 2013,"** submission to Brian Ernewein, General Director, Tax Policy Branch, Tax Legislation Division, Department of Finance, December 2, 2013, 9 pages

Joint committee submissions are often of ephemeral interest since the comments typically concern technical fixes to legislation that are of minor importance for most taxpayers and do not raise broad policy issues. However, this submission is an exception.

In the 2013 budget, the government proposed taxing all testamentary trusts at the top marginal rate and taxing estates at that rate after the first 36 months of administration, essentially eliminating the tax advantage that testamentary trusts and estates

9 Raj Chetty, Adam Looney, and Kory Kroft, "Salience and Taxation: Theory and Evidence" (2009) 99:4 *American Economic Review* 1145-77.

enjoyed over inter vivos trusts. The committee rejects this proposal, arguing that it will cause taxpayers to hurry property through a trust or estate for tax reasons and thereby frustrate non-tax objectives (for example, in the case of a testamentary trust that lasts until a young adult beneficiary is able to manage the assets). The committee prefers the status quo, but, if something has to be done, it favours an amendment to the principal beneficiary exemption to solve the testamentary trust issue and a generally worded anti-avoidance rule for estates in place of the 36-month bright line.

The submission contains much valuable information on the purpose of a testamentary trust, the history of the taxation of trusts (including a review of the Carter commission's analysis from 1965), and the application of the tax policy principle of neutrality to trusts and estates. It was surprising that the government did not include this sort of valuable background material in the budget or in its woefully short June 3, 2013 consultation paper, which consisted of fewer than 2,000 words.[10]

A.M.

**Omri Marian, "Are Cryptocurrencies Super Tax Havens?"** (2013) 112 *Michigan Law Review First Impressions*[11] 38-48

Cryptocurrencies are a subcategory of virtual currencies. One type of virtual currency that is getting a lot of attention is Bitcoin. Bitcoin functions as a unique currency with its own free-floating exchange. Over the past few years, Bitcoin gradually gained the confidence of consumers, retailers, and service providers, and it is now effectively functioning as a currency in the real world. In August 2013, Germany officially recognized Bitcoin as a legal form of tender. Other countries, such as Canada, China, and the United States do not officially recognize Bitcoin as a legal form of tender but recognize its use in the private sector. Recently, a US federal judge ruled that Bitcoin is money for the purposes of US securities regulation.

In this article, the author links the increasing popularity of cryptocurrencies to the ongoing debate about international tax evasion and fraud through the use of tax havens. The author maintains that cryptocurrencies have the potential of functioning as "super tax havens." They not only possess the traditional characteristics of tax havens (non-taxation of income and anonymity of taxpayers) but also offer an additional advantage to their users: their operation is not dependent on the existence of financial institutions. Any anti-evasion and anti-avoidance measures that depend on financial institutions for information reporting or withholding of taxes would be rendered ineffective.

10 Canada, Department of Finance, *Consultation on Eliminating Graduated Rate Taxation of Trusts and Certain Estates* (Ottawa: Department of Finance, June 3, 2013).

11 *Michigan Law Review First Impressions* is an online companion to the *Michigan Law Review*, and publishes op-ed-length articles by academics, judges, and practitioners in an online symposium format.

The author discusses the convergence of two processes: the increasing popularity of Bitcoin and an emerging global process requiring financial institutions to become "agents in the service of tax authorities."[12] The latter process was triggered by the US FATCA initiative. Financial institutions "face increased governmental pressure to deliver information about account holders, to withhold taxes from earnings accumulating in financial accounts, and to remit these taxes to taxing authorities around the world."[13] Examples include the actions taken by G7 governments against financial institutions as part of recent attempts to tax offshore accounts. The author observes that cryptocurrencies can defeat the development of a meaningful global tax enforcement regime. In light of the fact that Bitcoin can be used by legitimate businesses as well as illegitimate businesses, Bitcoin-based tax evasion may soon become a real problem. Tax evaders and money launderers can use Bitcoin to hide the sources as well as the destination of funds.

The author urges tax policy makers to take cryptocurrency-based tax problems seriously because the use of Bitcoin is not limited to virtual transactions; Bitcoin is increasingly used as real money to purchase real goods and services in the real world. Indeed, the growth potential for cryptocurrencies and super tax havens is, in theory at least, infinite. Governments are urged to develop enforcement mechanisms that allow tax authorities to discover funds hidden in cryptocurrency accounts.

J.L.

**Joshua D. Blank, *United States National Report on Tax Privacy*, New York University School of Law, Public Law & Legal Theory Research Paper Series Working Paper no. 13-76** (New York: New York University School of Law, November 2013) , 28 pages (papers.ssrn.com/sol3/papers.cfm?abstract_id=2348668)

Is public shaming or tax privacy more effective in encouraging tax compliance and deterring non-compliance? The author of *United States National Report on Tax Privacy* describes the current US tax privacy protections, provides an overview of the policy debates over whether tax privacy promotes individual tax compliance, and advances a new ground for supporting tax privacy.

The author traces the interesting history of the current US tax privacy rules, which prohibit the government from publicly releasing the details of any specific taxpayer's tax return or audit history unless the taxpayer consents. In 1862, when the US Congress first instituted income tax to pay for the Civil War, it required the names of taxpayers and their tax liabilities to be open to public inspection. When public support for income tax waned after the war, Congress prohibited the publication of income tax return information in 1870, just before the repeal of the income tax itself.

12 At 39.

13 At 39.

When income tax was reintroduced in 1913, tax returns were public. The press gave extensive coverage to tax return information, especially information concerning prominent people (such as J.D. Rockefeller, Henry Ford, J.P. Morgan, and Charles M. Schwab) and Hollywood icons (such as Douglas Fairbanks, Charlie Chaplin, and Gloria Swanson). Secretary Andrew Mellon and President Calvin Coolidge vigorously opposed the publication of tax return information. In 1926, Congress enacted a new statute, requiring the publication of lists of names and addresses but not tax liabilities. The stock market crash and Great Depression of 1929 caused Congress to consider public access to income tax returns once again as a way of preventing tax evasion and the exploitation of tax loopholes. In 1934, the law required pink slips (containing the taxpayer's name, address, total gross income, total deductions, net income, total credits, and tax liability) to be open to public inspection. This law was repealed the next year following a surge of public outcry. President Nixon apparently requested tax audits of political opponents and members of his enemies list, but the commissioner of the IRS refused to comply. In response to abuses that occurred during the Nixon administration, the current privacy law was enacted.

The IRS is authorized to share a taxpayer's information in certain circumstances; it may, for example, share this information with state tax authorities and foreign tax authorities pursuant to a tax treaty. It is also authorized to publicize examples of strong tax enforcement against specific taxpayers. With the help of the news media, the IRS is able to inflate taxpayers' perceptions of two principal motivators for deterrence: the probability of detection and the costs of non-compliance. Without tax privacy, examples of weak tax enforcement against specific taxpayers would surface and have the opposite effect on individuals' perceptions and tax compliance decisions. According to the author of the report, strategic publicity, a function of tax privacy, may also enable the government to increase confidence among compliant taxpayers that only a few of their fellow taxpayers cheat and that all cheaters face dire consequences.

It is beyond the scope of the report to discuss the recent global efforts in enhancing tax transparency. Readers of the report may wonder if this recent development would tip the balance of the debates toward more public access to taxpayer information, especially if the taxpayer is a multinational corporation.

J.L.

**European Commission, *Amended Proposal for a Regulation of the European Parliament and of the Council Establishing an Action Programme for Taxation in the European Union for the Period 2014-2020 (Fiscalis 2020) and Repealing Decision No. 1482/2007/EC*, COM(2012) 465 final** (Brussels: European Commission, 2012), 38 pages (http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/fiscalis_programme/fiscus/index_en.htm)

On October 16, 2013, the European Parliament released an amended text of a proposal for a regulation establishing an action program to improve the operation of taxation systems in the European Union from 2014 to 2020 (commonly known as "fiscalis 2020"). The proposed fiscalis 2020 is intended to provide mechanisms, means, and the funding necessary to improve cooperation among tax administrations in the European Union. It is a continuation of the annual action program for taxation that contributed to facilitating and enhancing cooperation between tax authorities within the European Union. With a budget of €234.3 million, the program will run for seven years, beginning January 1, 2014.

The program will support a common highly secured dedicated communication network to allow the exchange of information. The common network interconnects national tax administrations from approximately 5,000 connection points. A national tax administration needs to connect once to this network to be able to exchange any kind of information. Furthermore, fiscalis 2020 allows for agreements to be concluded with third countries, allowing them to use the EU components of the information systems to support a secure exchange of information between themselves and EU member states in bilateral tax agreements.

Similar to FATCA in the United Sates, fiscalis 2020 also focuses on supporting the fight against tax fraud, tax evasion, and tax avoidance. In addition, it aims at reducing administrative burdens for tax administrations and compliance costs for taxpayers. To achieve these objectives, fiscalis 2020 will facilitate networking, joint actions, and training among tax personnel and fund technological systems to support the exchange of information among tax administrations.

Fiscalis 2020 is an ambitious program. It is an important step in creating an international regime that enables national tax authorities to share tax information and cooperate with one another in enforcing national tax laws, EU tax laws, and tax treaties.

J.L.

**International Bar Association, *Tax Abuses, Poverty and Human Rights: A report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights*** (London: International Bar Association, 2013), 268 pages (www.ibanet.org/Article/Detail.aspx?ArticleUid=4a0cf930-a0d1-4784-8d09-f588dcddfea4)

In this report, the International Bar Association Task Force addresses international tax abuse from the perspective of human rights law, focusing on illicit financial flows, poverty, and human rights.

The report contains two explanations for the recent public spotlight on tax abuses. One is the sheer magnitude of the issue: tax abuses are thought to cause the most significant illicit financial flow out of the developing world, eclipsing the amount of official development aid. Another explanation involves an ethical dilemma: sophisticated tax-planning strategies result in individuals and corporations not paying their fair share of tax. The task force states:

> Especially in a context of persistent poverty and rising inequality between and within nations, the fact that tax strategies that produce unfair results may be technically legal is no longer a sufficient justification for their continued use. Wealthy individuals and

> multinational enterprises face increased risks of public censure if their tax practices are seen to be abusive.[14]

According to the task force, the term "tax abuses" describes tax behaviour that

> (a) was of greatest concern to stakeholders interviewed; and (b) potentially has the most significant impacts on the ability of developing countries to reduce poverty and satisfy basic human rights recognised by the International Covenant on Economic, Social and Cultural Rights. They include tax evasion, tax fraud and other illegal practices—including the tax losses resulting from other illicit financial flows such as bribery, corruption and money laundering.[15]

In addition, the task force seems to regard the following behaviour as abusive:

- Corporate profit-shifting, especially transfer mispricing.
- Lobbying by businesses and elites for tax holidays and exemptions.
- Inadequate taxation of natural resources.
- The use of offshore investment accounts.[16]

On the basis of extensive consultation with people of diverse perspectives, the task force concludes that there is a link between tax abuse, poverty, and human rights. Multinational enterprises that engage in tax abuse (specifically, illegal tax evasion and aggressive tax avoidance) as well as governments that fail to take steps to curb these practices may be violating international human rights. The task force states, "Simply put, tax abuses deprive governments of the resources required to provide the programmes that give effect to economic, social and cultural rights, and to create and strengthen the institutions that uphold civil and political rights."[17]

The task force also comments, "Actions of states that encourage or facilitate tax abuses, or that deliberately frustrate the efforts of other states to counter tax abuses, could constitute a violation of their international human rights obligations, particularly with respect to economic, social and cultural rights."[18] The task force cites offshore tax havens with strong banking secrecy as facilitators of human rights violations.

> Lawyers have a special role in addressing tax abuses. . . . Merely complying with tax law is not enough when this results in the violation of human rights. Responsibility for human rights includes situations where lawyers are associated with third parties' actions that violate human rights—including by their clients. In such situations, lawyers

14 At 1.

15 At 24-25.

16 At 26.

17 At 93.

18 At 148.

> should use their influence and leverage to encourage their client to not engage in that conduct.[19]

The task force recognizes that few human rights mechanisms can deal effectively with tax abuses. However, several United Nations mechanisms have the mandate and potential to articulate the links between tax abuses, poverty, and human rights on an authoritative basis. The task force suggests that a human rights perspective on the debate about tax abuses is important for developing coherent international standards and good practices for states, multinational enterprises, and their advisers and financiers.

This perspective will surely generate some interesting debate about tax abuse and the future development of international tax systems.

J.L.

**Richard Gordon and Andrew P. Morriss, "Moving Money: International Financial Flows, Taxes, & Money Laundering,"** *Hastings International and Comparative Law Review* (forthcoming)

The authors of this forthcoming article present an interesting perspective on the debate about tax evasion and tax abuse. They challenge the allegations by political leaders and others that offshore financial centres enable multinational enterprises to avoid paying their fair share of taxes, resulting in $21 to $32 trillion being hidden and untaxed. The authors argue that these allegations rest on poor data and analysis and on profound misunderstandings of how financial transactions, international taxation, and anti-money-laundering rules actually work. They advise against increasing regulation without considering its cost and effectiveness.

According to the authors, policy makers view international money movements on a continuum: at one end are those who believe that these movements are illegitimate unless subject to strict public control; at the other end are those who believe that international money movements reflect the legitimate workings of the market and need no public controls; and in the middle are those who acknowledge that some public control is necessary to prevent abuse. In the view of the authors, much current commentary and actual public policy is too close to the end of the spectrum that advocates strict public control; they believe that international trade and investment is a public good and that keeping transaction costs when moving money is also a public good. Any control must be judged by its costs in relation to market efficiency and benefits.

The authors maintain that globalized finance inevitably allows for tax planning, which reduces the transaction costs of doing business across borders and limits tax revenue. They also acknowledge that globalized finance provides financial privacy, which is desirable in its own right as well as being a means of encouraging additional

19 At 4.

wealth creation. They believe that governments should act as "forward-looking gardeners," whose main concern is not maintaining a fence to keep out marauders but rather improving the water supply, enhancing the fertility of the soil, and keeping a proper balance of sun and shade.

The authors explain that the global financial network is complex, serving legitimate as well as illegitimate purposes. The international tax system is also complex. Any international tax reform debate should be based on realistic cost-benefit appraisals and tradeoffs imposed by actual conditions rather than simplistic world views. One such actual condition is tax sovereignty.

J.L.

**Sunita Jorgarajan, "Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation"** (2013) 5:3 *World Tax Journal* 368-91

The 1923 League of Nations report by the "four wise men"[20] is well known to anyone who is involved in international taxation. However, there has not been much literature on the background and intellectual debates that surrounded the writing of the report. This article fills that void. Its chronological narrative highlights the views of two of the report's lead authors (Stamp and Seligman), the considerations that influenced each of them, and the compromises that were eventually reflected in the report itself. The author points out that even though the report has been credited with providing the theoretical foundation of the current international tax system, Stamp and Seligman considered practical issues and the likely inertness of economic forces in writing the report.

J.L.

**Calvin H. Johnson, "Ordinary Medical Expenses"**
(2013) 141:7 *Tax Notes* 773-80

Many observers have noted that both the Canadian and US tax systems treat employer-paid medical expenses and personally paid medical expenses inequitably; the latter are deductible only to the extent that they exceed a threshold (in Canada, the lesser of a dollar amount and 3 percent of income), while the former are completely non-taxable (in the case of private health services plans).

The standard proposal for correcting this problem is the elimination of the threshold from the medical credit. Johnson prefers to leave the threshold in place, apparently on the basis that smaller amounts of medical expenses are more likely to be voluntary expenses and thus less deserving of tax relief. Instead, Johnson proposes that employer-paid medical expenses should be non-taxable only if they are above the threshold. Similarly, employer-paid health insurance premiums should be a

20 Bruins, Einaudi, Seligman, and Stamp. See League of Nations, Economic and Financial Commission, *Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, League of Nations document no. E.F.S.73.F.19 (Geneva: League of Nations, 1923).

non-taxable benefit only if an insurer covered expenses above the threshold. Implementing this proposal in Canada would be more complicated than implementing it in the United States since either spouse can claim the couple's medical expenses in Canada. Which spouse's threshold should be used in determining non-taxability?

A.M.

**Pierre LeBlanc, Stephen Matthews, and Kirsti Mellbye, *The Tax Policy Landscape Five Years After the Crisis*, OECD Taxation Working Papers no. 17** (Paris: OECD, 2013), 45 pages

This paper by staff economists at the OECD provides a valuable perspective on the recent economic crisis and its aftermath, with particular attention on tax policy.

It is well known that the initial economic contraction of late 2008 and early 2009 moved rapidly throughout the OECD countries and the rest of the world in the form of a fall in international trade, and that economic recovery has been slow. These patterns reflect the growing interconnectedness of economies. Further evidence of this interconnectedness is provided in the trends in budget deficits and public debt documented in this paper. Deficits as a percentage of gross domestic product (GDP) are still far larger than their pre-crisis levels in almost all countries. Another general pattern is that public debt in relation to GDP has increased dramatically in recent years, with the figure for all OECD countries increasing from 73 percent in 2007 to a projected 113 percent in 2014. Both of these combined trends are observable in Canada. In particular, Canada was almost alone in having a budget surplus in 2007 (over 1 percent of GDP) but has subsequently fallen into substantial deficit (over 2 percent of GDP).[21]

Another OECD-wide trend is that total tax revenue as a percentage of GDP has fallen from 2007 to 2011, largely as a result of a decline in taxes on income and profits: 1.2 percent for all OECD countries combined and 2.0 percent for Canada in particular.[22] Subsequently, however, most countries increased tax burdens, leading to the austerity fatigue being felt in a number of countries. Canada is the exception because general government revenues as a percentage of GDP are expected to be lower in 2014 than in 2007.[23] Nevertheless, Canada has followed the OECD pattern of increasing top personal income tax rates, although to a more modest degree than in most countries.

The authors note an unusual pattern in Canada regarding real (inflation-adjusted) house prices; these prices have fallen in most countries but have risen in Canada. Of the 20 OECD countries studied, Canada has the second highest average annual percentage change in real house prices (2004 to 2007 compared with 2008 to 2011).[24]

21 At 11, figure 3.

22 At 16, table 3.

23 At 15, table 2.

24 At 33, figure 19.

Another unusual fact about Canada is its low rate of environmental taxes: the average effective tax rate on carbon dioxide emissions is the third lowest among the 33 countries studied.[25] Although the authors do not make this connection, these two facts suggest that one of the paper's recommendations about tax policy would apply with particular force to Canada: greater use of environmental taxes and recurrent taxes on residential property could increase taxation in a way that would provide relatively little economic distortion.[26] The reason for this lack of distortion with environmental taxes is that the taxes correct environmental externalities (for example, local air pollution as well as the worldwide effect on the level of greenhouse gases), while the similar reason with residential property tax is that the tax base may be less mobile internationally.

The authors note a wide divergence in environmental tax rates among countries, with Mexico, Canada, and the United States, all having rates of less than €10 per tonne of carbon dioxide, while the unweighted average of OECD countries is over €50 per tonne.[27] Further, there is no indication of any trend toward convergence of effective tax rates. The authors suggest that the financial crisis may have diverted the attention of some countries away from the need to address climate change.[28] Although the authors are too diplomatic to say so, coordinated North American action in this area over the next few years would be welcomed by most OECD countries.

A.M.

**Michelle Harding, *Taxation of Dividend, Interest, and Capital Gain Income*, OECD Taxation Working Papers no. 19** (Paris: OECD, 2013), 57 pages

This paper, by an OECD staff member, provides a quantitative comparison of the tax burden on four different types of capital income in the 34 OECD countries as of July 1, 2012. This information is difficult to get because it often requires consultation with the individual governments to ensure that fair comparisons are being made. The fact that this paper is an OECD publication suggests that the information is reliable. The four types of income and the key results for each (including Canada's ranking in tax burden) are listed below.

1. *Equity investment in a domestic public company with the return flowed out to shareholders as dividends:* Canada has a tax rate of 50 percent, which is 8th highest of 34.[29] Rates for OECD countries vary from 19 percent in the Slovak Republic to 61 percent in France, with an OECD simple average of 42 percent.[30]

25 At 35, figure 21.

26 At 36.

27 At 35, figure 21.

28 At 34.

29 At 45, table 16.

30 At 7.

The calculation involves both corporate tax on income and personal tax on dividends.

2. *Equity investment in a domestic public company with the return accumulated as retained earnings and received by shareholders as a capital gain:* Canada has a tax rate of 44 percent, which is 13th highest of 34.[31] Rates for OECD countries vary from 8 percent in Belgium to 60 percent in France, with an OECD simple average of 37 percent.[32] The calculation involves both corporate tax on income and personal tax on capital gains.
3. *Interest income from cash deposits and government bonds:* Canada has a tax rate of 48 percent, which is 2nd highest of 34.[33] Rates for OECD countries vary from 0 percent in Estonia to 50 percent in the United Kingdom, with an OECD simple average of 27 percent.[34]
4. *Capital gains realized on real property:* Canada has a tax rate of 24 percent, which is 13th highest of 34.[35] Rates in OECD countries range from 0 percent in many countries (including France and Germany) to 45 percent in Denmark, with an OECD simple average of 14 percent.[36]

The above data show that Canada's tax rate rankings tend to be high in relation to other OECD countries, with the tax rate on interest income being particularly notable. This reflects Canada's relatively high reliance on personal income tax as a source of revenue, when compared with other OECD countries. It would be interesting to compare the above results with rankings for tax rates on labour income.

Predictably, many assumptions are required to ensure that that the results are comparable across countries (fewer assumptions would probably be required to make a comparison among two or three countries). Generally, the authors compare the most basic type of income because more sophisticated types will generally have additional rules. The following are the key assumptions: only income taxes (not wealth taxes) are considered; the investor is resident in a particular country and is not related to the source of income; financial assets are held outside tax-preferred accounts (such as registered retirement savings plans); investors are taxable at the top of any progressive rate scale; and inflation adjustments (to tax only real gains) are not considered.[37] For the two types of income that involve capital gains, the underlying asset is assumed to have been held for longer than the longest holding period specified in the country's legislation. This last assumption tends to reduce

31 At 45, table 16.

32 At 29.

33 At 45, table 16.

34 At 22.

35 At 45, table 16.

36 At 31.

37 At 5-6.

the calculated tax rates because assets held for longer than the time specified in a holding-period test are usually exempt from taxation.[38]

Much of the paper is devoted to a description of the different tax systems that are applied in the 34 OECD countries to the four types of income. This description is not simply a list of countries and an overview of their tax systems; instead, the author analyzes the possible forms of taxation for each type of income and lists the countries that have these forms of taxation. It becomes apparent that Canada's system for taxing dividends is most similar to Korea's because the tax credit at the shareholder level is not dependent on the corporate tax paid, and that Canada's system of including 50 percent of capital gains as regular income is most similar to Australia's.

The variety of tax systems in the 34 countries is an eye-opener. Readers who have practised only within the Canadian system will have much to learn simply from the author's descriptions.

A.M.

38 At 33.