Current Tax Reading

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Rebecca Johnson, *Taxing Choices: The Intersection of Class, Gender, Parenthood, and the Law* (Vancouver: UBC Press, 2002), 239 pages,
ISBN 0-7748-0956-6

It has been nine years since the Supreme Court of Canada weighed in on the issue of the income tax treatment of child-care expenses and rendered its judgment in the controversial case of *Symes v. The Queen et al.*[1] Because we find it hard to imagine that there is much left to draw out of this saga in Canadian tax history, we must admit that we approached this book with muted enthusiasm. We were pleasantly surprised, therefore, by Professor Johnson's ability to bring a somewhat fresh perspective to the *Symes* case. That said, tax professionals and academics may remain disappointed, and even frustrated, by Johnson's failure to frame this perspective within a classic tax expenditure analysis of the income tax treatment of child-care expenses. The failure is especially troubling given her explicit recognition of the important analytical distinction between normative tax rules and tax expenditure provisions. The former define the basic structure of a tax system (that is, they define the tax unit, jurisdiction to tax, the tax base, the tax period, and the rate structure) and should be analyzed using traditional tax policy criteria. The latter provisions implement spending programs through the tax system and should be analyzed using budgetary criteria.

Johnson employs the apparent insights of "intersection theory" to explain the *Symes* saga. In particular, she focuses on what she calls the intersection of "power and wound." This intersection seems to amount to nothing more than the observation that Beth Symes was a conflicted actor in the sense that she suffered disadvantage

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1 94 DTC 6001; [1994] 1 CTC 40 (SCC).

because of her gender, but at the same time was advantaged economically because of her position as a highly compensated lawyer. This conflict was the focus of much commentary on the case and the principal source of the associated controversy, which Johnson recognizes. She attempts to go beyond this obvious recognition, however, to explore the significance of the intersection of power and wound as an explanatory and analytical tool.

The book is divided into three parts. Part 1 consists of three chapters. The first chapter reviews the explanatory power of intersection theory. The second describes the background of child-care politics in Canada. The third chapter explores the development of litigation strategies for a challenge to the treatment of child-care expenses under the Income Tax Act.[2] The review of intersection theory is particularly useful for those readers unfamiliar with feminist theory generally. The discussion of the politics of child care in Canada and the development of litigation strategies includes important reviews of prior case law in Canada, the United Kingdom, and the United States characterizing child-care expenses as non-deductible personal expenses. There is also some discussion of equality-based challenges in the United States to non-deductible treatment, as well as an interesting review of the broader political backdrop of the debate in Canada over the appropriate governmental response to child care. Johnson also directly and honestly faces the divisions within the women's movement in Canada that were created by the decision of Beth Symes and her high-profile counsel, Mary Eberts, to challenge the treatment of child-care expenses under the Act.

Part 2 consists of a single chapter that presents the litigation in *Symes* in the form of a five-act play. The play follows the litigation at each of its three stages—that is, the Federal Court Trial Division, the Federal Court of Appeal, and the Supreme Court of Canada. The format is used in a way that provides the essence of the evidence, arguments, and judicial reasoning in a unique and entertaining manner.

Part 3 consists of five chapters. Chapter 5 focuses on the power of the Supreme Court of Canada and the constraints that it faced in the *Symes* case. Johnson argues that the Supreme Court was free to reject prior case law characterizing child-care expenses as non-deductible personal expenses or, alternatively, free to accept an equality-based challenge to a non-deductible characterization and the limited deduction provided in section 63 of the Act. She also argues, however, that the Supreme Court was constrained by the failure of Crown counsel to lead evidence in support of a compelling argument that any restriction on the deduction of child-care expenses could be saved under section 1 of the Canadian Charter of Rights and Freedoms. The equality-based challenge and the response of Crown counsel to it are then analyzed more particularly in chapter 6, which considers the significance of language in framing the relevant issues. Chapters 7 and 8 follow with a review and analysis of the intersection of gender and class, because that intersection was supposedly reflected in the responses of non-experts and experts to the *Symes* case.

2 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this feature are to the Act.

In conclusion, chapter 9 presents a review of the lessons to be learned. In drawing out these lessons, Johnson uses a sports metaphor to examine the particular roles of the various actors.

The fresh perspective brought to the *Symes* case by Johnson undoubtedly lies in her use of the explanatory power of intersection theory. Although not always entirely convincing, the application of this theory provides some useful insights, particularly for those readers who are not thoroughly versed in feminist theory. Johnson seems to be skating on much thinner ice, however, when it comes to drawing out the policy lessons from the saga. Indeed, we believe a failure to draw on tax expenditure analysis to draw out those lessons arguably leaves the *Symes* case as, at best, nothing more than an interesting footnote in tax history and, at worst, a wrong-headed and damaging strategy in the fight to address the gendered delivery of child care in Canada. Perhaps most important, much of the policy significance of the issues of both gender and class that Johnson explores using intersection theory can arguably be balanced and resolved within the policy framework provided by tax expenditure analysis. It is unfortunate, therefore, that Johnson does not go beyond intersection theory to link its insights with a tax expenditure analysis of the treatment of child-care expenses under the Act. In this respect, we suspect that those members of the women's movement who opposed the litigation strategy adopted by Beth Symes and Mary Eberts, in fact, recognized the significance of the kind of budgetary criteria associated with this mode of analysis. More particularly, they may have rejected this strategy precisely because of its failure to frame issues of both gender and class in a manner that provides the potential for a defensible, policy-based resolution of the delivery of child care in Canada.

T.E.

Paul L. Caron, ed., ***Tax Stories: An In-Depth Look at Ten Leading Federal Income Tax Cases*** (New York: Foundation Press, 2003), 375 pages, ISBN 1-58778-403-3

This collection of 10 essays by 10 US legal academics is the first in a series of "law stories" books to be published by Foundation Press. The series will ultimately cover, first, all of the subjects in a standard first-year law school curriculum in the United States and, then, the principal subjects in the second- and third-year curriculum. The idea is to provide a doctrinal, historical, and social context for a particular area of law by exploring the leading cases in that area. If *Tax Stories* is representative of what is to follow in the series, the execution of the general idea will be an unqualified success. In particular, the essays engage in a form of scholarship that combines a traditional doctrinal inquiry with a storytelling narrative that provides a refreshing break from the normative and prescriptive analysis that has become the standard fare offered by the legal tax academy in the United States.

Although the 10 cases discussed in *Tax Stories* are necessarily significant for US income tax purposes, non-US readers should also find the volume of interest since the focus of the case selection is clearly on the foundation issues of an income tax that are common to the experiences in a broad range of countries. In fact, for a non-US reader, *Tax Stories* provides a terrific vehicle to compare the resolution of the particular issues in the United States with the resolution of many of the very same issues in his or her own country. In the process, non-US readers may even end up compiling their own list of leading cases that could provide the basis for a comparable volume in their own countries.

The first four essays discuss four leading cases considering fundamental issues for income inclusion purposes. Those issues include (1) the characterization of items as taxable amounts; (2) the realization requirement as the determinant of the timing of taxable amounts; (3) the treatment of the amount of debt forgiveness as a taxable amount; and (4) the realization of gain on the transfer of property incident to marital breakdown. The next three essays discuss three leading cases considering fundamental issues for deduction purposes. Those issues include (1) the definition of "ordinary and necessary" business expenses; (2) the definition of the range of capital expenses; and (3) the treatment of non-recourse debt. The final three essays are not linked by a common subject, but instead discuss three distinct issues: (1) the relationship between tax and financial accounting; (2) the choice of the individual or marital unit as the tax unit; and (3) the development of judicial anti-avoidance doctrines. As with the other essays, a leading case on each of these issues is selected as the vehicle for the discussion.

The essays are preceded by a brief introduction by the editor, entitled "Tax Archaeology." The introduction usefully summarizes each of the 10 essays, as well as the broad pedagogical methodology underlying the essays. Professor Caron also includes some passing comments on some of the "institutional lessons" from the 10 leading cases. The first lesson is the apparent support that the cases provide for a move to severely limit the role of the US Supreme Court as the final arbiter of tax cases. The second lesson is the apparent lack of support that the cases provide for the contention that the US government has "a dismal track record" in tax litigation. That is not to say, however, that the litigation strategy of the government has always been the reason for victory. All too often the chosen strategy, although producing victory in the immediate case, has caused unintended consequences with far broader ramifications than the result in the case itself. *Tax Stories* provides a number of instances of these pyrrhic victories. All of these institutional lessons from the US experience should resonate with the experience of non-US readers across a wide range of countries.

Finally, it is worthwhile to note that the archaeological feature of *Tax Stories* is supported by a companion Web site found at http://www.law.uc.edu/TaxStories/. The Web site provides the complete record of all court proceedings in each of the 10 cases. It also includes a copy of the briefs of the parties and any friends of the court, as well as written transcripts of the oral arguments and audio recordings (where available). Among other possible purposes, these materials provide a potentially useful teaching tool.

T.E.

Michael S. Knoll and Thomas D. Griffith, "Taxing Sunny Days: Adjusting Taxes for Regional Living Costs and Amenities"
(2003) vol. 116, no. 4 *Harvard Law Review* 987-1025

This article tackles an interesting issue in the personal income tax: the failure to adjust taxable income, and thereby tax payable, to account for regional differences in living costs and amenities. Despite any intuitive and popular appeal, this issue has received very little attention in the tax literature, largely for two reasons. First, it is commonly perceived that no adjustment is necessary on fairness grounds, because the combined purchasing power of incomes and tax burdens does not differ across high-cost and low-cost regions. Second, even if an adjustment were warranted, the associated measurement and implementation difficulties are insurmountable. The authors of this article challenge this conventional wisdom and argue that regional cost-of-living adjustments are defensible on efficiency grounds. They tentatively propose a general methodology for adjustment purposes, although they concede that any such methodology presents administrative and design issues that require further consideration.

Knoll and Griffith essentially apply the insight of tax capitalization to frame their arguments on the significance of regional differences in the cost of living and amenities. Tax capitalization posits that capital markets adjust pre-tax returns to fully taxable and tax-preferred assets in a manner that equalizes after-tax returns. The equalization of after-tax returns eliminates inequities that would otherwise be associated with investments subject to different tax burdens. The difference in tax treatment does, however, result in an allocation of capital that differs from that which would arise if all assets were subject to consistent tax treatment. Knoll and Griffith argue that the migration of individuals results in adjustments of pre-tax income that equalize the standard of living in high-cost and low-cost regions. The migration thus drives out inequities otherwise associated with the different tax burdens in different regions. However, they argue that in this context, the tax capitalization process results in a misallocation of labour and capital, discouraging investment and production in high-cost regions while favouring low-cost regions. For the purpose of their analysis, Knoll and Griffith distinguish the cost of living from consumption amenities. The former consists of housing costs and the cost of a basket of goods and services such as heating, food, and clothing. The latter consists of public goods, such as good weather, good schools, and access to recreation and entertainment.

Knoll and Griffith argue that the inefficiencies attributable to a failure to adjust for regional differences in the cost of living and amenities can be eliminated through a simple adjustment that "calls for dividing each taxpayer's income by the region's relative before-tax salary level."[3] As noted already, they acknowledge that there are a variety of implementation problems, although they suggest that such problems are not insurmountable. In the absence of a comprehensive adjustment of tax burdens to account for regional differences in cost of living and amenities, it

3 At 989.

is interesting perhaps to speculate whether the arguments put forward by Knoll and Griffith support the non-taxable characterization of adjustments in compensation specifically targeted to such differences. There has been considerable judicial and legislative activity recently in Canada in this area, of which many readers may be aware.[4] Arguably, the analysis of Knoll and Griffith provides support for a taxable characterization of employee-relocation payments designed to equalize differences in living standards. In particular, their analysis suggests that the process of tax capitalization ensures that fairness concerns associated with differences in living standards are equalized by adjustments to pre-tax salary. There appears to be no reason, therefore, to alter this process by treating general adjustments in salary differently from compensation adjustments targeted specifically to identified cost-of-living expenses. What remains, however, is the efficiency dimension emphasized by Knoll and Griffith. It seems that this dimension could only be addressed through some sort of tax adjustment along the lines that they propose.

T.E.

Arthur J. Cockfield, "The Law and Economics of Digital Taxation: Challenges to Traditional Tax Laws and Principles" (2002) vol. 56, no. 12 *Bulletin for International Fiscal Documentation* 606-19

The author of this article, who is a member of the Queen's University Faculty of Law, has written extensively on the income and consumption tax aspects of electronic commerce. In this article, he provides an accessible and comprehensive overview of the challenges presented by this form of commerce. He also touches on possible responses, many of which are the currency of current policy debate in the area. His analysis is carefully grounded in the economics of what he calls "information goods." Professor Cockfield describes this category of goods as "goods and services that can be converted into digital form."[5] The critical economic attribute of such goods is their high fixed costs of production and virtually non-existent marginal cost of reproduction and distribution. The article lucidly draws on these features as the source of both the challenges to traditional tax principles associated with the development of electronic commerce and the possible responses to those challenges.

T.E.

Graham Hill, "GST—An Income Tax To Be Interpreted by Reference to Income Tax Principles or Just Another Consumption Tax" (2002) vol. 17, no. 3 *Australian Tax Forum* 229-56

The author of this article is a member of the Australian Federal Court and is generally recognized as the leading tax judge in Australia. Accordingly, his musings

4 See, for example, subsections 6(19)-(23). For a discussion of some of this case law, see Brian J. Arnold and Jinyan Li, "The Appropriate Tax Treatment of the Reimbursement of Moving Expenses" (1996) vol. 44, no. 1 *Canadian Tax Journal* 1-37.

5 At 606.

in this article on the proper interpretive approach to the recently adopted goods and services tax (GST) in Australia merit some attention. In a sense, Justice Hill picks up a fundamental analytical point that was emphasized in an earlier article by two Australian tax academics[6]—that is, the value-added base for a GST is, with some important modifications, largely equivalent to the business-income base for income tax purposes. An obvious question raised by this equivalence is whether, and to what extent, parallels may be drawn from income tax legislation in interpreting and applying the legislative provisions implementing a GST. The earlier article explored this issue and other structural issues surrounding the design of a GST at a relatively broad level. Justice Hill focuses much more specifically, and in more detail, on the extent to which income tax parallels are appropriate for the interpretation and application of the Australian GST legislation.

The article identifies and considers several areas in the Australian GST legislation that have been the subject of judicial consideration in the income tax context. Justice Hill also emphasizes other areas in which the GST legislation uses concepts that have no obvious income tax parallel. In the areas in which there is an income tax parallel, the article discusses the development of the relevant concepts by the Australian courts. As a general proposition, Justice Hill suggests that the characterization of a value-added tax (VAT), such as the Australian GST, as either a consumption tax or a tax imposed on business value added can be a significant factor in determining the interpretive relevance of parallel income tax concepts. Critical to this characterization is the basic charging provision, which in the Australian context does not require that a taxable supply be made "to" someone. Justice Hill suggests that this type of charging provision opens up the possible characterization of the Australian GST as a tax on business value added, which tends to support a greater relevance for income tax concepts.

T.E.

Richard McGill, "Legal Professional Privilege and Tax" (2002) vol. 8, no. 4 *New Zealand Journal of Taxation Law and Policy* 341-49

Bronwyn Howell and Lisa Marriott, "Tax and Privilege: An Economic Perspective of Proposed Changes in New Zealand Taxation Policy" (2002) vol. 8, no. 4 *New Zealand Journal of Taxation Law and Policy* 371-82

In May 2002, the New Zealand government proposed two changes to the scope of legal professional privilege in the context of tax practice.[7] The first proposed

6 Graeme S. Cooper and Richard J. Vann, "Implementing the Goods and Services Tax" (1999) vol. 21, no. 3 *The Sydney Law Review* 337-436, reviewed in this feature (2000) vol. 48, no. 1 *Canadian Tax Journal* 194-207, at 197-98.

7 New Zealand Inland Revenue, *Tax and Privilege: A Proposed New Structure: Government Discussion Document* (Wellington: Inland Revenue, Policy Advice Division, May 2002).

change would expand the scope of the privilege to cover advice given by non-legal tax professionals such as accountants. The second proposed change would limit the scope of the privilege by excluding the protection of any such claim over factual matters. In effect, legal professional privilege would cover only the content of tax advice or opinion work. The proposed changes are intended to balance taxpayer rights with the need to protect the integrity of the tax base. Perhaps not surprisingly, the New Zealand tax community has praised the first proposed change and severely criticized the second. Although the reasons differ, these two articles add to the criticism of the proposed restriction of the scope of the privilege to matters of tax advice or opinion.

McGill argues that the proposed restriction on the scope of legal professional privilege fails to recognize the constitutional significance of the privilege and would inappropriately erode the scope of taxpayers' rights. As an alternative to the proposed change, he prefers the model advanced by the Institute of Chartered Accountants of New Zealand. Under this model, access to factual information would be limited to that which is necessary and relevant to the investigation being undertaken. Factual matters that could not be characterized in this way would remain privileged.

Howell and Marriott adopt an explicit efficiency-based framework as the basis for an outright rejection of the proposed restriction to the scope of legal professional privilege. In particular, they challenge the New Zealand government's assertion that claims of privilege in respect of factual matters have led to lost revenue that would be recovered by restricting the scope of the privilege. They conclude that the scope of the privilege should not be reduced until it can be established that any such restriction would produce additional revenue at a cost that is less than any revenue gain. Their analysis draws to a large extent on information economics.

T.E.

Eng-Hin Poh, "Broad-Based Consumption Tax Reform: The Economics and Politics of the Equity Implications" (2003) vol. 29, no. 1 *International Tax Journal* 41-65

This article is not the standard fare usually found in the *International Tax Journal*. The author presents an explicitly policy-based analysis of the economic and political dimensions of the introduction of a broad-based VAT. Drawing on the experiences in Australia, Canada, New Zealand, and Singapore, he argues that the failure to adopt a broad-based VAT with a single rate is attributable, in part at least, to a failure to distinguish the regressivity of the tax from its absolute burden. In particular, opponents of a broad-based VAT tend to emphasize its regressivity in terms of its short-term and marginal effects. This perspective leads to an overstatement of the perceived regressivity. The author argues that the appropriate perspective must view a broad-based VAT within the broader context of the fiscal mix in a country and should take into account the longer-term, life cycle effects on a household. The absolute burden of a broad-based VAT on the very poor is the much more problematic distributional feature, which ideally should be relieved through transfer payments. The political context, however, inevitably leads to the adoption of zero-rated or exempt status of a range of goods and services.

T.E.

Jack M. Mintz, Finn Poschmann, and William B.P. Robson, *Focus on the Future: A Shadow Federal Budget for 2003*, C.D. Howe Institute Backgrounder no. 69 (Toronto: C.D. Howe Institute, February 2003), 14 pages. Available on the Web at http://www.cdhowe.org/.

Shadow budgets are inherently interesting. They allow us to put into context the choices made by government. This shadow budget, by Jack Mintz, Finn Poschmann, and William Robson (all of the C.D. Howe Institute), is of particular interest because the direction it defines is in sharp contrast to that of the actual 2003 federal budget.

The emphasis of this shadow budget is on promoting investment, jobs, and growth over a five-year time frame. In the authors' view, the greatest obstacle to future prosperity is the growth in government spending—they are concerned that program spending is growing at an unsustainable rate, with non-defence spending growing twice as fast as the economy. In contrast to the actual budget, they therefore recommend that spending be constrained with reallocations from low- to high-priority areas. High-priority areas include increases in military spending.

Their specific program recommendations differ significantly from the 2003 budget. On health care, they propose that the federal government provide additional tax room for the provinces. They would vacate tax room through reducing the bottom personal rate by one percentage point in 2004, with a further point reduction in 2006 (worth approximately $7 billion per year). To eliminate the distortions associated with the employment insurance program, which is collecting premiums far in excess of payments of benefits, the shadow budget proposes that the employer's premium (which they recommend be experience-related) should fund the entire program. They would not enhance the Canada child tax benefit without further examination of the effects on marginal tax rates by modest-income families.

Perhaps the most notable recommendations in the shadow budget relate to taxation. Several recommendations are made on the retirement savings structure, including the introduction of tax-prepaid savings plans (similar to those in the United States), the removal of the foreign content rules, significantly raising retirement savings limits, and generating new registered retirement savings plan (RRSP) contribution room when amounts are withdrawn. Recommendations related to business taxation include changes to the taxation of dividends (to bring them back into line with capital gains rates), a reduction of the general corporate income tax rate, and a phaseout of the large corporations tax (LCT) and corporate income surtax. To assist municipalities, the shadow budget would reduce fuel excise taxes, providing room for local governments.

The shadow federal budget presented by Mintz, Poschmann, and Robson reflects an alternative vision that they argue is based on fiscal prudence and the creation of an environment for growth. Whether one agrees or disagrees philosophically with the C.D. Howe Institute, this is a very interesting and worthwhile document to read. It is well written and, further, it provides a coherent and consistent vision.

G.F.

Ken Battle, Sherri Torjman, and Michael Mendelson, *The 2003 Budget: Political Legacy Needs Policy Architecture* (Ottawa: Caledon Institute of Social Policy, February 2003), 16 pages. Available on the Web at http://www.caledoninst.org/.

In this paper, Ken Battle, Sherri Torjman, and Michael Mendelson (all of the Caledon Institute) support the direction taken by the federal government in the 2003 budget to restore and invest in public services in Canada. They argue that opposition to such reinvestment is based on "straight-out old fashioned ideology," and not based on economic realities—in essence, they argue that Canada has the resources to make these investments. Overall, they strongly support the direction taken in the budget, but argue that the overall levels of support offered may not be adequate. For example, they argue that the amount provided in the budget for the child-care initiative is insufficient given the magnitude of the need.

This critique of the 2003 budget is well written. It is worthwhile to read this critique alongside the shadow federal budget written by Jack M. Mintz, Finn Poschmann, and William B.P. Robson of the C.D. Howe Institute (reviewed above). The papers offer very different visions for Canada.

G.F.

Jon Davis, Gary Hect, and Jon Perkins, "Social Behaviors, Enforcement, and Tax Compliance Dynamics" (2003) vol. 78, no. 1 *The Accounting Review* 39-69

A consistent finding in the taxpayer compliance literature is that taxpayers are more likely to evade if they believe that their chances of getting caught are low or that the penalties associated with evading are low. It is reasonable to assume, therefore, that a tax jurisdiction with higher levels of enforcement will have less evasion. Using mathematical models, Jon Davis, Gary Hect, and Jon Perkins (all academic accountants) argue that this assumption may not be correct. In essence, they argue that the effect of changing enforcement levels depends on the compliance starting point—that is, if the population is reasonably compliant (for example, Canada), the population will be somewhat insensitive to changes in enforcement policy until that policy is perceived to be lax. Intuitively, if individuals do not know others who evade, they themselves are less likely to evade and, consequently, higher levels of enforcement are not necessary. In other words, enforcement can be reduced where the initial population is compliant, but there is an important line that the tax authority must not cross. Conversely, in relatively non-compliant populations, enforcement must be sufficiently harsh.

This paper is not written so as to be accessible to a general audience. It does, however, make an important contribution to our understanding of taxpayer compliance.

G.F.

Duanjie Chen and Jack M. Mintz, *How Canada's Tax System Discourages Investment*, C.D. Howe Institute Backgrounder no. 68
(Toronto: C.D. Howe Institute, January 2003), 10 pages. Available on the Web at http://www.cdhowe.org/.

It is believed that high business taxes adversely affect productivity and innovation in Canada—that is, that our tax system is a barrier to capital investment. While this belief is difficult to examine directly, relative tax rates can be examined. Duanjie Chen and Jack Mintz estimate effective tax rates for large corporate investments and entrepreneurial capital.

While the statutory corporate income tax rates for large corporations are lower in Canada than in the United States, Chen and Mintz demonstrate that effective corporate tax rates on capital are substantially higher in Canada—the effective tax rate on capital in 2002 was 24.3 percent in Canada and 16.8 percent in the United States. This difference arises primarily from higher Canadian capital taxes and less generous depreciation and inventory cost deductions in Canada. Chen and Mintz propose a solution: if federal and provincial capital taxes were eliminated, Canada's effective tax rate would be just over 17 percent—a rate close to that in the United States.

In examining the competitiveness of tax regimes for investments by entrepreneurs, one should include both business taxes and personal taxes on dividends, capital gains, and interest income. Chen and Mintz find that, while the effective combined rates (corporate and personal) are similar between Canada and the United States, our rates are significantly greater than those in other countries, including Ireland, Japan, and Italy.

The findings in this paper are interesting. Clearly, in comparing Canadian tax rates to rates in other countries, one must move beyond statutory corporate rates. In examining effective tax rates, it does appear that Canadian companies continue to be at a competitive disadvantage.

G.F.

Robert D. Brown and Yvan Guillemette, *Tax Treatment of Charitable Donations: How Much Is Enough*, C.D. Howe Institute Backgrounder no. 70 (Toronto: C.D. Howe Institute, February 2003), 9 pages. Available on the Web at http://www.cdhowe.org/.

This descriptive paper addresses an interesting issue—should more support for charities be made available through our taxation system? In particular, Robert Brown and Yvan Guillemette examine the individual tax rules related to charitable donations.

Brown and Guillemette first discuss the existing system. They briefly examine the structure, including rules with respect to gifts of listed securities. They point out that the current tax credit structure for individuals is generally more favourable, except for those in the highest tax bracket, than the deduction system it replaced. They further discuss the cost of this tax credit system. In forgone taxes, the cost to the provincial and federal governments is about $2 billion per year.

Brown and Guillemette argue that the decision as to the appropriate level of tax support depends on weighing the benefit of the charitable activity against the loss in government revenue. They conclude that the current system is generous, and that there is not a strong case for increasing the amount of support at this time. In addition, they argue that issues of accountability need to be addressed—that is, significant costs in forgone taxes exist with only moderate levels of accountability.

G.F.

Anna Meresidis, "The I.R.C. §2053(a)(3) Controversy: Should Events After Death Affect the Value of Estate Tax Deductions for Claims Against the Estate?" (2002) vol. 70, no. 6 *Fordham Law Review* 2707-44

The timing of estate valuation for the purposes of estate taxation is a contentious issue in the United States. The literature on the subject posits two basic timing rules: valuation at the time of an individual's death, or valuation at some point after an individual's death. If the former rule is adopted, the amount of all outstanding claims that are enforceable at the time of death reduces the amount of the estate subject to tax, whether the claim is actually enforced or not. If the latter rule is adopted, only the amount of outstanding claims that are enforced reduces the amount of the estate subject to tax.

This article considers estate valuation issues in the context of five scenarios of varying complexity: (1) definite claims with exact figures, (2) claims based on actuarial tables, (3) claims where the amount owed is difficult to prove and, as a result, is disputed, (4) enforceable claims that later become unenforceable, and (5) contingent claims. Drawing on these five scenarios, Meresidis argues that an estate should always be valued at the time of death.

As Meresidis describes, the two possible timing rules are established in *Ithaca Trust Co. v. United States*[8] and *Jacobs v. Commissioner of Internal Revenue*.[9] In *Ithaca Trust*, the US Supreme Court held that, while it is tempting to use after-death events to adjust the value of an estate, the estate should be valued at the time of death, because that is the instant when the relevant property is transferred by the deceased. Meresidis notes, however, that the Eighth Circuit Court in *Jacobs* limited the holding in *Ithaca Trust* to property that is subject to a charitable donation, and, as such, *Jacobs* became the leading case permitting after-death events to be accounted

8 279 US 151 (1929).

9 34 F. 2d 233 (8th Cir. 1929).

for when valuing an estate. She also notes that various circuit courts have relied on both decisions in considering the five different categories of claims noted above, but neither case has been universally adopted. She supports this proposition with a thorough review of the relevant case law under each of these categories. In fact, her analysis of the case law suggests that the main reason one approach is used over another is unrelated to the type of claim and is based solely on whether the particular circuit court follows the black-letter approach in *Ithaca Trust* or the actuality approach in *Jacobs*. In this respect, Meresidis concedes that the Eighth Circuit Court in *Jacobs* correctly pointed out that the estate would have received a windfall if it could have deducted an entirely unenforceable claim. However, she argues that, since the $75,000 claim was enforceable against the estate, and there was no knowledge at the time of death that the claim would not be exercised, it should still have been allowed as a deduction from the value of the estate.

Meresidis fails to discuss, nonetheless, why the ruling by the US Supreme Court in *Ithaca Trust* was incorrectly limited to charitable donations by the Eighth Circuit Court in *Jacobs*. In this respect, the Fifth Circuit Court in *Estate of Smith v. Commissioner* stated that "the Eighth's Circuit's narrow reading of *Ithaca Trust* . . . is unwarranted" because the Supreme Court in *Ithaca Trust* was trying to impose the estate tax "on the act of transferring property,"[10] which happens at the instant of death. Yet, Meresidis only mentions this case in her discussion of cases concerning claims that are difficult to value and does not stress this general position when commenting on *Jacobs*. Furthermore, she makes little mention of the fact that Treasury regulations enacted in 1958 apparently override *Jacobs* in requiring that the value of "personal obligations" at the time of death be accounted for in valuing an estate.

In considering the argument that the term "net estate" supports an accounting of events occurring after death for valuation purposes, Meresidis emphasizes that the appropriate approach depends on the characterization of an estate tax as an intention to tax the transfer of property by the deceased or the property received by the beneficiaries. In arguing that the US estate tax is intended to tax the transfer of property by the deceased, Meresidis discusses certain differences between the current Treasury regulations and the previous regulations. The latter use the term "net estate," which Meresidis notes could be construed as supporting taxation of the receipt of property by the beneficiaries, coinciding with the decision in *Jacobs*. However, she argues that the omission of the phrase "net estate" from the current regulations is a clear indication that estate tax laws are intended to tax the transfer of property by the deceased. She further supports this position by quoting from the decision in *Smith*, where the Fifth Circuit Court held that an estate tax is a tax "on the act of transferring property."

Meresidis notes that the actuality approach in *Jacobs* also has some direct statutory support. In particular, current Treasury regulations provide that a deduction is allowed even if "its exact amount is not then known, provided it is ascertainable with reasonable certainty, and will be paid." If the value of a claim is "vague or uncertain," the regulations allow a period after death to determine the value of the claim. Meresidis argues, however, that this regulation allows deductions of "personal obligations" to be valued at the time of death, which is inconsistent with an accounting of events after death in determining the value of a claim. Yet, the Treasury regulations' allowance for the deduction of funeral and administrative expenses provides further support for after-death valuation, since these expenses arise after an individual's death. Meresidis agrees with this inference, but argues that funeral and administrative expenses should be considered a limited exception to the general rule.

Meresidis then considers some relatively strong policy arguments in favour of the valuation of an estate at the time of death. She begins with the current Treasury regulations, which provide that estate assets are to be valued at the time of death. Since the valuation of claims affects the value of the estate as much as the valuation of estate assets does, the valuation of claims should be approached consistently with the valuation of assets. In addition, interest on claims against the estate is accounted for at the time of death. Interest that accumulates after the time of death cannot be deducted. Accounting for after-death settlements but not interest expense presents a stark contradiction in policy when both factors can affect the value of the estate. Meresidis's argument is, in fact, strongest when the focus of the article shifts to policy considerations. The value of the estate assets and claims are two sides of the same coin, both equally affecting the value of an estate.

Meresidis concludes by discussing the practical implications of allowing after-death events to be considered in valuing an estate. In particular, she points out that allowing such events to be considered requires some specified limitation period to ensure closure of the determination of estate tax liability. However, the definition of a limitation period creates a boundary that could be manipulated by, for example, postponing and settling claims just beyond the limitation period.

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