Current Tax Reading

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It is not entirely unfair to suggest that much of the existing comparative work in tax law is of limited interest or even usefulness. This work tends to fall into one of two general categories that reflect two distinctly different approaches. Perhaps the less interesting of these approaches is that which simply describes the broad features of country tax systems using a standardized format for comparative purposes. The most that can be said for this type of work is that it provides a minimal introduction into the broad design features of country tax systems and thereby serves a modest informational purpose. The other approach focuses on a selected tax issue and compares the ways in which different countries attempt to address the issue. Although the comparison often takes the form of standardized country descriptions, a policy angle is usually added by framing the descriptions within a broader conceptual analysis of the issue. This type of comparative work is certainly more interesting than straight descriptive work, but it is limited in scope.

This book is refreshing for the author’s ability to break free of these two conventional approaches to comparative tax law. In fact, by combining some of the positive features of existing comparative tax work with the much deeper tradition of comparative legal scholarship, this book breaks important new ground. More particularly, it combines breadth of coverage of country tax systems with a distinct conceptual focus. In the process, the book provides a wealth of observations and questions that should inspire future comparative work that probes more deeply in the search for explanations of differences and similarities in country tax systems. The author presumably drew extensively on his wide range of policy-based, academic, and practical experience in tax law, including his current position with the International Monetary Fund as senior counsel in the legal department.

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At a general level, the book focuses on differences and similarities in the legal institutions and legal culture of particular countries as a possible explanation of observed differences and similarities in those countries’ tax systems. Evidence of this causal relationship is gleaned from a survey of differences and similarities in legal systems as they are reflected in certain tax system features. Beyond this descriptive material, the value of the book lies in the important conceptual framework that it provides for further study of differences and similarities observed in the details of country tax systems. In this respect, Thuronyi observes in a footnote in the preface that “from a conceptual point of view, the tools of tax policy analysis are pretty much the same no matter what country one is analyzing.”¹ Social, political, and economic differences and similarities may explain divergence and convergence on broad policy issues, such as the choice of an income versus a consumption tax, tax rates, the mix of taxes, the treatment of capital income, and the use of tax expenditures. The unique slant of this book is the possible effect on tax system design of differences in modes of legal thought, which vary broadly across countries.

The first two chapters of the book outline Thuronyi’s comparative methodology. The first chapter provides a brief overview of comparative methodology generally and makes the case for a basic knowledge of comparative tax law. In particular, Thuronyi argues that such knowledge is essential to both practitioners and policy analysts. For practitioners, it is necessary in their work for clients whose affairs are affected by the tax laws of other countries. For policy analysts, knowledge of tax systems in other countries can provide ideas for the resolution of issues in their own country. Moreover, Thuronyi suggests that the study of comparative tax law is an interesting end in itself and fosters a deeper understanding of the student’s own tax system.

As noted above, the survey methodology chosen by Thuronyi is explicitly focused on the explanatory power of legal traditions for the observed differences and similarities in country tax systems. In this respect, chapter two provides an important overview of his “families of tax laws,” which are the basis of his comparative insight. In effect, Thuronyi classifies countries in terms of nine different families, which tend to reflect certain common features attributable to common legal cultures. Those families are (1) commonwealth; (2) American; (3) French; (4) Latin American; (5) transition and post-conflict; (6) northern European; (7) southern European; (8) Japanese/Korean; and (9) miscellaneous. The first two families are grouped together under their shared common law legal tradition. The other families are grouped together under a shared civil law tradition. A third group consists of countries in the European Union and applicant countries. These countries also belong to one of the other two groupings but are grouped together additionally under the EU umbrella because of the high level of commonality in their tax systems, which is mandated to some extent by EU membership.

¹ At xiii.
Not surprisingly perhaps, Thuronyi’s taxonomy of country tax systems does not necessarily provide a convincing explanation for every observed difference and similarity. In fact, he somewhat provocatively suggests that all tax systems ultimately trace their origins to one of three “mother systems”: the UK, US, or German system. In parts of the book, the taxonomy is rather strained in terms of its explanatory power, and sometimes it disappears in certain of the lengthier descriptive portions. Nonetheless, Thuronyi’s insight provides an exceedingly powerful conceptual framework; it is arguably one of the more interesting and important contributions to the tax literature to be made in quite some time. Indeed, we believe that this framework has almost limitless potential as the basis for extensive, and more detailed, comparative research into specific aspects of country tax systems.

Chapter three provides a brief excursus into the meaning of a tax and the various types of taxes used in most countries. This chapter is followed by a lengthy overview in chapter four of the general legal context within which country tax systems are embedded. The overview includes a survey of broad contextual aspects, including the constitutional framework, administrative law, criminal law, and religion and religious law. Other surveyed subjects are EU law and tax treaties.

Chapters five to nine apply the comparative methodological approach explicitly to various aspects of country tax systems. Chapter five probably provides the most interesting application of Thuronyi’s conceptual framework. The chapter reviews the interpretation of tax law and anti-avoidance doctrines. It is arguably in this area that differences in legal traditions provide the greatest explanatory power for differences in tax law. Although other country experiences are drawn on selectively, Thuronyi uses the experience in the United States, the United Kingdom, France, and Germany to highlight the principal differences in interpretive approaches that are attributable, at least in part, to differences in legal traditions. He discusses at some length the Supreme Court of Canada decision in Shell Canada Limited v. The Queen et al. as an example of the application of a formalistic literal approach to the interpretation of income tax legislation made in the name of a supposedly purposive approach. The object lesson from this decision is to rely on what judges do and not on what they say they do.

Chapter six surveys tax administration and procedure; specific topics include the organization of tax administration laws, return filing, withholding and information reporting, advance rulings, audits, litigation, collection, civil penalties, tax crimes, and tax amnesties. As Thuronyi notes, there is much convergence among country practices in each of these areas. This convergence is somewhat counterintuitive, since one would expect that differences in legal culture would have a significant influence on tax administration. One area that is not covered, and that might reveal

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2 99 DTC 5669; [1999] 4 CTC 313 (SCC); rev’g. 98 DTC 6177; [1998] 2 CTC 207 (FCA); rev’g. 97 DTC 395; [1997] 2 CTC 2023 (TCC).

3 See, for example, Ann Mumford, Taxing Culture: Towards a Theory of Tax Collection Law (Aldershot, UK: Ashgate, 2002), reviewed in this feature (2002) vol. 50, no. 5 Canadian Tax Journal 1818-29,
some differences in country practice attributable to different legal traditions, is the status of client-adviser privilege.

Chapters seven to nine survey the basic design features of different tax bases. Chapter seven surveys the income tax, and chapter eight surveys the value-added tax (VAT). Chapter nine surveys other taxes, including excise taxes, wealth taxes, property taxes, social security taxes, stamp and financial transaction taxes, customs duties, and taxes on mineral extraction. It is arguable that, in much of the detail of the substantive features of these tax bases, differences in legal tradition have been relatively muted in their effect, at least when compared with differences in approach to statutory interpretation and tax avoidance. Although there are some broad structural differences attributable to differences in legal tradition (for example, differences in the concept of income), even these differences have tended to narrow with convergence in economics-based policy analysis. Thuronyi correctly points out that convergence is most pronounced with the VAT, whose relatively recent vintage may mean that economics-based policy analysis has played a more prominent role than legal tradition in the development of the tax.

One of the three appendixes to the book provides an interesting summary of some research tools for comparative tax law. Another appendix provides the legislative text of general anti-avoidance rules in some selected countries, including Canada. There is also a selected bibliography. Updates of the book will be made available on the Kluwer Law International Web site (http://www.kluwerlaw.com/).

T.E.


This monograph-length article describes the rationale for and design details of yet another proposal for reform of the corporate income tax in the United States. Like other proposals for reform, Schlunk's proposal focuses on the inconsistent taxation of income and loss realized in different legal entities and the returns on different forms of contributions (both financial and non-financial) to these entities. He argues that the current distinctions in US law are not defensible on any theoretical grounds, but unlike most commentators, he does not advocate abolition of the corporate income tax or integration of the tax with the shareholder-level tax. Instead, he proposes the extension of a single-level tax to the income of a broad range of entities, including corporations, partnerships, and trusts. The sole exception would be “small” entities, which would be defined in terms of the number of “participants.” In this respect, he would also extend the single-level tax to the returns on the contributions of a broad range of “participants,” which would include equity and debt investors, employees, and lessors and licensors.

at 1822-23 (examining differences in legal, social, and political culture as explanations for differences in approaches to tax collection in the United States and the United Kingdom).
Schlunk acknowledges that his proposed reform is broadly similar in its design details to the X-tax proposed by David Bradford, as well as a subtraction-method VAT. In fact, his proposal is closest to the business-value tax recently proposed by Richard Bird and Kenneth McKenzie as a replacement for provincial corporate income and capital taxes in Canada. Nonetheless, Schlunk’s proposal differs in some of the design details. In particular, it would extend to a broader range of entities than any of these other reform proposals, and it would extend to the return on hedging transactions entered into by affected entities. Many of the differences in these design details are attributable to the very different rationale that Schlunk describes as the basis for his proposed reform. Instead of focusing on supposed efficiency gains attributable to consistent taxation of different legal entities and returns to different forms of participant contributions, he emphasizes the economic benefits that accrue to joint economic activity and the facilitation of such activity by government as the basis for an entity-level tax. This rationale leads him to conclude that the definition of entities and participants subject to a single-level tax should be broad. “Small” entities can be excluded from the tax on the assumption that any benefits from joint economic activity are insignificant enough to be ignored as a justification for imposition of an entity-level tax. Schlunk is consistent, however, with proponents of an efficiency-based rationale for corporate income tax reform in his emphasis on the ability of his proposal to permit lowering of the corporate tax rate.


A casual empiricism suggests that high levels of tax law uncertainty and complexity deter foreign direct investment (FDI) in developing countries. This article provides systematic evidence supporting this proposition. The focus of the article is the countries of the former Soviet Union and Eastern and Central Europe, rather than developing countries generally. These countries all moved rapidly from centrally planned economies to market economies in the 1990s. Part of the transition included a revamping of their tax systems, which had served goals under a planned economy that made them entirely unsuitable for a market economy. The result has been a series of frequent and substantial changes in tax law that have tended to cause a general state of flux. In short, the determination of tax liability often has been, at any particular time, an indeterminate exercise in the application of complex and unnecessarily opaque provisions. In many instances, the exercise has not been eased by

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tax administrators, who quite commonly do not understand the new laws that they are charged with applying.

After a brief discussion of the costs of complexity in tax structures and the sources of tax law uncertainty, the article presents the results of a regression analysis in which proxies for complexity and uncertainty are used as independent variables. The dependent variable is FDI in the selected countries as a percentage of gross domestic product (GDP). After suitably controlling for other variables, the authors conclude that complex and vaguely worded tax legislation has been a significant deterrent to FDI in the selected countries. The obvious policy lesson is that tax policy makers seeking to attract FDI should focus more critically on simplicity and certainty in assessing different tax reform alternatives. However, the authors emphasize that this goal is not necessarily realized through shorter, but vaguely worded, tax legislation. They suggest that uncertainty is sometimes more effectively avoided through detailed and precise drafting. The wild card under either approach remains the level of sophistication and knowledge of tax administrators.

T.E.


The authors of this article criticize both the rationale for and the design of the surtax introduced by the Alberta government on the income of National Hockey League (NHL) players earned in games played in Alberta. The tax, which became effective in September 2002, has attracted considerable media attention and was proposed by the Alberta government as a means of assisting the two NHL franchises playing in Edmonton and Calgary. The proposal was developed after an initiative by the federal government to subsidize Canadian NHL franchises met with stiff public resistance and was jettisoned. The tax is essentially equal to 12.5 percent of a player’s base salary attributable to regular season games played in Alberta. Revenue from the tax is earmarked for the two NHL franchises in the province.

The article begins with a review of the stated rationale for the NHL players’ tax and its design details. The review of those details includes a summary of the associated jurisdictional issues: that is, residence and source liability to tax international athletes’ income, the effect of tax treaties on the liability issue, and the creditability of the NHL players’ tax in residence countries. This survey is followed by a discussion of the possible economic incidence of the tax and a critique of the tax as a public policy instrument. The authors acknowledge some of the legal arguments against the tax (for example, that it contravenes both the collective bargaining agreement between players and management and the North American free trade agreement) already highlighted in the popular press. But much of the critique in the article centres on the more interesting tax policy issue that is raised by the presumed incidence of the tax and, not surprisingly perhaps, has largely been ignored by the press.
In this respect, Brean and Forgione point out that the bulk of the revenue from the tax is derived from players employed by the two NHL franchises in Alberta. On the assumption that the tax is reflected in higher base salaries demanded by players, the earmarking of the associated revenue does nothing other than recycle the relevant funds back to the franchises. Alternatively, the legal incidence of the tax can be avoided by repackaging base salary as signing bonuses or deferred compensation. The earmarked tax thus accomplishes nothing in terms of the bulk of its revenue base, but is left to apply, in practice, to base salary paid under existing contracts and possibly new contracts of players employed by NHL franchises outside Alberta. In the former instance, the tax cannot be avoided through shifting or salary repackaging. In the latter instance, the amount of the tax may not matter to the overall tax liability of these players because it is ultimately creditable against their residence-country tax. Moreover, to the extent that owners of the two NHL franchises can shift the tax forward to consumers, they reap a windfall.

T.E.


The case for income averaging has tended to focus on differences in tax liabilities attributable to fluctuations in annual income within the same broad income classes. Income averaging has not been seen as a response to differences in tax liabilities among income classes. In this latter area, the focus has tended to be the case for a progressive rate structure and the effect of fluctuations in annual income on the transfer-payment entitlements of low-income families. This article, however, re-casts income averaging as a defensible response to the effects of fluctuations in annual income on the tax liabilities of low-income families in the United States.

Batchelder argues that the consequences of the application of the annual income measurement requirement have become more pronounced for low-income families because of the increased reliance on the earned income tax credit (EITC) as the principal form of social assistance for working families in the United States. In addition, she provides convincing evidence that income instability has become much more pronounced for these families. She suggests that the combination of this increased income instability and the design features of the EITC means that the annual income measurement requirement increases the tax burden of the working poor by an average of 2 percentage points as compared to some form of long-term income averaging. This increase is more significant than that for middle- and high-income families. Batchelder proposes two “targeted averaging” mechanisms to eliminate the tax burden imposed on the working poor by the annual income measurement requirement. The first mechanism involves the smoothing of income over a two-year period for the purpose of calculating the EITC. The second mechanism involves a one-year carryback of unused standard deductions and personal and dependant exemptions.

T.E.

This article provides survey evidence of the transfer-pricing practices used by US-based financial institutions in the context of their global dealing of financial instruments. The development of appropriate transfer-pricing guidelines for this activity has been the subject of a comprehensive study by the Organisation for Economic Co-operation and Development (OECD)\(^6\) and proposed Internal Revenue Service (IRS) regulations in the United States. The article focuses on the transfer-pricing practices of US-based financial institutions in the light of the proposed IRS regulations, which have yet to be finalized after 12 years of development. The survey evidence is quite tentative and severely limited in its usefulness, given the veil of secrecy that tends to shroud transfer-pricing practices generally. This evidence suggests, however, an important willingness of US-based financial institutions to wait further for final regulations in an effort to ensure that the regulations are ultimately “correct” in their approach. This exploratory study is apparently to be followed by a similar study of Japanese-based and UK-based financial institutions, with considerable potential for cross-country comparison.

T.E.


This article is one of many critiques of the much-maligned initiative of the OECD to combat harmful tax competition.\(^7\) The initiative has been criticized in some quarters as overly broad and indefensible, and in other quarters as underinclusive and far too modest in its ambition. This article clearly falls into the former camp. Salinas argues that the OECD initiative is fundamentally flawed in that it overrides state sovereignty in the tax policy-making process. In effect, he believes that national tax policy makers are best placed to determine tax levels and that competition for foreign direct investment is healthy. Distortions in the pattern of investment that results from the availability of tax incentives are presumably to be tolerated in the face of the primacy of state sovereignty over tax matters.

T.E.

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A hybrid or compound financial instrument is a legally indivisible instrument whose cash flows are attributable to two or more basic instruments embedded in the single instrument. A synthetic financial instrument consists of the combination of two or more legally distinct instruments that together replicate the cash flows associated with another single instrument. Two of the more vexing questions in the income taxation of financial instruments are (1) in what circumstances should a hybrid or compound instrument be separated into its constituent components and taxed as separate instruments and (2) in what circumstances should legally distinct instruments be combined and taxed as a single instrument? The Tax Court of Canada recently considered the second question in *Hayes et al. v. The Queen* in the specific context of “convertible hedge transactions.” This article provides an interesting review of two recent IRS rulings considering the first question in the specific context of debt exchangeable into shares and a life insurance contract wrapped around a hedge-fund investment.

Leeds argues that, in deciding whether to separate the constituent elements of a hybrid or compound instrument, the specific factual context should be the critical consideration. Because the factual context is everything, different income tax treatment can result for different instruments. In effect, inconsistent treatment is seen to be defensible despite superficial similarities in particular instruments. The details of each of the two IRS rulings are considered in the broader context of past guidance provided by both the IRS and US courts as to when hybrid or compound instruments can be divided into their constituent instruments and taxed consistently with the treatment otherwise accorded those instruments when they are issued on a stand-alone basis.

T.E.

New Zealand has one of the most comprehensive income tax systems of the OECD countries. The lack of a comprehensive capital gains tax thus stands out as an obvious gap in its income tax base. The adoption of such a tax has been the subject of contentious political debate for some time now and was recently revisited by a committee commissioned to examine all aspects of the New Zealand tax system.
The committee recommended rejection of a comprehensive realization-based capital gains tax and preferred instead that the New Zealand government continue to respond in an ad hoc manner, usually by deeming ordinary income treatment of gains or losses from specified transactions or assets.

This article provides a first-rate analysis of the policy case in favour of the adoption of a comprehensive realization-based capital gains tax. In this respect, Burman and White argue that the committee acted too precipitously in its rejection of such a tax. After reviewing the broad policy case for the taxation of capital gains, they analyze and reject various alternatives to a realization-based capital gains tax. Although they concede that such a tax is far from perfect, they believe that many of its principal defects, including the supposed lock-in effect attributable to realization-based recognition and the negative effect on risk taking attributable to necessary loss limitations, are overstated. On balance, the article suggests that a realization-based capital gains tax is the best of the possible options, including the non-taxation of a range of such gains.

T.E.


Section 87 of the Indian Act\(^\text{10}\) provides an exemption from tax for status “Indians” who live and work on a reserve. The precise scope of this statutory exemption has been the subject of considerable judicial and scholarly comment.\(^\text{11}\) This article contrasts the scope of this statutory exemption with that of two other possible bases for exemption: aboriginal rights and treaty entitlement. Both of these bases have been the subject of very limited comment—that is, until the recent Federal Court Trial Division decision in Benoit et al. v. The Queen,\(^\text{12}\) which considered treaty entitlement as a basis for exemption. The author suggests that either of these two alternative bases has the potential to provide a much wider and more robust exemption consistent with the rationale for exemption.

T.E.

\(^{10}\) RSC 1985, c. I-5, as amended.


\(^{12}\) 2002 DTC 6896; [2002] 4 CTC 295 (FCTD); under appeal to the Federal Court of Appeal and stay granted pending appeal 2002 DTC 7064 (FCA).

As I was born and raised in Alberta and now live in Saskatchewan, this study instantly caught my attention. The authors, both economics professors from the University of Calgary, address a question that almost all residents of Alberta and Saskatchewan have thought about at one time or another—should the provinces join? Specifically, the authors examine whether the people of Alberta and Saskatchewan would gain from a merger, or at least from closer coordination.

Emery and Kneebone start their paper with a review of the historical context and some basic facts. Alberta and Saskatchewan were created in 1905 as provinces of roughly equal area, population, and economy. Alberta now has approximately three times the population and 4.5 times the GDP. From 1972 to 1999, approximately 700,000 residents migrated to other provinces, with close to half choosing Alberta.

An interesting contribution of this paper is its description of the differences between Alberta and Saskatchewan. These include differences in income distribution (for example, there is a far smaller proportion of individuals in Saskatchewan making over $60,000), demographics (for example, Saskatchewan has, and will continue to have, more elderly persons), tax structures (for example, Saskatchewan continues to have a general capital tax and an overall higher tax burden), and levels of provincial ownership (for example, there is significantly greater government involvement in the economy in Saskatchewan).

Emery and Kneebone argue that, while there may be significant advantages to closer coordination between Alberta and Saskatchewan, there are clear differences in preference between the two provinces—differences that are evident in their policy choices over time. The authors assert that overcoming these differences would likely be the greatest impediment to greater policy coordination.

Whatever one's view on whether Alberta and Saskatchewan should merge, or at least have greater policy coordination, this paper is worthwhile to read. It is well written and provides interesting analysis. For readers who live in Alberta or Saskatchewan, the paper will likely provoke endless discussion over the kitchen table. For readers who live elsewhere, the paper provides an interesting historical perspective on the divergent development of two neighbouring provinces.

G.F.


much to their credit, have transformed Hanson’s 50-year-old 800-page doctoral thesis into this 450-page book. Without their efforts, an important work of Canada’s economic history would have remained unread.

Hanson takes us from the birth of Alberta in 1905 through the discovery of oil in Leduc in 1949. During this period, Alberta went through economic highs and lows. There are intriguing stories of boom and bust, of budget surpluses and overwhelming debt burden. The contexts for decisions in terms of personalities, ideology, and social, political, and economic forces are provided throughout the book.

It is interesting to note that much of the period analyzed by Hanson was a period in which he lived (he was born in 1912). One has the enjoyable challenge in reading this book to remember that the content was completed in 1952. Clearly, Hanson had greater benefit of removal in time from the earlier period than for the later period (particularly the last five years). For example, at the time he completed his thesis, he did not believe that the energy industry could become more important than agriculture. In fact, he believed that revenue from oil and natural gas had likely reached its peak in 1950.

I thoroughly enjoyed reading this book. There are few, if any, Canadian financial history books that provide this level of context. Readers who like financial history will likely love this book, whether or not they have ties to Alberta.

G.F.


Fred McMahon, the director of the Centre for Globalization Studies at the Fraser Institute, provides an in-depth analysis of prosperity in Quebec. This paper, 82 pages long, provides a wealth of comparative facts and figures that compare Quebec with other Canadian provinces and US states.

The paper first examines Quebec’s economic performance. McMahon demonstrates that Quebec has a lower level of per capita GDP, and a higher unemployment rate, than any other large industrialized province or state. As important, Quebec is not closing the gap. In 1961, Quebec’s per capita GDP was 90 percent of the Canadian average; in 2001, it remained 90 percent. From 1991 to 2001, the number of jobs in Quebec increased by 12.8 percent, far below the national average of 17.3 percent. Finally, net business investment in Quebec is significantly smaller ($29,000 per person) than the national average ($38,000 per person).

Having demonstrated that Quebec has been, and continues to be, less prosperous than other jurisdictions, McMahon explores potential reasons for underperformance. He focuses first on the size of government and then examines tax policy. Government spending in Quebec, as a percentage of the economy, is larger than in any other industrialized province or US state. To pay for this, Quebec has the highest total tax burden of any jurisdiction in North America. Further, the nature of tax
policy may discourage investment and growth. Quebec has the highest top marginal personal income tax rate in Canada, among the highest corporate income tax rates, and a significant corporate capital tax rate.

McMahon ends the paper with a recommendation to allow Quebec “to live up to” its economic potential. He argues that the province should reduce expenditures, reduce the tax burden, simplify and reorganize the tax structure (including the elimination of the capital tax), and increase flexibility in the labour market.

This is a truly fascinating paper, particularly in its collection of information; there are over 250 references. The comparative analysis is presented in a manner that is straightforward and convincing. One’s interpretation of the statistics, and the conclusions one may want to draw, may differ from those of the author. Irrespective, there is a compelling story. Quebec’s economic performance has consistently been lower than that of other jurisdictions. Part or all of this underperformance may be related to policy decisions.

G.F.


I found this Department of Finance document extremely interesting, primarily because I knew very little about the federally administered First Nations sales tax (FNST). Essentially, the FNST replaces the federal goods and services tax (GST) on the sale of fuel, tobacco, and alcohol sold on the reserves of taxing First Nations. Tax revenues collected are remitted to the First Nation. As with other federally administered taxes, the Canada Customs and Revenue Agency is responsible for compliance, enforcement, and collection. Legislation has been tabled that would allow First Nations to impose a broader-based First Nations goods and services tax (FNGST).

As of June 2003, only nine First Nations have elected to introduce the FNST. Perhaps this small number reflects a perception that collecting taxes on reserve may be a first step toward ending tax-free status.

While the primary purpose of this Finance document is to communicate audit results, I found that it provided an excellent summary of the structure and adoption of the FNST. With respect to the audit, overall responsibilities were being met with appropriate management controls in place.

G.F.


This article addresses the question, how effective are tax incentives for research and development (R & D)? Prior research on this topic has been inconclusive. In this article, Thomas, Manly, and Schulman introduce an additional factor—the
effect of dividend taxation. Their argument is that, in countries where the double taxation of dividends is reduced or eliminated through an imputation credit to shareholders (as in Canada), this may mitigate the effect of R & D credits. Firms must allocate funds between the payment of dividends and new investment opportunities. Offering R & D credits should increase investment. Conversely, offering imputation credits should increase the payment of dividends.

The authors find that the firm response to the R & D tax credit is mitigated by the existence of an imputation credit, for those firms that pay dividends. In the Canadian context, the authors estimate that without the imputation credit, the R & D tax credit increases spending by 3.95 percent; where the effect of the imputation credit is included in the analysis, spending increases by only 2.64 percent.

This article is interesting on three dimensions. First, the results help explain the effects of R & D incentives across countries—dividend taxation, as a mitigating factor, matters. Second, the theory section of the article provides a strong framework for understanding the nature of the tradeoffs. Finally, the empirical tests (using simultaneous equations modelling) were rigorous and convincing. While it would help to have an extensive economics background for reading this article, the narrative is accessible. Readers can skip the math and fully understand the story and conclusions.

G.F.


William Robson, the director of research at the C.D. Howe Institute, addresses the question, how will expected changes in demographics in Canada affect the cost of public programs? A central finding is that a large implicit liability for future health care spending ($652 billion) will present a significant long-term challenge. Partially offsetting this effect is a decline in the share of public spending on education ($263 billion) and child benefits ($103 billion). Adding the unfunded liabilities in the Canada and Quebec pension plans, and other liabilities, Robson calculates the total figure for public sector liabilities in Canada to be $1.3 trillion. The implication is that demographic changes will lead to very large liabilities over time.

This paper provides a glimpse of what we may expect in the future. It is important, however, to understand that these models are sensitive to underlying assumptions—in particular, to growth assumptions.

G.F.