Current Tax Reading

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"Incremental and Fundamental Tax Reform" (2003) vol. 56, no. 1 *SMU Law Review* 3-717

This massive issue of the *SMU Law Review* consists of 15 papers and 6 commentaries on incremental and fundamental tax reform in the United States. The apparent impetus for the symposium issue was the recent report on tax simplification by the US congressional Joint Committee on Taxation.[1] Most of the contributors to the issue are US tax academics, and some are US tax practitioners. Some of the contributors were also involved in the development of the joint committee report.

For the most part the subjects of the papers are entirely unconnected and can only be lumped together under the title "tax reform," be it incremental or fundamental in nature. Perhaps not surprisingly, four of the five papers collected under the heading "fundamental tax reform" focus, in whole or in part, on the seemingly unique US obsession with the choice of a consumption or an income tax base. Indeed, it seems that this particular subject is the only one that US tax academics consider worthy of the label "fundamental tax reform." While tax policy makers in most other countries have long held the view that a mix of consumption and income taxes is desirable for a number of reasons, US tax academics and politicians continue to labour under the belief that the choice of tax base is an "either/or proposition." As an alternative to the income tax, a consumption tax has been proposed under all kinds of guises and labels, the latest being David Bradford's "X-tax."[2] Because of the seemingly bizarre framing of this debate in the United States and the rather tired

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1 United States, Staff of the Joint Committee on Taxation, *Study of the Overall State of the Federal Tax System and Recommendations for Simplification, Pursuant to Section 8022(3)(B) of the Internal Revenue Code of 1986*, JCS-3-01 (Washington, DC: US Government Printing Office, April 2001).

2 Bradford has developed this latest consumption tax proposal in some of his recent written work. See David F. Bradford, "International Taxation in an X-Tax World," at http://www.princeton.edu/~bradford/.

nature of the details, given their extensive coverage in the literature, we could not resist the urge to skip over most of the four papers focusing on a consumption tax.

We found the fifth paper under the heading "fundamental tax reform" to be much more interesting because of its original and refreshing perspective. In this paper, entitled "A Thermometer for the Tax System: The Overall Health of the Tax System as Measured by Implicit Tax," Calvin Johnson argues that fundamental reform of the US income tax is required to eliminate the broad range of tax expenditures that have crept back after the tax reform effort of 1986. The basis for this conclusion is his examination of the implicit tax associated with tax-exempt state and local bonds. This tax is equal to the reduction in the pre-tax return required by taxable investors purchasing such bonds. Johnson observes that this tax has become virtually non-existent, largely because of the many alternative tax-effective investments available to taxable investors. In effect, an oversupply of tax-preferred investments and tax-avoidance strategies has led to an erosion of the implicit tax associated with tax-exempt state and local bonds, which has effectively eliminated any tax subsidy for such borrowers.

The subjects of the other 10 papers in the symposium issue involve incremental reform proposals, and the papers are set out under eight separate headings: (1) corporate taxation, (2) partnership taxation, (3) international taxation, (4) financial instruments, (5) financial asset securitization investment trusts (FASITs), (6) estate and gift taxation, (7) deferred compensation, and (8) tax-exempt organizations. With the exception of corporate and international taxation, each section consists of a single paper on the subject, sometimes accompanied by a commentary on the paper. One of the two papers under the "corporate taxation" heading considers the reform of the US rules governing the non-recognition treatment of spinoff transactions. The other paper considers the case for repeal of the alternative minimum corporate income tax. One of the two papers under the "international taxation" heading proposes a set of simplification measures for the US source-country taxation of the income of non-residents. The other paper proposes certain reforms of the US foreign tax credit regime.

T.E.

Maria Amparo Grau Ruiz, *Mutual Assistance for the Recovery of Tax Claims* (The Hague: Kluwer Law International, 2003), 332 pages, ISBN 90-411-9893-8

The "nitty-gritty" of tax systems lies in issues of enforcement and collection. Tax academics are especially guilty, however, of a failure to explore the policy and design features of this critical procedural aspect of taxation. This book is a welcome addition, therefore, to the tax literature. The author explores, in detail, both the conceptual and the technical aspects of efforts by national tax administrations to provide mutual assistance in the enforcement of tax claims. For analytical purposes, she distinguishes between the state power to request mutual assistance and the obligation between state and taxpayer in the enforcement of tax claims. The former

category describes the scope of the mutual assistance procedure in the relations between two states. The latter category describes the restrictions on that procedure that are imposed out of concern about the power of the state over taxpayers.

After a brief introduction, chapter 1 of the book describes the conceptual nature of the various categories of mutual assistance and their legal bases. Chapter 2 explores in more detail the power to request assistance in the recovery of tax claims and the obligation to provide such assistance. Chapter 3 examines representative rules on mutual assistance, including bilateral tax treaty articles on mutual assistance, as well as certain multilateral instruments providing for such assistance. Chapter 4 focuses on the procedural specifics of the enforcement mechanism as set in motion by a mutual assistance request. One appendix includes a table describing the kinds of mutual assistance articles commonly adopted by member countries of the Organisation for Economic Co-operation and Development (OECD). There are also some interesting statistics on the processing of mutual assistance claims in Spain for the period 1995-2001. Another appendix sets out the text of some representative bilateral and multilateral mutual assistance articles. The appendixes are preceded by a brief description of recent developments in the area of mutual assistance. These developments apparently arose in the interval between the completion of this text as the author's doctoral thesis and its publication as a book.

T.E.

Robert Couzin, *Corporate Residence and International Taxation*
(Amsterdam: International Bureau of Fiscal Documentation, 2002),
280 pages, ISBN 90-76078-48-3

Some of the most fundamental tax issues—often the most interesting—can be deceptively complex and difficult to understand. One such issue is the determination of the residence of a corporation, which defines both the jurisdiction to tax under the domestic legislation of most countries and the entitlement to treaty relief under most bilateral income tax treaties. This issue has a long legislative and judicial history in Canada and in other countries. The two accepted tests of corporate residence—the place of central management and control of a corporation and the place of incorporation—have often been manipulated for income tax purposes, because there are few non-tax factors that constrain the choice of residence for domestic tax and tax treaty purposes. The manipulability of the traditional tax tests of corporate residency has recently been highlighted in the United States by "inversion transactions."[3]

This excellent book by a leading Canadian tax practitioner provides a wonderful re-examination of corporate residency and its implications. The book is the outcome of a series of lectures delivered by the author and sponsored by the Canadian

3 United States, Department of the Treasury, *Corporate Inversion Transactions: Tax Policy Implications* (Washington, DC: Department of the Treasury, Office of Tax Policy, May 2002).

branch of the International Fiscal Association (IFA). The perspective is thus a Canadian one, but the common nature of the concept in a broad range of countries should make the book appeal to non-Canadian tax practitioners and academics.

It is somewhat difficult to categorize the book in terms of conventional types of tax writing. On the one hand, Couzin does not attempt to provide any detailed prescriptive policy analysis. On the other, he eschews the description and analysis of tax-planning techniques that one would find in a practitioner's handbook. Instead, he focuses on the development of the concept of corporate residence as an intellectual exercise worthy of study unto itself. Invariably, however, even this approach cannot wholly ignore policy considerations, which can be detected under the surface of much of the analysis.

Chapter 1 provides the broad fiscal, legal, and commercial context of the subject. Chapter 2 reviews the development by the UK judiciary of a concept of corporate residency. Chapter 3 examines the concept for income tax treaty purposes, focusing particularly on its articulation in the OECD model treaty. Chapter 4 provides an analysis of the series of ad hoc rules in the Income Tax Act[4] that modify the concept of corporate residency in a variety of ways, including the adoption of (1) a place of incorporation test alongside the place of central management and control test developed by the UK courts; (2) a tiebreaker rule for dual-resident corporations; and (3) special deeming rules for corporate continuances and international shipping corporations. There is also a separate discussion of the residence of a foreign affiliate for the purpose of the foreign affiliate rules in the Act. The concluding chapter provides some brief and very general observations on possible directions for the future development of the concept of corporate residence.

T.E.

Anthony C. Infanti, "Eyes Wide Shut: Surveying Erosion in the Professionalism of the Tax Bar" (2003) vol. 22, no. 3 *Virginia Tax Review* 589-614

The author of this article draws on two recent examples of aggressive tax planning in the United States as evidence of an erosion of the professionalism of the tax bar. He posits a definition of "professionalism" that is articulated in the sociology literature and that consists of three elements: (1) a mastery of some esoteric and difficult body of knowledge, (2) an altruistic motivation, and (3) a self-regulating body. Infanti frames the altruistic motivation for tax lawyers in terms of their perceived duty to ensure the integrity of a revenue system based on the principle of self-assessment. He argues that aggressive tax planning runs the risk of undermining this duty and, by extension, the integrity of the altruistic motivation that defines the tax bar. This trend could lead, he argues, to the introduction of non-lawyers in

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

a regulatory capacity. As evidenced by the two recent tax-planning techniques described in the article, this possibility is supported by increased coverage of tax-avoidance transactions in the US popular press.

T.E.

Diane M. Ring, "One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage" (2002) vol. 44, no. 1 *Boston College Law Review* 79-175

The term "cross-border tax arbitrage" refers to the process by which taxpayers reduce or eliminate tax payable by structuring a transaction to take advantage of the inconsistency between countries in the characterization and taxation of the transaction. Some commentators have questioned whether the characterization of a transaction in one country should affect the characterization in another country, and have even questioned whether inconsistent tax treatment in two countries presents a policy problem.[5] This article challenges both of these propositions and suggests a general framework for analyzing a cross-border tax-arbitrage transaction as a policy problem.

Ring divides her analysis into two discrete inquiries. The first concerns the identification of those circumstances in which cross-border tax arbitrage presents a policy problem. The second inquiry focuses on the issues of when and how national tax policy makers should respond unilaterally. She argues that both inquiries require "a comprehensive consideration of tax policy goals, competing values, and practical constraints."[6] She rejects an entirely benign characterization of cross-border tax arbitrage on the basis that such a characterization is premised on the paramountcy of domestic policy goals that lead a country to treat a particular transaction in a particular manner. But this paramountcy fails to account for the goals of another country that is affected by a cross-border tax-arbitrage transaction. More particularly, this failure does not account for the distortionary economic effects and problematic equity considerations that cross-border tax-arbitrage transactions entail. At the same time, it gives unconditional priority to the value of regulatory independence and, to a lesser extent, considerations of administrability. Ring also rejects, however, the view that all cross-border tax-arbitrage transactions should be eliminated. She believes that this view would inappropriately elevate considerations of economic efficiency and equity to a place of paramountcy, at the expense of regulatory independence and considerations of administrability. Instead of accepting either extreme position, she proposes an approach that considers and balances all of these

5 See, for example, H. David Rosenbloom, "International Tax Arbitrage and the International Tax System" (2000) vol. 53, no. 2 *Tax Law Review* 137-66, reviewed in this feature (2001) vol. 49, no. 1 *Canadian Tax Journal* 242-57, at 254-57; and Philip R. West, "Foreign Law in U.S. International Taxation: The Search for Standards" (1996) vol. 3, no. 4 *Florida Tax Review* 147-85.

6 At 4.

policy considerations in deciding whether a cross-border tax-arbitrage transaction presents a policy problem that warrants a response.

Ring describes four types of cross-border tax-arbitrage transactions, which she uses to illustrate both the fundamental features of such transactions and the details of her suggested policy approach. She readily admits that her approach is necessarily indeterminate, but believes it is preferable to a categorical acceptance or rejection of all cross-border tax-arbitrage transactions. The article concludes with some observations on perceived similarities and differences between the processes of international tax competition and cross-border tax arbitrage. Harmonization of national tax systems is an obvious response to these two processes. For various practical and theoretical reasons, however, the adoption of such a response in any sort of complete form remains an elusive, and even undesirable, goal.

T.E.

David H. Sohmer, "Fundamental Issues in Shifting Income to Low-Tax Provinces" (2003) vol. 22, no. 2 *Estates, Trusts & Pensions Journal* 127-39

This article reviews the use of trusts and corporations to shift investment income to a low-tax province. These techniques have been used particularly by Quebec-resident individuals as a means of substituting the lower personal tax rate in Alberta for the higher rate in Quebec on their investment income. In their simplest form, these transactions involve the transfer of property to a trust resident in Alberta or a corporation with a permanent establishment in that province. The apparent result is an allocation of the associated investment income to Alberta. The article provides a useful overview and analysis of possible limitations on provincial taxing powers that may constrain Quebec's ability to respond to these income-shifting techniques. There is also some discussion of the Quebec government's response to the trust technique, which involves a special tax on beneficiaries of trusts that can be considered to have been used to shift income to a low-tax province.

T.E.

"Preliminary Assessment of the Impact of *The New Tax System*," in Commonwealth Treasury of Australia, *Economic Roundup: Autumn 2003* (Canberra: Commonwealth Treasury of Australia, 2003), 1-49, ISBN 642 74187 5. Available on the Web at http://www.treasury.gov.au/.

Australia has recently undergone a fundamental reform of its tax system. The reform process began with a government announcement in 1998 and culminated in the implementation of legislation in July 2000. The reforms included (1) the introduction of a goods and services tax (GST); (2) the introduction of a targeted capital gains preference; (3) increased family assistance and pensions and benefits; (4) the reduction of personal and corporate income tax rates; and (5) the elimination of a broad range of inconsistencies in the treatment of entities and financial instruments, as well as certain reforms of the core computation rules for business income. The

package of reforms was labelled "the New Tax System." This paper assesses various short-term macroeconomic effects of the reforms, as well as selected implementation issues.

The paper concludes generally that critics of the reform proposals were incorrect in their prediction that the package would adversely affect the Australian economy. The Australian Treasury department cautions, however, that it is still too early to draw any definitive conclusions on the long-term economic impact of the reforms. The assessment is framed in terms of certain macroeconomic transitional effects, the impact of the reforms on income distribution, and the compliance costs associated with implementation, especially the reforms affecting businesses. The paper concludes that the transitional effects have largely "washed out" over the first two years of the application of the reform package. These effects include the impact of the reforms on housing, household consumption expenditure, the labour market, and prices and wages. The paper also concludes that family income has increased over all income groups. The assessment of the compliance costs associated with the implementation of the reforms is similarly rosy; it concludes that the transition to the new system has been "relatively smooth" compared with transitions in other countries recently undertaking reform. The Australian experience is compared with the tax reform experiences in Canada, Japan, New Zealand, and Singapore. An appendix to the paper describes the reforms in these countries. The Canadian reforms consist of the recent reductions in personal and corporate tax rates, the introduction of the GST in 1991, and the base-broadening measures of the 1988 reform exercise.

T.E.

Institute for Fiscal Studies, Tax Law Review Committee, *Making Tax Law*, TLRC Discussion Paper no. 3 (London: Institute for Fiscal Studies, March 2003), 16 pages, ISBN 1-903274-32-X

This discussion paper was commissioned by the Institute for Fiscal Studies (IFS), an independent UK tax research body, in response to the comments of Lord Howe on the relationship between tax simplicity and tax politics.[7] The Tax Law Review Committee of the IFS established a working party to review the institutional processes for parliamentary scrutiny of tax legislation, with a view to promoting simplification and improvement of the tax laws. The principal recommendation of the discussion paper is the need to institutionalize the involvement of Parliament in prelegislative scrutiny of tax proposals. This goal would be realized through a select committee on taxation. The discussion paper also recommends the establishment of a tax structure review project, which would complement the ongoing tax law rewrite project. The recommended project would be funded by Inland Revenue, but would

7 Lord Howe of Aberavon, "Simplicity and Stability: The Politics of Tax Policy" [2001] no. 2 *British Tax Review* 113-23.

include tax practitioners and members of the UK public. Like the tax law rewrite project, the tax structure review project would be established with the explicit goal of developing simpler tax legislation, but without the constraint of an acceptance of existing tax policy. In effect, the tax structure review project would have the power to assess the underlying policy of tax legislation and consider any alternative approaches that may be simpler.

T.E.

Antony Ting, "Taxation of Trust Income: A Comparison Between Australia and the United Kingdom" (2003) vol. 18, no. 1 *Australian Tax Forum* 69-105

The income tax treatment of trust income under the Act has recently received a lot of attention, focused primarily on the proliferation of royalty and income trusts as substitutes for the corporate form, as well as proposed changes to the legislative regime governing non-resident trusts. The somewhat modest legislative regime in Canada contrasts sharply with the recent ambitious proposals in Australia to treat a broad range of trusts as corporations. The Australian government, however, ultimately abandoned these proposals. This article provides a useful comparison of the current Australian and UK regimes for the income taxation of resident trusts with resident beneficiaries. Although the article focuses on the treatment of discretionary family trusts, it also discusses the specialized regimes for unit trusts. The author argues that the Australian regime often taxes the wrong person on the wrong amount, while the UK regime consistently realizes correct results, which are defined in terms of a principle of "entitlement to income."

T.E.

John Hasseldine and Ann Hansford, "Tax Auditing Under Self-Assessment: Survey Evidence from the United Kingdom" (2003) vol. 9, no. 1 *New Zealand Journal of Taxation Law and Policy* 110-22

This article differs from the existing empirical literature on the tax audit process in that it considers the perspectives of both tax practitioners and tax auditors. The authors organize survey evidence from the United Kingdom using a general framework of the audit process, which is divided into three different stages: the initial interview, data gathering, and the final interview where adjustments are settled between the parties. The authors find that there are significant differences in the attitudes of tax practitioners and tax auditors at the initial interview and final interview stages. There are also important differences in the benefits of providing bank account records at the data-gathering stage for accrual-based businesses. The general lessons drawn from the study are not especially surprising. For example, the authors conclude that the different attitudes of tax practitioners and tax auditors can exacerbate the adversarial relationship and engender increased compliance costs associated with procedural wrangling. The study does represent, nonetheless,

an important new approach to empirical research on the tax audit "game process," and it will be interesting to see whether researchers in other countries take up the authors' plea for comparative evidence.

T.E.

Edwin Van Der Bruggen, "'Good Faith' in the Application and Interpretation of Double Taxation Conventions" [2003] no. 1 *British Tax Review* 25-68

The author of this article argues that a principle of good faith properly informs the interpretation and application of tax treaties. For this purpose, he develops a concept of good faith that is understandably vague and arguably meaningless beyond a minimal requirement to observe a tax treaty in the sense of avoiding treaty overrides in the domestic law of a contracting country. Van Der Bruggen is able to illustrate, however, in both the interpretation and application of treaties, that the concept of good faith may have a relevance beyond the narrow issue of tax treaty overrides. He argues that good faith is, in fact, an overriding principle that "emphasises common intent and uniformity with respect to treaty interpretation and application."[8] With respect to treaty interpretation, this principle supposedly dictates the adoption of interpretive positions that are consistent with a common or uniform treaty meaning. With respect to treaty application, the good faith principle is said to apply to any measures that a contracting state adopts to extend or restrict treaty benefits to taxpayers. Van Der Bruggen illustrates the application of the principle in this latter context primarily through a discussion of the mutual agreement procedure and exchange-of-information articles commonly found in tax treaties. He also comments on the possible relevance of the good faith principle for the application of domestic anti-avoidance rules to tax treaty relations.

T.E.

Matthias Sutter and Hannelore Weck-Hannemann, "Taxation and the Veil of Ignorance—A Real Effort Experiment on the Laffer Curve" (2003) vol. 115, nos. 1-2 *Public Choice* 217-40

The Laffer curve posits a relationship between income tax rates and revenues. If the tax rate is zero, no revenue will be raised because individuals pay no tax. Similarly, if the tax rate is 100 percent, little revenue will be raised because there is no economic incentive to work. At some tax rate between the extremes, revenue will be maximized. In an experimental setting, Sutter and Weck-Hannemann, both of the University of Innsbruck, estimate the rate that maximizes revenue to be between 50 and 65 percent.

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The article develops a rich experimental setting. In an interactive two-person game, one individual generates income and the second individual taxes the generated income. The tax rates are therefore endogenous—that is, set by the participants. Two treatments are used: in the certainty treatment, each individual knows his or her role prior to the game; in the uncertainty treatment (a "veil of ignorance"), roles are assigned only after each individual makes decisions for both roles. The primary results are as follows. First, as expected, effort decreases as tax rates increase—the expected disincentive effect. Second, tax rates are set by the tax authority at about 50 percent, which is also the amount that maximizes revenue. It is notable that the rates were set lower when the players did not know their roles prior to the game than when they did.

This article is well written and interesting. It supports the existence of the Laffer curve and provides further evidence as to its properties.

G.F.

Danielle Goldfarb, *The Road to a Canada-U.S. Customs Union: Step-by-Step or in a Single Bound?* C.D. Howe Institute Commentary no. 184 (Toronto: C.D. Howe Institute, June 2003), 30 pages. Available on the Web at http://www.cdhowe.org/.

The North American Free Trade Agreement (NAFTA) significantly increased economic integration between Canada and the United States. A further step in economic integration would be the adoption of a customs union, creating common external tariffs on imports from the rest of the world. Under a customs union, Canada and the United States would adopt common trade barriers against other countries and eliminate barriers between each other. In this paper, Danielle Goldfarb, a policy analyst with the C.D. Howe Institute, examines the feasibility and desirability of a customs union between Canada and the United States.

Goldfarb notes that a significant benefit of a customs union would be the elimination of NAFTA's complicated and costly rule-of-origin requirements. She argues that adjustments to certain industries would be a challenge, but that the greater challenges are political and practical. These include reconciling bilateral agreements and the politically sensitive issue of trade policy independence. Specific sectors such as agriculture and textiles may prove difficult, as might reaching agreement on how to treat certain countries (for example, Cuba).

The paper presents a compelling case for the movement toward a customs union between Canada and the United States. It further discusses considerations in determining the appropriate extent and speed of adoption. The author argues that it may be more practical to move forward on a sector-by-sector basis initially, where some of the expected benefits will be received with relatively few adjustment costs.

Goldfarb provides an excellent introduction to an important topic and clearly sets out options that Canada should consider. The paper is well written, informative, and very accessible.

G.F.

Michael Mendelson, *Child Benefit Levels in 2003 and Beyond: Australia, Canada, the UK and the US* (Ottawa: Caledon Institute of Social Policy, April 2003), 10 pages, ISBN 1-55382-053-3. Available on the Web at http://www.caledoninst.org/.

Significant increases to the Canada child tax benefit, to be phased in by 2007, were announced in the 2003 federal budget. These increases raise an interesting question. Relative to other countries, what is Canada's level of child benefit support? Michael Mendelson of the Caledon Institute addresses this question by providing an informative comparison of child benefits in Canada, the United Kingdom, the United States, and Australia. It is important to note that this paper does not analyze the overall treatment of families with children, but rather focuses on a single element—child-related benefits.

Mendelson finds that child benefit levels for 2003 are, in general, significantly lower in Canada across most income levels than in the other countries. At very low levels of income, however, the United States provides little or no child benefits. Even with the 2007 scheduled increases, Canada will lag behind the United Kingdom and the United States in its benefits to families with annual family incomes above approximately $10,000.

G.F.

Richard Shillington, *New Poverty Traps: Means-Testing and Modest-Income Seniors*, C.D. Howe Institute Backgrounder no. 65 (Toronto: C.D. Howe Institute, April 2003), 9 pages. Available on the Web at http://www.cdhowe.org/.

This short paper makes an interesting assertion—that registered retirement savings plans (RRSPs) are a terrible investment for lower-income Canadians. This assertion is based on two factors: (1) on contribution, an individual will receive little tax assistance and (2) on withdrawal, the individual may face a very high marginal tax rate related to income testing of benefits, such as the guaranteed income supplement (GIS).

Using Statistics Canada's *Survey of Financial Security*, Shillington first demonstrates that the proportion of households near retirement with modest retirement savings (under $100,000) is relatively large at 32 percent—on average, these households have $23,000 in RRSPs. Shillington provides convincing analysis that this group will receive very little retirement income from these savings. After GIS and income taxes, many will have an effective tax rate of approximately 70 percent. With provincial income-tested credits and non-tax income testing (for example, nursing homes, provincial drug plans), the rate may in fact equal or exceed 100 percent. What is the solution for retirement savings for lower-income families? Shillington recommends the adoption of tax prepaid savings plans similar to those in the United States—that is, Roth individual retirement accounts.

G.F.

Helmar Drost and John Richards, *Income On- and Off-Reserve: How Aboriginals Are Faring*, C.D. Howe Institute Commentary no. 175 (Toronto: C.D. Howe Institute, March 2003), 24 pages. Available on the Web at http://www.cdhowe.org/.

Aboriginal poverty in Canada is a very serious problem. It is widely understood that economic indicators for the aboriginal population in Canada are worse than for other Canadians. Using the 1996 census, Drost and Richards provide evidence as to the size of this gap. They find that the median income of aboriginal peoples in 1995 was only 58 percent of that of non-aboriginals ($11,300 versus $19,400). Further, they find that income is distributed much more unequally in the aboriginal population.

What is less understood is the difference in the economic welfare of aboriginal peoples living off-reserve compared with those living on-reserve. This is an important issue because the majority of the aboriginal population (71 percent) lives off-reserve. The medium income of those living off-reserve ($12,400) is significantly greater than the medium income of those living on reserve ($8,900)—a gap of 42 percent. This gap is greatest in the prairie provinces (50 percent) and smallest in Quebec and the Atlantic provinces (30 percent). This paper is well written and objective—the authors' intent is not to derive policy but to provide data that readers may interpret.

G.F.

Merle Erickson, Austan Goolsbee, and Edward Maydew, "How Prevalent Is Tax Arbitrage? Evidence from the Market for Municipal Bonds" (2003) vol. 56, no. 1, part 2 *National Tax Journal* 259-70

This article provides evidence on the use of tax arbitrage. Although it focuses on a form of arbitrage specific to the United States, its central message is interesting and relevant to Canada.

In the United States, income earned from municipal bonds is exempt from tax. If the person holding these bonds also has deductible debt, the person can earn an arbitrage profit. For example, assume that a firm purchases municipal bonds paying 5 percent and issues corporate bonds at 6 percent. If the firm's marginal tax rate is 35 percent, for each dollar in municipal bonds the firm will earn 1.1 percent ($0.05 - 0.06(1 - 0.35)$) in arbitrage profits. Although there is significant opportunity for corporate tax arbitrage, it has not been exploited much. The authors suggest that the transaction costs of such arbitrage must be significant enough to discourage its use. The message seems to be that even relatively simple arbitrage may be difficult and costly.

G.F.

Duanjie Chen and Jack M. Mintz, *Taxing Investments: On the Right Track, but at a Snail's Pace*, C.D. Howe Institute Backgrounder no. 72
(Toronto: C.D. Howe Institute, June 2003), 9 pages. Available on the Web at http://www.cdhowe.org/.

Chen and Mintz argue that reductions of corporate tax rates in Canada will improve the corporate climate for investment. They calculate that from 2003 to 2008 the corporate effective tax rate will decline from 31.8 percent to 27.4 percent, with the elimination of the federal general capital tax accounting for almost half of this decline (a 2 percent reduction). Chen and Mintz argue, however, that even with these rate reductions, business income will be more heavily taxed in Canada than in the United States. They further discuss the importance of provincial taxation on investment. The highest effective tax rates are in Saskatchewan (37.6 percent), Manitoba (36.4 percent), and Ontario (32.5 percent). The lowest rates are in Alberta (26 percent) and Newfoundland (21 percent).

G.F.