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## CURRENT TAX READING

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***Canada, Report of the Auditor General of Canada to the House of Commons*** (Ottawa: Office of the Auditor General of Canada, April 2002). Available on the Web at <http://www.oag-bvg.gc.ca/>.

CCRA management must be starting to feel singled out, because it is now five years in a row that the auditor general has put some aspect of the CCRA's administration under the microscope. Indeed, the auditor general's report is now the main source of information about the internal workings of the CCRA. This year, the issue is writeoffs and forgiveness of amounts owed by taxpayers.

Unlike businesses in the private sector, which can choose whether and to whom they will grant credit, the CCRA must accept as accounts receivable all taxes owed by taxpayers. The current amount owing is about \$13 billion, and taxes written off averaged \$1 billion per year over the past three years.<sup>1</sup> This uncollectible amount seems small relative to the roughly \$300 billion in total annual federal and provincial taxes and duties collected annually.<sup>2</sup> However, the amounts written off are totally borne by the federal government, since the tax-collection agreements with provinces provide that the federal government pays the provinces the amount of provincial income taxes assessed regardless of whether these amounts are ultimately collected.

Three recent developments give the auditor general some concern about a potential increase in future writeoffs: the total amount owed on funds held in trust (payroll deductions and GST) has increased by 27 percent in the two years ending March 2001;<sup>3</sup> the provision in the 2001 federal budget that allowed small businesses to defer their first-quarter 2002 corporate income tax instalments increases the collection risk on \$2 billion of payments;<sup>4</sup> and the recent court decision that held that provincial limitations (ranging from 2 to 20 years) apply to the collection

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of federal income taxes could prevent the Crown from collecting \$1 billion in owed income taxes.<sup>5</sup> Amounts written off fall into various categories:

- debts written off under the Bankruptcy and Insolvency Act, which are permanent writeoffs;
- debts written off under the Financial Administration Act (FAA), which are deleted from the active inventory but may be revived for collection action when the taxpayer's financial position improves; and
- interest and penalties cancelled or waived under the fairness provisions, which are a permanent writeoff (and which totalled an impressive \$185 million for the fiscal year 2000-1).<sup>6</sup>

A major concern of the auditor general is that the procedures followed in approving such writeoffs are not consistent across categories. For FAA writeoffs, various thresholds from \$5,000 to \$500,000 are applied to determine the level of CCRA official who can approve the writeoff.<sup>7</sup> On the other hand, for fairness provision writeoffs of previously imposed interest and penalties, there are only two, relatively low approval thresholds applied (under \$5,000 and over \$5,000). The approval process for the waiver of interest and penalties not yet imposed is even less rigorous—it appears to be subject to the whims of the individual auditor, and amounts waived are not recorded in any computer system. With respect to the GST in Quebec, the auditor general's concern was that the Quebec Department of Revenue administers the tax without the CCRA's being able to monitor their writeoffs, owing to the fact that the department's systems contain confidential provincial sales tax information.

A.M.

**Canada Customs and Revenue Agency, *Performance Report, for the period ending March 31, 2001, and Annex: Supplementary Performance Information by Business Line*** (Ottawa: Public Works and Government Services, November 2001). The first title is available on the Web at [http://www.tbs-sct.gc.ca/rma/rma\\_e.html](http://www.tbs-sct.gc.ca/rma/rma_e.html).

This is the first of the full-year annual reports of the CCRA (as metamorphosed from Revenue Canada in November 1999) required by the Canada Customs and Revenue Agency Act. The main report provides most of the key information, while the annex adds interesting details. Although the documents contain much self-congratulatory fluff, they also provide such interesting nuggets as the following:

- A first “baseline study” of public attitudes toward the CCRA indicates that 9 percent of Canadians believe the CCRA is doing a very good job while 52 percent of Canadians believe it is doing a good job.<sup>8</sup>
- The same study shows that benefit recipients are among those demonstrating higher levels of satisfaction: three-quarters of recipients of the Canada

child tax benefit and the GST credit believe that the CCRA is doing a good job with respect to those programs.<sup>9</sup>

- The CCRA is the most frequently contacted part of the federal government, and constitutes one-quarter of the federal public service.<sup>10</sup>
- Ninety-two percent of all Canadians 18 years of age and older filed an individual tax return during the 1999 tax year, most likely because of the tax return's role in establishing their eligibility for government benefits.<sup>11</sup>
- Over the last two years, from 1998-99 to 2000-1, the percentage of personal income tax returns that were filed electronically rose from 25 percent to 32 percent (which speeded up processing, since paper returns take four weeks and e-filed returns take two weeks).<sup>12</sup>
- Ninety-four percent of individuals and 92 percent of corporations paid their reported taxes on time, and 95 percent of federal revenues are collected without any direct enforcement action.<sup>13</sup>
- The Crown won 65 percent of the tax cases that proceeded to court, meeting its own expectations.<sup>14</sup>
- Random audits of selected personal deduction and credit items showed a non-compliance rate of 7 percent, which is relatively unchanged from recent years.
- Access to information requests increased by 48 percent over the year, but the turnaround time decreased substantially.<sup>15</sup>

Although the above is mostly good news, some of the reported facts may be less favourable:

- Only 86 percent of Canadian corporations filed a tax return in the 1999 tax year, which is remarkably low given that all corporations are required to file.<sup>16</sup>
- Only 41 percent of Canadian corporations were taxable.<sup>17</sup>
- The percentage of client accounts with a substantive risk of non-compliance was 29 percent for corporate returns, 19 percent for self-employed individuals, and 18 percent for GST/HST accounts.<sup>18</sup>
- Accounts receivable as a percentage of gross revenue has increased over time, and the government is reconsidering whether its target of 4 percent, set in 1995, is still realistic.<sup>19</sup>
- Overall ratings of client satisfaction for income tax were the lowest of all the areas assessed.<sup>20</sup>
- Audit rates have declined substantially—for example, the rate for mid-sized corporations has declined from 27 percent in 1993-94 to 12 percent currently.<sup>21</sup>
- The dispute resolution process is admittedly “not timely,” with the Appeals division taking 119 to 237 non-consecutive calendar days to complete its reviews of disputes.<sup>22</sup>

A.M.

**James Kirkbride and Abimbola A. Olowofoyeku, *The Law and Theory of Income Tax*** (Merseyside, UK: Liverpool Academic Press, 2001), 379 pages, ISBN 1903499003

Canadian income tax law borrows heavily from the UK income tax system, although it is also substantially influenced by the US Internal Revenue Code. Those wanting a quick overview of the UK income tax, either for its own sake or to illuminate Canadian law, couldn't ask for a better reference than this.

The book is structured much like an introductory course in personal income taxation. Chapter 1 discusses the history and functions of the UK tax system as well as the influences on it, though too summarily to be of much value beyond a brief introduction. Chapter 2 turns to the territorial scope of the UK statutes, with excellent sections on the concepts of individual and corporate residence, "ordinary residence," and the specific rules governing when taxpayers are deemed to be resident in the United Kingdom. Chapters 4 to 9 review the various categories of income subject to tax in the United Kingdom, as well as allowable deductions and timing issues: employment income (chapter 4); income from trades, professions, and vocations (chapter 5); trading receipts (chapter 6); trading expenditure (chapter 7); capital allowances (chapter 8); and the taxation of "pure profit income," which is essentially interest, discounts, and annuity income (chapter 9). Chapter 10 discusses trusts and settlements, and chapter 11 deals with judicial developments concerning tax avoidance.

The book is extremely well written and provides an excellent review of key cases defining each area of the UK law. Canadian courts still refer to UK decisions, and certain areas of the book are particularly relevant to Canadian law: the characterization of trades and adventures in the nature of trade (chapter 5); the characterization of damage payments, compensation for the sterilization of assets, and the cancellation of business contracts and non-competition agreements (chapter 6); the distinction between current and capital expenditures (chapter 7); and judicial responses to tax avoidance (chapter 11).

D.D.

**Alan J. Auerbach and Martin Feldstein, eds., *Handbook of Public Economics*, vol. 3** (Amsterdam: Elsevier Science, 2002), 744 pages, ISBN 044482314X

This is a book of survey articles on public economics by leading experts. Volumes 1 and 2 were published previously, and volume 4 is in preparation. The chapters in volume 3 are as follows:

- "Taxation, Risk-Taking, and Household Portfolio Behavior" by James Poterba;
- "Taxation and Saving" by Douglas Bernheim;
- "Taxation and Corporate Financial Policy" by Alan Auerbach;

- “Tax Policy and Business Investment” by Kevin Hassett and Glenn Hubbard;
- “Taxation and Economic Efficiency” by Alan Auerbach and James Hines;
- “Tax Avoidance, Evasion and Administration” by Joel Slemrod and Shlomo Yitzhaki;
- “Environmental Taxation and Regulation” by Lans Bovenberg and Lawrence Goulder;
- “Political Economics and Public Finance” by Torsten Persson and Guido Tabellini; and
- “Economic Analysis of Law” by Louis Kaplow and Steven Shavell.

A.M.

**François Vincent, *Transfer Pricing in Canada: A Legal Perspective***

(Toronto: Carswell, 2002), 298 pages, ISBN 0459277650

This book, by a top person in the field, leaves the reader wishing for more inasmuch as it ends after just 155 pages of commentary. It would have been worthwhile to have some discussion of those cases that many people associate with transfer pricing but that the author views as separate from the transfer-pricing provisions of the Act—cases such as *Spur Oil*, *Redpath Industries*, and *Irving Oil*.<sup>23</sup>

A.M.

**Joel T. Cuperfain and Florence Marino, *Canadian Taxation of Life***

***Insurance*** (Toronto: Carswell, 2002), 533 pages, ISBN 0459277499

This comprehensive treatment of a specialized subject should prove valuable to many tax practitioners. Its one weakness is that it contains very few references to the literature to guide readers seeking further information.

A.M.

**René Morissette, Xuelin Zhang, and Marie Drolet, *The Evolution of Wealth Inequality in Canada, 1984-1999, Analytical Studies Branch***

**Research Paper Series no. 187** (Ottawa: Statistics Canada, February 2002), 58 pages, ISBN 066231705X

Arguments over the proper degree of progressivity of the tax system have risen nearly to the top of the public agenda with the Alliance party’s proposal for a single-rate income tax. This study by Statistics Canada contributes to this debate by showing how inequality in the distribution of personal wealth in Canada has changed from 1984 to 1999.

Median wealth fell in the bottom three deciles of the wealth distribution but rose 27 percent or more in the top three deciles. Furthermore, only families in the top decile have increased their share of net wealth over the period.<sup>24</sup> Thus, it may not be surprising that wealth inequality has risen over this period according to economists’ technical measures of inequality. The Gini coefficient increased by between

4 and 8 percent, depending on the details of the calculation. Also, excluding the bottom 0.5 percent of the wealth distribution, the Lorentz curves do not cross.

Equity in principal residences contributes the most to wealth inequality, simply because it is by far the most important wealth component. However, the role of RRSPs in contributing to overall inequality rose from 4 percent to 15 percent over the period, reflecting the increase of RRSPs as a factor in wealth.<sup>25</sup>

A.M.

**Anthony J. Cataldo II and Arline A. Savage, *U.S. Individual Federal Income Taxation: Historical, Contemporary, and Prospective Policy Issues*** (Amsterdam: Elsevier Science, 2001), 344 pages, ISBN 0762307854

As the title suggests, this book attempts to provide an overview of individual federal income taxation in the United States, offering historical information on the evolution of specific rules and policy issues, a summary of contemporary tax policy research, and an indication of “trends in individual federal income taxation for the next few decades” in order to “identify significant *prospective* topics likely to warrant further development and examination.”<sup>26</sup> This is an ambitious agenda. Unfortunately, the book’s treatment of the many issues it attempts to cover is extremely brief, with the result that it is not the magnificent tax policy resource that its title might lead one to believe.

The book is divided into five parts: an introduction to US individual taxation (part 1); an overview of issues related to the taxation of the family (part 2); a discussion of the alternative minimum tax and the taxation of capital gains (part 3); a survey of different intergenerational tax issues such as social security taxes, tax encouragement for individual retirement savings, and estate and gift taxation (part 4); and a summary of “prospective individual tax policy issues” identified by the authors (part 5). Most of these chapters are extremely brief (5-10 pages) and largely descriptive. This is especially true of chapter 3, “The History of U.S. Individual Taxation,” which describes every major amendment to the Internal Revenue Code since 1913. The chapter entitled “The Marriage Tax,” on the other hand, provides a little more in the way of analysis. While the text is only 163 pages, too brief to do more than scratch the surface of the many issues the authors take on, the book contains another 160 pages of appendixes in which there is information on various aspects of the US federal individual income tax, as well as brief 2-3 page summaries of such topics as medical and dental expenses and interest deductions. The structure seems odd, but these brief summaries may be useful for reference purposes.

Finally, an interesting feature of the book, which is written by two accounting professors from Michigan, is the attention that it devotes to comparisons with the Canadian income tax. Unfortunately, this does not help a book that is already spread too thin.

D.D.

**Michael J. Prince, "Tax Policy as Social Policy: Canadian Tax Assistance for People with Disabilities"** (2001) vol. 27, no. 4  
*Canadian Public Policy* 487-99

This article reviews the trends in disability policy at the federal level over the last 20 years and discusses why measures in this area are increasingly undertaken through the tax system rather than through public expenditures. Since the author is a political scientist, he puts particular emphasis on analyzing the role of different federal departments in this process. The author also discusses various means of involving Canadians with disabilities in the formulation of tax policy—for example, encouraging such individuals to publish personal stories of their dealings with the tax system. Unfortunately, perhaps because of the usual academic problems in communicating across disciplinary boundaries, the author makes no reference to the recent work of law professor David Duff in this area.<sup>27</sup>

A.M.

**Thomas A. Gresik, "The Taxing Task of Taxing Transnationals"** (2001)  
vol. 39, no. 3 *Journal of Economic Literature* 800-38

The focus of this literature survey is the influence of corporate income tax laws and investment policies on the nature and composition of foreign direct investment. The article contends that the ability of governments to raise tax revenues and extract rents is challenged by financial and real investment flexibility, tax competition, and informational asymmetries. In short, as the author says, "Governments cannot accurately measure transnational profits they plan on taxing."<sup>28</sup>

A.M.

**Richard Bridge, "The Law of Advocacy by Charitable Organizations: The Case for Change"** (2002) vol. 21, no. 2 *Estates, Trusts & Pensions Journal* 92-129

This is a welcome contribution to the currently controversial question concerning the extent to which charities should be allowed to engage in lobbying and advocacy for changes in laws. Many useful international comparisons are made. However, as the title of the article must lead us to expect, the author does not discuss the weakening of public support for charitable tax incentives that could result from charities' advocating political changes that not all voters would support (for example, the abortion issue).

A.M.

**Ronald D. Kneebone and Kenneth J. McKenzie, "Electoral and Partisan Cycles in Fiscal Policy: An Examination of Canadian Provinces"** (2001)  
vol. 8, no. 5/6 *International Tax and Public Finance* 753-74

This article investigates the fiscal policy choices of the 10 Canadian provinces over the period 1966-1997, which covers 320 budget years and 87 provincial elections. The dependent variables are of three types:

1. aggregate spending, revenue, and primary deficit changes;
2. discretionary changes to program spending by category; and
3. discretionary changes to revenue by category (for example, personal income tax revenue).

The independent (or explanatory) variables are control variables for various economic indicators and dummy variables for the year that an election is held and for the type of political party that is in power.

One finding is of a clear electoral cycle: political parties of all stripes tend to stop increasing taxes during election years. Responses in spending are shown to be similarly opportunistic, though their precise nature varies with the category, with some categories of spending decreasing in election years while other categories (for example, spending on roads, hockey rinks, and schools) increase. Generally, no such differences appear in the types of revenue sources.

A.M.

**Joel Slemrod, “A General Model of the Behavioral Response to Taxation”** (2001) vol. 8, no. 2 *International Tax and Public Finance* 119-28

This article extends the standard economic model of a labour-leisure choice to describe how individuals may change both their labour supply and their avoidance effort in response to tax changes. This extension is valuable insofar as empirical studies that find a low substitution response to tax changes may be misinterpreting the data, because a higher substitution response could be masked by a change in avoidance effort, with an offsetting effect on taxable income. Separating these two effects would be possible empirically if one could specify observable determinants of the cost of avoidance.

A.M.

**Adam Wagstaff and Eddy van Doorslaer, “What Makes the Personal Income Tax Progressive? A Comparative Analysis for Fifteen OECD Countries”** (2001) vol. 8, no. 3 *International Tax and Public Finance* 299-315

Policy makers wishing to influence the progressivity of the personal income tax may do so through a wide variety of means: the rate structure, which is the most obvious choice; personal allowances, such as a married person's allowance; deductions, such as a deduction for mortgage interest; tax credits; and exemptions of certain types of income from taxation. This article empirically examines the tax structures of 15 OECD countries in the mid-1980s and finds three clusters of countries: (1) the rate-structure countries, such as France, Italy, and Australia; (2) the allowance countries, which are the English-speaking countries other than Australia; and (3) the mixed-structure countries, such as Germany and Sweden, where roughly half of the progressivity is attributable to the rate structure.

A.M.

**NOTES**

- 1 At paragraph 2.5.
- 2 Canada Customs and Revenue Agency, *Performance Report*, for the year ended March 31, 2001 (Ottawa: Public Works and Government Services, November 2001), 3. Of this amount, provincial taxes constitute \$37 billion.
- 3 At paragraph 2.68.
- 4 At paragraph 2.70.
- 5 At paragraph 2.4. The report notes (at paragraph 2.67) that leave to appeal to the Supreme Court has been granted.
- 6 At paragraph 2.1.
- 7 Some problems were observed, notably that the thresholds have been misapplied insofar as the amounts at issue have not included accrued interest and have not been aggregated across related parties. However, the CCRA has promised to correct these problems (see the CCRA's response following paragraph 2.28).
- 8 *Performance Report*, at 18.
- 9 *Ibid.*, at 40.
- 10 *Ibid.*, at 23 and 16.
- 11 *Ibid.*, at 27.
- 12 *Annex*, at 2-29.
- 13 *Performance Report*, at 34. Interestingly, the government claims it is unable to measure the degree of filing and remittance compliance for the GST/HST.
- 14 *Ibid.*, at 48.
- 15 *Ibid.*, at 53.
- 16 *Ibid.*, at 27.
- 17 *Ibid.*
- 18 *Annex*, at 2-35.
- 19 *Performance Report*, at 34.
- 20 *Annex*, at 2-150.
- 21 *Performance Report*, at 36.
- 22 *Ibid.*, at 48.
- 23 *Spur Oil Ltd. v. The Queen*, 81 DTC 5168; [1981] CTC 336 (FCA); *The Queen v. Redpath Industries Ltd. et al.*, 84 DTC 6349; [1984] CTC 483 (Que. SC); and *The Queen v. Irving Oil Limited*, 91 DTC 5106; [1991] 1 CTC 350 (FCA).
- 24 At 1.
- 25 At 18.
- 26 At 3.
- 27 David G. Duff, "Disability and the Income Tax" (2000) vol. 45, no. 4 *McGill Law Journal* 797-889.
- 28 At 801.