Current Tax Reading

Co-Editors: David Duff, Tim Edgar, Glenn Feltham, and Alan Macnaughton*

Steven R. Weisman, *The Great Tax Wars: Lincoln to Wilson—The Fierce Battles Over Money and Power That Transformed the Nation* (New York: Simon and Schuster, 2002), 419 pages, ISBN 0-684- 85068-0

This entertaining book, written by Steven R. Weisman, a journalist with the *New York Times*, proves yet again that all tax is politics, and that tax history is an important element of social and economic history that is all too often neglected by historians. The book also proves that the adage "everything old is new again" rings true in matters of tax policy.

Weisman provides a thorough account of the political wars that raged in the United States from 1860 to 1920 over the enactment of an income tax. However, the book not only gives an account of this important period of tax history in the United States, but also explores how Americans think about taxes. In particular, he frames these tax wars in terms of competing views of equity and social justice, issues that continue to inform tax policy debates in both the United States and other western democracies. For example, on the one hand, there is the view that income, as a measure of an individual's ability to pay, should be taxed at graduated rates to ensure a measure of wealth redistribution. On the other hand, there is the view that income taxation at graduated rates amounts to an indefensible confiscation of property that depresses incentives to work, save, and invest, elements that are vital to economic growth.

The book provides an account of three distinct periods within the six decades covered by the narrative. The first period, covered in the first four chapters, begins with the US Civil War and ends in the early 1870s. These chapters are devoted primarily to the politics of the Civil War, a conflict that led to the adoption of an

* David Duff is of the Faculty of Law, University of Toronto. Tim Edgar is of the Faculty of Law, The University of Western Ontario, London, and a senior research fellow, Taxation Law and Policy Research Institute, Deakin University, Melbourne. Glenn Feltham is of the College of Commerce, The University of Saskatchewan, Saskatoon, and is the Chuck and Norma Childers' Chair for Saskatchewan Enterprise. Alan Macnaughton is the holder of the KPMG professorship in accounting at the University of Waterloo. The initials below each review indicate which of the four co-editors authored the review.

income tax by the Union government as a means of financing the war effort. Much of the narrative centres on President Lincoln's secretary of the Treasury, Salmon Chase. The Union government's adoption of an income tax is contrasted with the rejection of such a tax by the Confederacy. Indeed, Weisman attributes the failure of the Confederacy, in part at least, to its failure to use an income tax as a means of financing the war effort. Although the income tax was accepted as a necessary war-financing mechanism in the Union states, it remained in effect for eight years after the end of the Civil War in order to finance the retirement of the public debt incurred during the war. In a somewhat brief account, Weisman describes how lobbying by powerful business interests brought about the repeal of the income tax despite its acceptance by the general populace, who were largely unaffected by the tax but who bore the brunt of the regressive tariffs that taxed much of their consumption and protected US domestic businesses.

The second period discussed in the book, covered in chapters 5 to 7, begins in 1893 and ends in 1909. The discussion of this period's tax politics focuses on the fallout over the US Supreme Court decision in *Pollock v. Farmers' Loan & Trust Co.*,[1] which upheld a constitutional challenge to legislation that reintroduced the income tax in 1893. However, as with his account of tax politics during the Civil War period, Weisman frames the debate in the broader context of the economic and social conditions of the period, while bringing to life the often larger than life political and business leaders who were the principal actors in the drama. Not surprisingly, Theodore Roosevelt is one of the leaders that Weisman discusses at great length, largely for his ineffective support of an income tax. Roosevelt's lukewarm commitment is contrasted with that of another major political figure during this period, William Jennings Bryan; in fact, much of Weisman's narrative focuses on the efforts of the "Great Populist" to reintroduce income tax legislation that would withstand the constitutional requirement that the tax affect the states proportionally.

Chapters 8 to 12 are devoted to the third part of the tax wars, a time that saw both the development of an initiative to enact and ratify the 16th amendment, which would give Congress the power to enact an income tax, and the application of the tax to finance the US effort in the First World War under the Wilson administration. In this period, the debate surrounding the implementation of the income tax was similar to the debate that occurred earlier, with those who favoured an income tax and the reduction of tariffs being pitted against those who favoured the retention of tariffs and rejected an income tax.

Weisman concludes the book by tracing the themes of the Great Tax Wars through the political tax debates of the past 80 years. Although this account is necessarily superficial, it does manage to link the more recent debates to the earlier ones in a manner that illustrates the currency of the adage noted at the outset of this review. Despite the common nature of the themes emphasized by Weisman, there are two striking differences between the US tax politics of the 60-year period described in the book and the current political tax debates being played out in the United States and other western democracies, including Canada. First, the political discourse in the earlier period was marked by a refreshing candour about the differences between an income tax and a consumption tax. Neither side shrank from an honest acknowledgment that the debate necessarily involved class conflict that the political process is intended to resolve. In this respect, those who favour consumption taxes over income taxes have lately become adept at avoiding the inevitable class dimensions of the debate. Indeed, they often accuse those who favour wealth distribution of inciting class warfare. Second, tax discourse is now dominated by concerns over efficiency and economic growth at the expense of wealth redistribution. Certainly, in the period from 1860 to 1920 the debate was much more evenly balanced, with those who supported wealth redistribution having a stronger political voice than the voice of those in today's traditional political parties. Moreover, leading economists of the day tended to praise the income tax for its redistributive properties, unlike most economists today, who focus on the barriers to economic growth imposed by the tax.

Unfortunately, Weisman fails to emphasize these and other important differences in the past and present debate over taxes. Instead, he offers only the rather indifferent proposition that most citizens probably favour a balance between the goals of wealth redistribution and economic growth, and that the difficulty for politicians continues to be finding that balance. This weak conclusion detracts somewhat from Weisman's stated goal of writing a history of how Americans think about taxes. Arguably, Americans do think very differently about taxes than they did during the period of the Great Tax Wars. Weisman's failure to draw out a full range of implications should not detract, however, from a first-rate tax history.

T.E.

Doron Herman, *Taxing Portfolio Income in Global Financial Markets*
(Amsterdam: IBFD Publications BV, 2002), 482 pages, ISBN 90-76078-43-2

This book is the second instalment in the Doctoral Series of the Academic Council of the International Bureau of Fiscal Documentation. In general, the author provides a commendable discussion of an area that continues to confound tax policy makers. His discussion draws extensively on the relevant economic and legal literature and provides a good balance between the theoretical and practical considerations that impact equally on the income tax treatment of cross-border portfolio investment. The material is laid out logically in six chapters, although the prose is a bit dense and could have benefited from a vigorous editing.

The book begins with a useful overview of the structural features of capital markets, which form the background for the income taxation of cross-border portfolio investment. The markets are reviewed for various financial products and the institutional participants. There is also some discussion of the integration of national financial markets, the determinants of international capital flows, and the regulatory environment.

The tax analysis is found primarily in chapters 2 and 3. Chapter 2 provides an overview of much of the theoretical literature in the area of international income taxation. After a discussion of some standard normative principles governing the income tax treatment of capital income domestically, the author focuses on the different international principles that have been debated in the literature over the past four decades. He provides a review of some standard principles, such as capital-export neutrality, capital-import neutrality, inter-nation equity, interpersonal equity, and national welfare maximization. Throughout the review of these principles, the author draws on much of the relevant economic literature. Chapter 2 ends the review of international tax principles with a discussion of the international tax competition debate. Chapter 3 follows this review of the theoretical literature with a lengthy overview of the status quo for the taxation of income from cross-border portfolio income. The discussion is divided into unilateral, bilateral, and multilateral approaches in this area. Unilateral approaches include the familiar use of source-country withholding taxes and anti-deferral regimes applicable to the income of controlled foreign corporations and foreign investment funds. Bilateral approaches focus on tax base allocation issues and the provision of administrative assistance through bilateral tax treaties. Multilateral approaches simply extend this same focus to a broader range of agreeing countries.

The issue of international cooperation in various non-tax areas is reviewed in chapters 4 and 5. Chapter 4 examines the theoretical literature, particularly various game theories, as a means of explaining country behaviour in the international arena. This review is followed by a discussion of the politics of international cooperation in practice. The discussion focuses on cooperative efforts in the areas of international trade law, the international monetary system, and the regulation of international financial markets.

Chapter 6 provides a series of observations on both the positive and normative aspects of the international tax system as it pertains to cross-border portfolio income. For the most part, these observations are fairly standard. For example, Herman explores the role of politics as a barrier to the realization of cooperation in international taxation and the explanatory power of game theory. In the absence of comprehensive base coordination, he argues for the use of more robust forms of information exchange and administrative assistance among national governments.

T.E.

Tax Policy in the Global Economy: Selected Essays of Peggy B. Musgrave (Cheltenham, UK: Edward Elgar, 2002), 470 pages, ISBN 1 84064 313 7

Peggy Musgrave is one of the pioneers of international tax analysis. This volume brings together 22 of her papers published over a span of almost 40 years. Some of the papers will be familiar to readers as classic works that effectively mapped the international tax debate for a whole generation of tax economists, legal academics, and practitioners. In this respect, she is probably most famous for her articulation of the concepts of "national neutrality" and "inter-nation equity." However, this collection also includes several papers that may be unfamiliar to readers, particularly a set of papers on fiscal coordination and tax competition that speak insightfully to the current debate in these areas. The papers are organized under seven general topics: tax policy and economic aspects of foreign investment (7 papers); public debt and investment abroad (3 papers); interjurisdictional equity and efficiency in taxation (3 papers); fiscal decentralization (2 papers); interjurisdictional fiscal coordination and competition (3 papers); tax treaties and tax coordination (2 papers); and consumption taxes in an international setting (2 papers).

T.E.

Alan J. Auerbach and Roger H. Gordon, "Taxation of Financial Services Under a VAT" (2002) vol. 92, no. 2 *The American Economic Review* 411-16

Donald J. Rousslang, "Should Financial Services Be Taxed Under a Consumption Tax? Probably" (2002) vol. 55, no. 2 *National Tax Journal* 281-91

New Zealand, *GST & Financial Services: A Government Discussion Document* (Wellington, NZ: Inland Revenue, Policy Advice Division, October 2002), 70 pages, ISBN 0-478-27103-4. Available on the Web at http://www.taxpolicy.ird.govt.nz/.

Conventional wisdom holds that the consumption of financial intermediation services is properly taxable under a consumption tax, such as an invoice/credit value-added tax (VAT) or a goods and services tax (GST). However, an inability to measure financial margins and allocate them on a transactional basis has led to the standard country practice of exempting financial services, with no input tax credits for financial intermediaries in respect of the taxable services that they consume. Two recent articles in the *National Tax Journal* have challenged this conventional wisdom, arguing that the consumption of a range of financial services is properly non-taxable under a consumption tax.[2] This challenge, which suggests that a range of financial services should be zero-rated, contrasts sharply with the part of the literature devoted to the development of a cash flow methodology that would permit the taxation of financial services under an invoice/credit VAT or GST.[3] The article by Auerbach and Gordon, as well as the Rousslang article, reasserts the theoretical case for the taxable treatment of financial services under a consumption tax. The discussion document released by the Policy Advice Division of the New Zealand Inland Revenue accepts the conventional wisdom that such services are properly taxable, and outlines a way forward from a system of exemption as an alternative to the adoption of a cash flow tax methodology.

Auerbach and Gordon emphasize the fundamental objectives of a VAT as the basis for deciding how to tax financial services. They argue that this category of intermediate production should be subject to a VAT on the same basis as other sectors where resources are used up in the production process. In particular, Auerbach and Gordon rely on the equivalence of a labour-income tax and a VAT to support the proposition that a VAT should be applied to tax all primary factors that enter into the production of financial services consistent with a tax on the income of all such factors. They reject the efficiency-based analysis supported by the proponents of the non-taxable status of financial services by showing that the application of a VAT to the real resources consumed by the financial sector should not distort prices where the same costs remain and would otherwise be taxed under an equivalent labour-income tax.

Rousslang apparently accepts the premise that the real resources used up in the delivery of financial services should, as an initial proposition, be subject to a VAT unless it can be shown that: (1) the use of financial services to shift consumption intertemporally is not wasted in its associated shifting of tax revenue; and (2) imposition of the tax to financial services causes consumers to increase their consumption of such services. In effect, Rousslang posits that the suggested distinction in the literature between financial services and other intermediate services, which are subject to a VAT, depends on the answer to these two propositions. He argues that the first proposition is unlikely, and that the better answer to the second is "no." The basis for the former is that the intertemporal shifting of tax revenue is largely offset by lending and borrowing transactions, so that there are no positive externalities associated with such shifting of revenue. In short, the effort is largely wasted because of the offsetting positions. The basis for his second response is simply the proposition that there is no empirical evidence in support of the assumption that the imposition of a VAT on financial services would result in increases in transaction costs that are proportional to nominal prices. In other words, there is no empirical evidence that consumers would increase their borrowing requirements in response to the imposition of a VAT on financial services. Rousslang thus concludes that the better view is that financial services should be taxed under a VAT consistent with other sectors.

The New Zealand discussion document acknowledges the recent theoretical debate in the literature regarding the appropriate status of financial services under a consumption tax, and accepts that, in the absence of any consensus on this issue, taxable status remains the preferred policy choice. The discussion document rejects, however, the adoption of a cash flow tax methodology for financial services generally on the basis that the compliance and administrative costs are too severe. Application of this methodology remains limited to property and casualty insurers, which has been the case in New Zealand since the introduction of the GST in 1986. As an alternative to the comprehensive application of cash flow taxation, the discussion document proposes two broad approaches. The first is the zero-rating of the business consumption of financial services. This approach is intended to eliminate the cascading that otherwise results from the application of input taxation to such consumption under an exemption regime. The second approach would apply to the household consumption of financial services, which the discussion document proposes to continue to subject to exempt treatment, but with a narrower definition of exempt financial services that would expose a broader range of financial services to full taxation. The discussion document also considers the changes that are required to the grouping rules as a consequence of the proposals.

T.E.

Howell H. Zee, "Taxing Capital Income in a Globalized World"
(2002) vol. 27, no. 10 *Tax Notes International* 1185-1211

This article by a senior economist with the International Monetary Fund provides a worthwhile view of the income tax policy landscape associated with internationally mobile capital. The overview is especially useful for the manner in which it frames the traditional issues associated with the taxation of capital income in a world of internationally mobile capital. In particular, Zee reviews the longstanding debates over the relative tax rates on capital and labour income and the integration of the corporate and personal income taxes. The theoretical aspects of this debate are also reviewed in terms of trends in country practices, including the move away from integration and the move toward the adoption of separate tax rates for capital and labour income. In the second part of the article, Zee reviews five different issues raised by internationally mobile capital: (1) the impact of globalization on income tax revenues; (2) the proposals to move toward taxing consumption; (3) the merits and limitations of the dual-income tax structure adopted in the Scandinavian countries; (4) the role of non-resident withholding taxes; and (5) the effectiveness of information exchange among tax administrators in controlling the evasion of tax on capital income.

T.E.

Lara Friedlander, "The Role of Non-Discrimination Clauses in Bilateral Income Tax Treaties After GATT 1994" [2002] no. 2
British Tax Review 71-118

The rationale for and the scope of the non-discrimination principle in bilateral income tax treaties are two of the little mysteries in international taxation that are receiving increasingly critical scrutiny in the literature, apparently in light of the parallel principle in international trade law.[4] This article adds to the growing literature exploring the role of the World Trade Organization (WTO) and the general agreement on tariffs and trade (GATT 1994) in controlling the use of tax subsidies as barriers to the free flow of international trade.[5] This role is contrasted with the more limited role of the non-discrimination principle in bilateral income tax treaties. As with earlier literature on the subject, the obvious impetus for this article is the recent successful challenge to the US foreign sales corporation regime under the GATT 1994.[6] The article is not limited, however, to a consideration of this litigation, but reviews in detail both the non-discrimination principle in bilateral tax treaties and the comparable principle developed in the case law considering the EC treaty. In light of the very limited development of the non-discrimination principle in the context of the income tax, the author prefers the GATT 1994 as a potentially more robust means of controlling the use of tax subsidies.

T.E.

Julie Roin, "Taxation Without Coordination" (2002) vol. 31, no. 1, part 2 *The Journal of Legal Studies* S61-92

This article is the logical followup to an earlier article by Roin on international tax competition.[7] In general, she is skeptical of the policy case for broad tax base coordination as a response to international tax competition. In this article, she focuses more on the practical public choice barriers that prevent the realization of comprehensive base coordination, even accepting that the advantages of such coordination outweigh its disadvantages. She divides the barriers into two general categories: sources of "legislative hostility" and sources of "taxpayer hostility."

Roin uses the term "legislative hostility" to describe the resistance of national governments to base coordination efforts. She identifies three specific sources of such resistance. The first is their obvious loss of control over national tax policy without a corresponding increase in control over the policies of other countries. In effect, the loss of political power associated with this loss of control arises from an exchange of power that is "narrow and deep" for power that is "broad but shallow." Because of increased lobbying costs attributable to a more diffuse decision-making process, the exchange of power can result in new political players and associated disruptions in the nature of political relationships. The second source of legislative hostility is the need for a new international organization to propose and consider legislative proposals in an efficient manner. Such an organization would invariably "freeze out" public officials who exercise decision-making power in a national context. The third source of resistance is the loss of the ability to use the tax base as a mechanism to deliver tax expenditures. Although policy independence in this area could, in principle, be maintained through the use of tax rates and credits, this approach is arguably more transparent and, therefore, potentially more constraining. Revenue gain from the closing of avoidance opportunities is arguably too uncertain as a potential source of funding for direct spending programs.

Roin uses the term "taxpayer hostility" to describe the resistance of taxpayers to international base coordination. She also identifies three particular sources of resistance. The first is the loss of avoidance opportunities that are not necessarily offset by gains in compliance costs. Because these opportunities are the special preserve of multinational firms, their concentrated minority interest presents a stiff barrier to the cause of base harmonization, which is supported by a diffuse majority at best. The second source of taxpayer resistance follows from the transition costs that would invariably arise from the change to a new coordinated base. Although these costs may be offset, in part, by gains in compliance costs attributable to a harmonized base, the gains do not accrue to a wide range of taxpayers whose investments are purely domestic, yet these taxpayers incur transition costs. Their sole benefit is a much vaguer and longer term one, attributable to a more efficient base structure that eliminates a broad set of avoidance opportunities and tax expenditures. The third source of taxpayer hostility is the possible loss of tax expenditures delivered through the base computation rules. As noted above, these expenditures may not necessarily be replaced with comparable expenditures delivered in the form of rate reductions or tax credits.

Roin concludes that these barriers to the adoption of comprehensive base coordination mean that the perceived social benefits of such coordination must significantly outweigh the perceived social costs. Although she does not engage in a cost-benefit assessment in this article, she does review the benefits, which are generally described as savings in administrative and compliance costs and the elimination of tax-avoidance opportunities presented by differences in country tax bases. Her earlier article on international tax competition reviewed in detail what Roin would see as the costs of base coordination. Those costs would follow from the suppression of what she regards as a largely beneficial process of international tax competition.

T.E.

Jason Chang and Richard Krever, "Is Hong Kong Part of China for Tax Treaty Purposes?" (2002) vol. 6, no. 2 *The Tax Specialist* 62-67

This little article is a comment on the decision of the Tax Court of Canada in *Edwards v. The Queen*,[8] which held that Hong Kong is not part of China for the purposes of the Canada-China tax treaty. The authors are generally critical of the Tax Court's analysis of Hong Kong's legal status. After reviewing in detail the decision of the Tax Court, Chang and Krever explore its implications for the Australia-China tax treaty, as well as Australian tax law in general.

T.E.

"Symposium on Corporate Tax Shelters" (2002) vol. 55, no. 2 and no. 3 *Tax Law Review* 125-288 and 289-464

These two issues of the *Tax Law Review* consist of six papers and five commentaries presented at a symposium on corporate tax shelters held in May 2001 at the New York University School of Law. The participants are a cross-section of legal academics, economists, and tax practitioners. Perhaps not surprisingly, there is disagreement on just about every aspect of the corporate tax shelter problem, which continues to receive considerable attention in the United States. The papers and the commentaries review all aspects of the corporate shelter phenomenon, including the definition of abusive shelters, the empirical evidence of the phenomenon, the incentives of the participants, and the desirability of responses such as increased penalties, robust disclosure requirements, and general anti-avoidance doctrines. Although it is impossible to draw any definitive conclusions from the symposium proceedings, they do provide a rich source of thoughtful analysis of the corporate shelter problem and, more generally, the timeless dichotomy between acceptable and abusive tax planning.

T.E.

Canada, Standing Senate Committee on Social Affairs, Science and Technology, *The Health of Canadians—The Federal Role*, vol. 6, *Recommendations for Reform* (Ottawa: Communications Canada—Canadian Government Publishing, October 2002), 392 pages. Available on the Web at http://www.parl.gc.ca/.

The Kirby report on health reform has provided additional focus to the health-care debate in Canada. An important element of the report relates to the financing of heath care: chapter 14 examines the need for additional financial resources and the role of the federal government in funding health care; chapter 15 analyzes how federal funds should be raised; and chapter 16 discusses the consequences of not making the system fiscally sustainable.

Central to the Senate committee's message is that Canada's health-care system is not fiscally sustainable. It is anticipated that health-care costs will continue to increase as a result of increasing drug costs, new technology, an aging population, human resources, and growing public expectations. The committee concludes, given competing demands, that additional federal funding will have to come from new money. They go on to argue that the federal government must shoulder more financial responsibility for health-care reform with financial contributions and that the federal government should have a seat at the table during the discussions about the structuring of the system. The report also argues that these funds should be earmarked (separate from the Consolidated Revenues Fund), targeted (the money must buy change and reform), and subject to accountability.

The Senate committee estimates that the annual increase necessary to fill major gaps in the health-care system is $5 billion. The report discusses at length how this amount should be raised. While they examine both public and private sources of funding, the primary focus in on public federal funding. After discussing alternatives, the committee recommends adoption of a National Variable Health Care Insurance Premium (NVHCIP). In table 15.3 of the report, it sets out a proposed structure. This structure is based on the federal taxable income brackets. In the lowest bracket ($0 to $31,677), an individual would pay up to $185 per year. This doubles to $370 per year in the second bracket ($31,678 to $63,354), $740 in the third bracket ($63,355 to $103,000), and $1,400 in the highest bracket (over $103,000). Note that a notch relief provision (a phase-in for each bracket at a 10 percent rate) is in place to ensure that when an individual first enters a bracket he or she is not fully burdened. The committee notes that this structure has the advantage of being progressive. It is interesting to note that the report attempts to distinguish the NVHCIP from an income tax increase, even though it is based on the bracket structure of the Income Tax Act—the Senate committee strongly opposes an income tax increase.

Canada may soon have a new health-care tax based on income. To understand the rationale for the Senate committee recommendation, it is worthwhile reading chapters 14 to 16 of the report.

G.F.

Valentino Dardanoni and Peter J. Lambert, "Progressivity Comparisons" (2002) vol. 86, no. 1 *Journal of Public Economics* 99-122

This article makes a simple, but important, point. In measuring the progressivity of a tax system, it is important to look at both the rate structure and the distribution of income. For example, a province with high marginal tax rates may have a less progressive tax system than a province with low marginal tax rates if, in the first province, there are few people actually taxed at these higher rates. Most prior articles that have compared progressivity across regimes, or over time, assumed a fixed and common distribution of before-tax income.

A primary contribution of Dardanoni and Lambert is their presentation of a method for correcting income tax schedules for before-tax distributional differences across regimes—a transplant-and-compare procedure. To demonstrate this procedure, Dardanoni and Lambert examine the Canadian, Israeli, and UK tax and benefit systems over time. The Canadian results are interesting. They demonstrate that from 1981 to 1990 the Canadian tax structure became more progressive at all levels of income.

This article is not written for a general audience; it does, however, effectively call into question the nature of comparisons of progressivity across regimes and over time.

G.F.

Jenna Robbins and Michael R. Veall, *Registered Savings Plan Holdings as a Government Asset*, C.D. Howe Institute Backgrounder no. 63 (Toronto: C.D. Howe Institute, October 2002), 8 pages. Available on the Web at http://www.cdhowe.org/.

Robbins and Veall estimate the present value of future personal tax revenue that will be generated from registered retirement savings plans (RRSPs) and registered pension plans (RPPs). They note that when Canada's future fiscal position is analyzed, unfunded liabilities such as the Canadian Pension Plan are often considered. However, assets such as the future tax revenue from RRSPs and RPPs are not usually considered. They also argue that in assessing Canada's long-term fiscal position, the most transparent and accessible means of producing estimates is to develop liability (for example, CPP) and asset (for example, RRSP and RPP) accounts to supplement debt figures.

Using conservative assumptions, Robbins and Veall find that the present value of Canadians' RRSP and RPP assets is approximately $300 billion. To put this amount into context, the federal government's debt is currently $550 billion and the unfunded liability on CPP is approximately $440 billion.

G.F.

Michael Smith, "Tax and Incentive Trade-Offs in Multinational Transfer Pricing" (2002) vol. 17, no. 3 *Journal of Accounting, Auditing & Finance* 209-36

In multilateral transfer pricing, there can exist a tradeoff between managerial incentives and the minimization of taxes. First, with a compensation contract firms can motivate the manager to work harder at earning income in the low-tax jurisdiction (ex ante shifting). Second, the firm can allocate realized income to the low-tax jurisdiction (ex post shifting). Michael Smith examines the relationship between these two incentives.

Smith finds that there is an incentive for firms to use a different transfer price for contracting than for tax purposes, although regulators will likely object to this practice. Further, where the same price is used for contracting and tax purposes, in general the price will be set at a level that allocates less income to the low-tax jurisdiction.

G.F.

Stacey Dickert-Conlin and Scott Houser, "EITC and Marriage" (2002) vol. 55, no. 1 *National Tax Journal* 25-39

The earned income tax credit (EITC), which is income-tested on family earnings, distributes almost $26 billion to 18.5 million households in the United States. The credit provides the greatest assistance to those with qualified children. The structure of the credit is interesting: depending on the income levels of the individuals, the EITC will in some circumstances create a marriage penalty, and in others a marriage subsidy. This discrepancy occurs because the credit has both phase-in and phase-out provisions. An effect is that, in general, the EITC subsidizes marriage for single-income families and penalizes marriage for dual-income families. It is unclear, therefore, what the overall effect of EITC is on marriage.

Dickert-Conlin and Houser find that the EITC discourages divorce among married women (although the effect is not large). For unmarried women, the EITC has no significant effect on the decision to marry.

G.F.

NOTES

1 158 US 601 (1895).

2 Harry Grubert and James Mackie, "Must Financial Services Be Taxed Under a Consumption Tax?" (2000) vol. 53, no. 1 *National Tax Journal* 23-40; and William Jack, "The Treatment of Financial Services Under a Broad-Based Consumption Tax" (2000) vol. 53, no. 4 *National Tax Journal* 841-51. See also Ngee Choon Chia and John Whalley, "The Tax Treatment of Financial Intermediation" (1999) vol. 31, no. 4 *Journal of Money, Credit and Banking* 704-19.

3 See, for example, Satya Poddar and Morley English, "Taxation of Financial Services Under a Value-Added Tax: Applying the Cash-Flow Approach" (1997) vol. 50, no. 1 *National Tax Journal* 89-111, reviewed in this feature (1997) vol. 45, no. 4 *Canadian Tax Journal* 876-90, at 880.

4 See Alvin C. Warren Jr., "Income Tax Discrimination Against International Commerce" (2001) vol. 54, no. 2 *Tax Law Review* 131-69, reviewed in this feature (2001) vol. 49, no. 3 *Canadian Tax Journal* 843-55, at 846-47.

5 See, for example, Paul R. McDaniel, "Trade and Taxation" (2001) vol. 26, no. 4 *Brooklyn Journal of International Law* 1621-40; Reuven S. Avi-Yonah, "Treating Tax Issues Through Trade Regimes" (2001) vol. 26, no. 4 *Brooklyn Journal of International Law* 1683-92; and Joel Slemrod and Reuven Avi-Yonah, "(How) Should Trade Agreements Deal with Income Tax Issues?" (2002) vol. 55, no. 4 *Tax Law Review* 533-54.

6 World Trade Organization Appellate Body Report, *United States: Tax Treatment for "Foreign Sales Corporations*," WT/DS108/AB/RW, January 14, 2002, adopted by the WTO Dispute Settlement Body on January 29, 2002.

7 Julie Roin, "Competition and Evasion: Another Perspective on International Tax Competition" (2001) vol. 89, no. 3 *The Georgetown Law Journal* 543-604, reviewed in this feature (2001) vol. 49, no. 3 *Canadian Tax Journal* 843-55, at 847-48.

8 2002 DTC 1856; [2002] 4 CTC 2202 (TCC).