Current Tax Reading

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New Zealand Tax Review Committee, *Issues Paper* (Wellington: Tax Review Committee, June 2001), 215 pages. Available on the Web at http://www.taxreview2001.govt.nz.

New Zealand Tax Review Committee, *Tax Review 2001: Final Report* (Wellington: Tax Review Committee, October 2001), 169 pages, ISBN 0478-11819-8. Available on the Web at http://www.taxreview2001.govt.nz.

On August 1, 2000, the New Zealand minister of finance announced the government's intention to establish an independent review of the tax system, with the ultimate goal of developing policy initiatives to be put before the electorate in 2002. After receiving submissions from interested members of the public, the five-member review committee released a preliminary report in June 2001 ("the issues paper"). This report, which describes in some detail the thinking of the committee on a broad range of issues, formed the basis for further submissions before release of the committee's final report ("the final report") in October 2001. For the most part, the final report does not deviate markedly from the policy directions suggested in the issues paper. In general, the New Zealand tax system gets high marks. In particular, its principal structural features are considered sound and in no need of radical reform. The committee prefers, instead, a path of incremental reform in the directions it suggests in the final report. Some of its recommendations can be fairly characterized, however, as significant departures from the status quo in New Zealand. Many of the ideas are worthy of consideration and analysis by tax policy makers in other OECD countries.

Both the issues paper and the final report focus on six broad areas: (1) the tax base, (2) eco-taxation and carbon taxes, (3) tax rates, (4) the treatment of legal entities, (5) international taxation, and (6) the treatment of savings. In all of these areas, the detailed analysis is found in the issues paper. The final report reiterates much of that analysis and indicates where it has been ultimately rejected or accepted after further consultation and reflection.

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With respect to the New Zealand tax base, the committee categorically rejects a cash flow consumption tax as an alternative to the income tax. Neither the issues paper nor the final report contains any significant recommendations for the goods and services tax (GST). The principal focus is, instead, the income tax base and the use of various excise taxes. One of the distinguishing features of the income tax base in New Zealand is the lack of a comprehensive capital gains tax. The committee sees no compelling case for adopting such a tax and rejects it out of hand in favour of the current approach of "nibbling at the edges" through specific income inclusions. In this respect, one of the more interesting ideas articulated in the issues paper is the application of a "risk-free return method" (RFRM) to tax housing stock in New Zealand. This method of taxation involves the imputation of a riskless, inflation-adjusted return on the equity that New Zealand taxpayers have in their homes. This imputed return is accepted as an alternative to the imputation of a market rent to homeowners and is designed to lower the tax bias for home ownership, which has caused overinvestment in housing stock. The RFRM proposal for home ownership is well developed in the issues paper, but, not surprisingly, it created a political stir, which led to its rejection in the final report.

The committee is uncompromising in its analysis of excise taxes applied to the consumption of alcohol, gaming, and tobacco. Both the issues paper and the final report criticize the use of these "sin taxes" as responses to perceived social costs imposed by this particular consumption behaviour. The committee's analysis is generally consistent with the existing literature in questioning the extent of these perceived costs. Moreover, even if the existence of such costs is accepted, the issues paper and the final report point out that the level of sin taxes in New Zealand is inconsistent with their justification as a deterrent or cost-recovery mechanism. Despite the compelling case presented by the committee, it is unlikely that the current government in New Zealand will forsake sin taxes as a revenue source.

The chapters in the issues paper and the final report on eco-taxation and carbon taxes are the most analytically rigorous. The use of eco-taxation has become particularly trendy in continental Europe. The committee argues persuasively that this trend is misguided. In particular, eco-taxes at the national government level tend to be poorly targeted at the costs associated with problems that are almost always local. Such taxes are defensible, therefore, primarily at the local government level. The one possible exception acknowledged by the committee is the use of carbon taxes.

The discussion of tax rates, the treatment of legal entities, and the treatment of savings is largely unremarkable. The committee prefers a mildly progressive two-rate structure for individuals, with a lower 18 percent rate applying to the first NZ $29,500 of taxable income. The top rate would be set at 33 percent and aligned with the general corporate rate. Given the small segment of high-income earners in New Zealand, the committee sees public spending on benefits, education, and health as a more effective means of redistributing wealth.

The committee would rationalize the treatment of legal entities by distinguishing closely held and widely held entities. The former would be treated as conduits for income tax purposes. The latter would be subject to a separate corporate income tax, with the existing imputation system applying to dividend distributions. Much of the rationalization of the treatment of legal entities is driven by the committee's rejection of the existing separate entity treatment of pooled investment vehicles. This treatment has resulted in the imposition of tax on share gains that would not otherwise occur if the investment were held directly by individuals. The final report goes further than the issues paper, however, in exploring the possible application of the RFRM as an alternative to the corporate income tax. The analysis focuses on various technical design features that would be required to implement this approach. The committee ignores the fact that the theoretical case for the broad application of the RFRM to shares is much more problematic than it is for investment in housing. In fact, it is difficult to see how the RFRM improves upon the existing dividend imputation system in New Zealand for resident shareholders of resident corporations. One is left with the impression that the committee fell madly in love with the conceptual attractiveness of the RFRM. When political considerations led to the method's rejection as a means of taxing investment in housing, the committee apparently felt compelled to find a home for this orphaned idea. As a result, it proposes to apply the RFRM to share investments, even though such application is largely unnecessary as a matter of tax theory.

The committee rejects any form of tax assistance for private retirement savings. New Zealand is unique in not offering such assistance, and this uniqueness has attracted considerable political attention recently. Both the issues paper and the final report throw cold water on any notion of tax assistance. The primary basis for rejection is the lack of evidence supporting the proposition that the savings rate in New Zealand is too low. The rate is seen to be entirely consistent with that of other countries, once public and private savings are accounted for properly.

Some of the more problematic proposals of the committee concern the international tax regime in New Zealand. In a desperate attempt to attract foreign investment, the final report prefers a lower income tax rate (18 percent) for such investment. As proposed by the committee, the lower rate could take various forms, each of which is a version of the standard tax holiday used, with mixed results, by developing countries. The specific rate was chosen to ensure that New Zealand stands out from the crowd in attracting foreign investment. The committee also recommends a NZ$1 million "tax cap" on migrants, as well as a seven-year exemption from New Zealand tax on the foreign-source income of these individuals. These proposals are intended to attract high-value human capital to New Zealand.

The committee's proposals for the taxation of the foreign-source income of New Zealand residents are more conventional. In an effort to improve the competitiveness of New Zealand businesses, the committee recommends the adoption of deferral treatment for foreign-source income from active businesses. Current attribution would be limited to passive investment income of controlled foreign corporations. The existing New Zealand tax rules apply current attribution of all income of controlled foreign corporations resident in a country other than the six listed high-tax countries (one of which is Canada). The committee's proposals would move the New Zealand system for the taxation of foreign-source income closer to the OECD norm. For investment in non-controlled foreign corporations and other pooled investment vehicles, the committee suggests that the RFRM could be applied as an alternative to current attribution of foreign-source income earned in such entities.

T.E.

John O. Fox, *If Americans Really Understood the Income Tax*
(Boulder, Colorado: Westview Press, 2001), 344 pages, ISBN 0-8133-9795-2

There is an excellent body of literature intended to explain issues of tax policy and legislative design for the layperson.[1] This book by a US tax lawyer is squarely within that genre. Yet, like much of this literature, it provides more than enough food for thought for the tax specialist. The author, in fact, aims for a broad audience that includes both the layperson and the tax specialist. By and large, he achieves his goal of appealing to this broader audience, although the core audience is probably the lay reader. In fact, this book should be required reading for politicians on the left and the right in liberal democracies throughout the world. As tax legislative history suggests, they could do worse than slavishly follow Fox's policy prescriptions.

The genesis for the book was apparently the author's experience teaching a course for many years at Holyoke College called "Taxation and the Values of Democracy." Fox argues passionately and persuasively for a broad income tax base that approximates the Haig-Simons ideal. He would trade off, however, a broadening of the existing US base against a lower personal rate structure that would raise the same amount of revenue. This argument is, of course, familiar to tax specialists who lived through the reforms of the 1980s in the United States and other countries. The principal difference between Fox's position and that of the earlier reform movement is one of degree. Fox advocates a much broader base that would eliminate virtually all of the existing deductions for personal expenses under the US system. He describes clearly and simply the tax theory that underlies the case for a broad-based, low-rate income tax and contrasts this ideal with the existing US income tax. Critical to his argument are the familiar concepts of Haig-Simons income and tax-expenditure analysis. The interesting wrinkle added by the book is an important political dimension that emphasizes the appeal of this ideal tax for both liberals and conservatives. Indeed, this dimension, which has presumably been refined through the author's teaching experience, constitutes much of the value added of the book.

The first five chapters cover standard ground for tax policy junkies, but are still useful enough to merit a quick review even for this hard-core group. The primary focus of these chapters is the Haig-Simons concept of income and the important deviations from that concept under US tax law. Chapters 6 and 7 explore the political appeal of a broad-based, low-rate income tax and the reasons why this appeal has been muted in the real world of US tax policy making. Chapters 8 to 13 focus on specific contentious areas of tax policy, including the debate over a flat or progressive rate structure, the behavioural responses to taxation, tax subsidies for the family home and retirement savings, and the capital gains tax debate. Each of these chapters reviews the major arguments and makes a convincing case for Fox's goal of a broader income tax base. Some of the chapters are especially good examples of classic tax-expenditure analysis.

T.E.

Eric C.C.M. Kemmeren, *Principle of Origin in Tax Conventions: A Rethinking of Models* (Dongen, The Netherlands: Pijnenburg Publishing, 2001), 623 pages, ISBN 76115 35 4

This book by a Dutch tax academic is a thorough description and analysis of the source taxation principle as reflected in certain tax treaties. Contrary to much of the conventional wisdom in the literature, Kemmeren argues that tax policy makers should rely more on source-based taxation in the assignment of taxing jurisdiction between residence and source countries under tax treaties. More particularly, he believes that the origin principle can be used to extend the existing source taxation principles in tax treaties. Kemmeren defines the origin principle generally as the assignment of taxing jurisdiction on the basis of the location of economic activity where income is generated or wealth is created. He believes that much of cross-border tax arbitrage is attributable to a failure to allocate a greater portion of taxing jurisdiction to source countries and posits various ways to expand this jurisdiction under tax treaties using his origin principle. Kemmeren bases his preference for source taxation over residence taxation on a traditional "benefits theory," which holds that the source country should have the prior right to tax because it provides infrastructure and other publicly financed benefits to non-residents earning income in the country.

The book consists of two main parts preceded by a brief introductory chapter, as well as a summary chapter in both English and Dutch. The two main parts respond in varying degrees to three research questions posed by the author:

- What role should the origin principle play in allocating taxing jurisdiction?
- What role does the origin principle currently play in allocating taxing jurisdiction?
- How might tax treaties be altered to place greater reliance on the origin principle?

The first main part covers much of the necessary background for the development and application of Kemmeren's origin principle. This background material includes lengthy discussions of the legal and economic principles underlying the broad features of the international tax status quo. There is also an extensive chapter that reviews the influence of European Community (EC) law on the development of the origin principle. The analysis in this part of the book leads Kemmeren to posit a hierarchy of jurisdictional principles that he believes should govern how the income tax base is divided under tax treaties. The origin principle is ranked first in this hierarchy, followed by the source principle as currently defined, and then the residence and nationality principles.

The second main part of the book explores the parameters of the origin principle and, in particular, its implications for the status quo. After reviewing the general aspects of the origin principle for existing tax treaties, the author compares the current source-based principles with the origin principle. He makes the comparison separately for immovable property, business income, employment income, investment income, the provision of personal allowances and reliefs, other income, and methods for the relief of double taxation. For comparison purposes, Kemmeren draws on the OECD model tax treaty, the UN model treaty, the US and Netherlands model treaties, and the preliminary draft EC multilateral tax convention.

T.E.

Australia, Senate Economics References Committee, *Inquiry into Mass Marketed Tax Effective Schemes and Investor Protection: Interim Report* (Canberra: Commonwealth of Australia, Senate Printing Unit, June 2001), 93 pages, ISBN 0 642 71142 9. Available on the Web at http://www.aph.gov.au/senate/committee/economics_ctte/.

The 1990s saw a substantial increase in tax shelters marketed to high-income individuals in Australia. The Australian Taxation Office (ATO) has been active recently in challenging the effectiveness of many of these shelters. In particular, the ATO has issued reassessments denying the deduction of expenses by investors. The basis for the reassessments is usually that the investor cannot satisfy the basic income-earning purpose requirement under the Income Tax Assessment Act or that the general anti-avoidance rule in part IV A of the legislation applies to deny purported tax benefits. Not surprisingly, the reassessments have provoked an outcry from affected individuals, which has attracted the attention of Australian politicians. The immediate result of the politicization of the tax issue was a reference to the Australian Senate Economics References Committee to conduct an inquiry into three aspects of mass-marketed shelters:

- the adequacy of measures to promote investor understanding of the taxation and financial implications of tax-effective schemes;
- the conduct of scheme promoters and financial advisers, with special emphasis on the adequacy of measures for controlling their conduct; and
- the ATO's approach toward and role in relation to mass-marketed, tax-effective schemes.

This interim report of the Senate committee focuses exclusively on the third aspect described in the terms of reference. The majority report quite correctly offers no opinion on the merit of the ATO's reassessment positions and expressly acknowledges that the substantive issues raised by mass-marketed shelters must be resolved ultimately by the Australian courts. Nonetheless, even accepting that the issues may be resolved in the ATO's favour, the majority report is critical of the ATO's handling of mass-marketed shelters. The majority report emphasizes the failure of the ATO to respond publicly and quickly with warnings about the questionable tax-effectiveness of the shelters. In view of this apparent failure, the majority report prefers that the ATO develop and apply guidelines for the remission of penalties and interest on outstanding tax balances, taking into account the unique circumstances of individual investors. The majority report also prefers to see the ATO use the test litigation program in a broader range of cases. The attractive feature of the program is its requirement that the ATO fund all taxpayer expenses in eligible cases.

The minority report is critical of the majority report's failure to understand the nature of the reassessment process and its necessarily retrospective focus. The minority report also notes that the ATO had already implemented many of the responses favoured in the majority report. Instead of focusing on the handling of the mass-marketed shelters by the ATO, the minority report would like to see a greater emphasis placed on the role of promoters and financial advisers and, in particular, how their incentives can be altered. The final report is supposed to address this issue, as well as possible substantive rules that can be adopted as responses to generic aspects of mass-marketed shelters. Two obvious possibilities are registration requirements for tax shelters and robust at-risk and limited-recourse debt rules along the lines of those in Canada's Income Tax Act.[2]

T.E.

Jim Phillips, Bruce Chapman, and David Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada*
(Montreal and Kingston: McGill-Queen's University Press, 2001), 594 pages,
ISBN 0-7735-2112-7

New Zealand, *Tax and Charities: Discussion Document* (Wellington:
Inland Revenue, Policy Advice Division, June 2001), 63 pages,
ISBN 0-478-10343-3

Income tax systems generally support the activities of charitable organizations by recognizing gifts by donors and exempting income earned by charities. These longstanding tax subsidies are arguably sacred provisions in most OECD countries. Some of the essays in this collection, as well as the discussion document, canvass a broad range of the policy and technical design issues associated with tax subsidies for charitable activities in Canada and New Zealand, respectively.

The collection of essays includes five essays on the income tax treatment of charitable gifts and charitable organizations in Canada. Three of the essays focus on the definition of a charity and the regulatory regime for charitable organizations. The other two essays consider the treatment of charitable gifts under the

Act and the policy case for providing tax relief. The essays were published before September 11, 2001 and do not, therefore, discuss the recent legislative restrictions in Canada on organizations that use charitable status to fund terrorist activities. The authors and titles of the essays are as follows:

- Mayo Moran and Jim Phillips, "Charity and the Income Tax Act: The Supreme Court Speaks";
- Lorne Sossin, "Regulating Virtue: A Purposive Approach to the Administration of Charities";
- David G. Duff, "Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit";
- Neil Brooks, "The Tax Credit for Charitable Contributions: Giving Credit Where None Is Due"; and
- Kevin E. Davis, "The Regulation of Social Enterprise."

The New Zealand discussion document addresses many of the same issues considered in these essays. A principal focus of the discussion document is the design and implementation of information-reporting requirements as a means of monitoring the cost of the tax subsidies provided to charitable organizations and ensuring a measure of accountability on their part. New Zealand's regime for charitable gifts limits tax recognition to cash gifts, which avoids the tax-avoidance problems associated with in-kind gifts. Surprisingly, however, there is very little in the way of information-reporting requirements for charitable organizations.

The discussion document also provides interesting analyses of the definition of eligible charities for income tax purposes and the treatment of income from the trading operations of charities. With respect to the former, the discussion document considers whether the common law definition of a charity should be rejected in favour of an explicit legislative definition for income tax purposes. Such a definition is critical because it targets the tax subsidy, but it is hard to write legislatively without some clear idea of the rationale for the subsidy. With respect to the treatment of the income from the trading operations of charities, the discussion document rejects both a US-style unrelated business income tax and the more draconian response of deregistering a charitable organization for income tax purposes. The discussion document proposes, instead, a distribution requirement for business profits. This proposal is justified on the ground that a charitable organization will demand the same after-tax return from a business operation that it would from passive investments. A charitable organization should not, therefore, undercut its return from a business to gain a perceived competitive advantage, which is the usual reason cited in support of an unrelated business income tax. The distribution requirement is intended to ensure that the presumed beneficiaries of a charitable organization actually benefit from its business profits.

In addition to these major policy issues, the discussion document reviews the provision of relief for charities with purposes outside New Zealand, limitations on the amount of tax relief for donors, and the availability of GST input tax credits for charities. The sacred nature of the tax subsidy for charitable organizations is reflected in the fact that the discussion document does not even raise the possibility of eliminating tax recognition for cash, as well as in-kind, charitable gifts.

T.E

Catherine A. Brown, "The Taxation of Trusts: Reconciling Fundamental Principles" (2001), vol. 21, no. 1 *Estates, Trusts & Pensions Journal* 1-57

This article reviews some fundamental issues associated with the fiction under the Act that a trust is an individual. Estates and trusts practitioners should find the review especially useful. The author, who has written extensively on the Canadian taxation of estates and trusts, focuses on four separate questions:

- When is a trust a trust for tax purposes?
- How does the trust as an individual affect relationships for tax purposes?
- When are amounts paid or payable to a beneficiary? and
- When are amounts not payable for tax purposes?

Each of these questions is examined in terms of the relevant statutory provisions, case law, and administrative positions of the Canada Customs and Revenue Agency (CCRA). Important interpretive issues are highlighted and discussed thoroughly. There is also an appendix that summarizes in checklist form the actions that a trustee should take to ensure that amounts are considered payable to a beneficiary and, therefore, taxed to the beneficiary.

T.E.

Grant Richardson and Roman Lanis, "The Influence of Income Taxes on the Use of Debt by Publicly Listed Australian Corporations" (2001), vol. 16, no. 1 *Australian Tax Forum* 3-31

There is a vast literature considering the effect of taxation on corporate capital structure. Much of this literature examines the subject in the context of the classical corporate income tax in the United States, with its bias in favour of the use of debt to avoid the double tax on equity income. This US literature is of very limited usefulness, therefore, for countries that have adopted a dividend imputation system that minimizes or even eliminates the different tax treatment of debt and equity. This article examines the use of debt by publicly traded Australian corporations subject to a dividend imputation regime. Simply because of this different context, the article makes an important contribution to the existing literature.

The authors draw on a sample of Australian publicly traded corporations as the basis for their regression models. After controlling for the effect of dividend imputation, the authors conclude that there is evidence that the tax advantage for debt finance is neutralized under a dividend imputation system. There is, however, evidence of a negative correlation between the level of debt capital and the availability of deductible, non-debt expenses. The first finding is particularly relevant for the recent reforms in Australia, which include comprehensive classification rules for financial instruments as debt or equity. At least in a purely domestic context, the tax-avoidance opportunities presented by these rules may be muted significantly by the dividend imputation system. As the US experience suggests, comprehensive classification rules are probably ill advised where there is an incentive for the use of debt capital that opens up the rules to tax planning. Even in dividend imputation countries, however, this incentive remains generally for cross-border investment.

T.E.

"International Tax Policy in the New Millennium" (2001), vol. 26, no. 4 *Brooklyn Journal of International Law* 1251-1721

This massive volume of the *Brooklyn Journal of International Law* consists of 8 papers, 13 commentaries, and a discussion transcript, which are the product of a two-day symposium on international taxation held at the Brooklyn Law School. The participants are primarily US tax academics and practitioners, although there is a smattering of representation from Canada and Europe. The symposium papers and commentaries are divided into three panels. The first is devoted to the nature and effects of globalization on international tax policy. The focus of the second panel is a re-examination of the theory of international taxation. The third panel examines the issue of US multinational and international competitiveness. A final part consists of the transcript of a lively discussion by symposium participants of a broad range of international tax issues.

T.E.

Keith Engel, "Tax Neutrality to the Left, International Competitiveness to the Right, Stuck in the Middle with Subpart F" (2001), vol. 79, no. 6 *Texas Law Review* 1527-1607

Reform of the anti-deferral regime in subpart F of the Internal Revenue Code ("the Code") has figured prominently in recent years in the United States. The debate has been fuelled in no small part by the use of certain transactions by US multinationals to avoid source-country tax on business income, while avoiding the provisions of subpart F that apply to related-party transactions that divert income in this way. These recent transactions provoked a series of responses from the Internal Revenue Service (IRS). This article provides an accessible overview of the legislative history of subpart F and the significance of the challenge presented by this latest form of avoidance transactions. The author argues that subpart F represents a defensible compromise between the irreconcilable principles of capital-export and capital-import neutrality and the legislative regimes that an unqualified acceptance of one or the other principle would necessarily dictate. He then develops some reform proposals that maintain this compromise but alter the scope of subpart F by expanding the range of income subject to current attribution to US-resident shareholders of a controlled foreign corporation. He also develops a set of alternative proposals that similarly alter the scope of the US anti-deferral regime, but in the direction of a narrower application that ensures a greater range of income of a controlled foreign corporation would be provided with the benefit of deferral of US tax until its repatriation to resident shareholders.

Engel's article is followed by a brief comment from a US tax academic, Robert Peroni.[3] He is critical of Engel's proposed reforms both in their technical details and in their underlying theoretical premises. Instead of maintaining the compromise reflected in subpart F, Peroni would prefer to see current attribution of all income of a controlled foreign corporation to US shareholders in a manner consistent with the tax treatment of foreign branches of US corporations.

T.E.

Erik Lueth, *Can Inheritances Alleviate the Fiscal Burden of an Aging Population?* IMF Working Paper WP/01/97 (Washington, DC: International Monetary Fund, August 2001). Available on the Web at http://www.imf.org.

It has been argued that the young and unborn will have to shoulder the burden of supporting our aging population—largely a result of pay-as-you-go defined benefit programs. The question that this paper attempts to answer is whether inheritances can provide an offsetting intergenerational transfer. In simple terms, will the kids receive back about as much in inheritance as the additional amount they will have to pay to support their parents?

Lueth's main finding is that the increase in future generations' inheritances does not fully offset the demographic burden: a fiscal burden continues to exist even after inheritances are taken into account. The paper uses both partial equilibrium and computable general equilibrium models in reaching this conclusion. If you do not have a background in economics, you will likely want to read just the introduction and conclusion.

G.F.

Canada, Department of Finance, "Canada's Life and Health Insurers," August 2001. Available on the Web at http://www.fin.gc.ca.

Canada, Department of Finance, "Canada's Banks," August 2001. Available on the Web at http://www.fin.gc.ca.

In these two documents the Department of Finance provides a good introduction to the insurance and banking industries, including a discussion of the structure of the two industries, important accounting numbers, the legislative framework, regulation and supervision, and future challenges.

The two reports provide a wealth of information. For example, over the last decade the number of companies in the life and health insurance industry has shrunk significantly, from 168 to 117, with 5 companies now accounting for over half of the industry. As a result of legislative changes in 1999 that allowed companies to convert from mutual companies, the 5 largest are now publicly held. The industry employs over 110,000 Canadians and has total revenue of about $75 billion. Perhaps the most interesting information is where these companies earn their income—51 percent comes from annuities (for example, registered pension plans), 27 percent from life insurance, and 22 percent from accident and sickness insurance.

Canada has 13 domestic banks, 34 foreign bank subsidiaries, and 11 foreign bank branches; in total, they manage over $1.6 trillion in assets. However, as with the life and health insurance industry, a few banks dominate. For example, the 6 major domestic banks account for over 90 percent of the assets held by the banking industry. I was somewhat surprised by the impact of foreign banking. In 2000, international operations accounted for about half of the net revenue earned by Canada's "big 6" banks. It is also clear from the report that the performance of Canadian banks is very strong along several dimensions.

Most or all of the statistics in these publications could probably be found through other primary sources, but not delivered so accessibly. If you want to understand the fundamentals of the life and health insurance industry or the banking industry, these documents by the Department of Finance provide an excellent starting point.

G.F.

Organisation for Economic Co-operation and Development, *Economic Survey of Canada* (Paris: OECD, September 2001). Available on the Web at http://www.oecd.org.

International Monetary Fund, *Canada: Select Issues*, IMF Country Report no. 01/157, (Washington, DC: IMF, September 2001). Available on the Web at http://www.imf.org.

How is Canada performing? Two recent reports, one by the OECD and the second by the IMF, paint an interesting picture.

The OECD economic survey discusses the nature of the downturn in the Canadian economy. Perhaps of greater interest, the authors of the report assert that the downturn is likely to be short-lived. Their rationale is that the US economy has shown signs of strengthening, an inventory correction is almost complete, tax cuts continue to stimulate growth, and monetary conditions have been eased. The authors note that even if the US downturn is more protracted than expected, Canada's macroeconomic fundamentals are more favourable than they were during previous international downturns. Sources of OECD enthusiasm include the stimulus provided by federal and provincial tax reductions and the recent reduction in the debt-to-GDP ratio—the fact that, in real terms, we are reducing our public debt levels. In terms of challenges, the report expresses concern over increased pressure to spend to meet social policy objectives. Overall, the OECD report argues that Canada is well prepared to handle an economic slowdown.

The IMF report gives a detailed and reasonably complete picture of the Canadian economy. The report addresses issues of labour productivity, exchange rates and economic integration with the United States, the management of government debt and inflation, and reforms in the financial sector. The primary findings are as follows. Since 1995, labour productivity has remained relatively unchanged in Canada while it has accelerated in the United States. Much of the growth in this gap is attributed to the manufacturing sector. The report argues that exchange-rate flexibility has played a useful role in buffering our economy, while not preventing integration of the Canadian and US economies. The arguments should be of interest to those who are following the current debate on fixed exchange rates or a common currency between Canada and the United States. On the issue of government debt, the report notes that Canada will eliminate its debt over a far longer horizon than that of other countries—a result of a higher initial level of debt and a slower pace of reduction. The report suggests that it will take until the end of the decade for Canada to get to the same relative level of debt that the United States is currently at.

Together, the OECD and IMF reports provide a relatively complete picture of Canada's economic performance. The OECD study is non-technical, well written, and informative. Its findings are also comforting: we are expected to do well into the immediate future, even with an economic slowdown. The IMF report, which is equally informative, well-written, and accessible, points out some areas of concern.

G.F.

Ken Battle and Sheri Torjman, *The Post-Welfare State in Canada: Income-Testing and Inclusion* (Ottawa: Caledon Institute of Social Policy, May 2001), 53 pages, ISBN 1-894598-77-6. Available on the Web at http://www.caledoninst.org.

This paper focuses on a major transition in Canada's income security system: the movement from universal income benefits and needs-tested social assistance to income-tested programs. The authors examine both the evolution of the income security system and the roots of reform. Their discussion is well written, balanced, and informative.

G.F.

Chistopher A. Sarlo, "Measuring Poverty in Canada" [July 2001], *Critical Issues Bulletin* 1-79. Available on the Web at http://www.fraserinstitute.ca.

This relatively lengthy document (79 pages) provides a comprehensive review and analysis of the measurement of poverty in Canada, and refines a measure previously created by the author. Sarlo begins by pointing out a major issue in Canada: we have no official poverty line. Therefore, measures that are not designed to provide a measure of poverty are often used for that purpose. The most significant such measure—the one most frequently used—is Statistics Canada's low-income cut-off. The author discusses the nature of the biases in this measure (for example, it rises with increases in average income and is not tied to actual costs of necessities), and then offers an alternative: a measure of poverty based on the costs of a list of necessities. This measure is compelling if you believe, as Sarlo does, that poverty is largely an absolute condition, not a relative condition. The basic necessities measure developed in this paper builds on a measure that Sarlo created in 1992.[4] The paper provides significant detail on the calculation of the costs of necessities. A further interesting aspect is the calculation of poverty lines both by province and by city. This is a very informative, well-written document.

G.F.

Notes

1 See, for example, Michael J. Graetz, *The Decline (and Fall?) of the Income Tax* (New York: W.W. Norton, 1997), reviewed in this feature (1998), vol. 46, no. 3 *Canadian Tax Journal* 731-43, at 731-33; Linda McQuaig, *Behind Closed Doors* (Markham, ON: Penguin Books Canada, 1987); and Louis Eisenstein, *The Ideologies of Taxation* (New York: Ronald Press, 1961).

2 RSC 1985, c. 1 (5th Supp.), as amended, subsections 96(2.1)-(2.7) and section 143.2.

3 Robert J. Peroni, "Deferral of US Tax on International Income: End It, Don't Mend It—Why Should We Be Stuck in the Middle with Subpart F?" (2001), vol. 79, no. 6 *Texas Law Review* 1609-20.

4 Christopher Sarlo, *Poverty in Canada* (Vancouver: Fraser Institute, 1992).