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Editor's Introduction

Through the Policy Forum, the *Canadian Tax Journal* tries to stimulate informed debate about important Canadian tax issues. At the moment, among the most notable issues is the ongoing study of Canada's international tax rules being conducted by the Advisory Panel on Canada's System of International Taxation. The panel's outlook on its mandate is set out in its April 2008 consultation paper, "Enhancing Canada's International Tax Advantage." Related to this undertaking has been the more general examination of Canada's competitive position internationally, which culminated in "Compete To Win," a report published in June 2008 by the Competition Policy Review Panel. Professor George R. Zodrow's Policy Forum article is another contribution to the debate in the international tax area which the journal has very deliberately encouraged, keeping pace with the broader conversation about this issue in the tax community.

Whether Canada's international position is approached exclusively from a tax policy point of view or more expansively to address international trade issues, the impact of corporate taxation, and in particular the effect of corporate tax rates, is a necessary but very complex and often confusing aspect of the analysis. In the interest of bringing together various strands of this inquiry, Professor Zodrow probes the measurement and impact of corporate taxation from a number of perspectives, blending a cogent economic analysis with its practical implications for international tax planning and the location decisions faced by multinational enterprises as they take into account the relative taxation of capital income around the world.

An examination of the taxation of capital income and of the appropriate measurement standards for evaluating the impact of corporate taxation on the movement of capital and the location of international business is daunting for those who do not have a background in economics. In 2006, the Organisation for Economic Co-operation and Development published paper no. 43 in its Economic Studies series, "Taxation and Business Environment as Drivers of Foreign Direct Investment in OECD Countries"; in 2007, it published paper no. 17 in its Tax Policy Studies series, "Tax Effects on Foreign Direct Investment: Recent Evidence and Policy Analysis." These are important studies in international tax policy and tax rate and economic analysis; they inform the way in which multinational enterprises are advised of and anticipate business responses to tax changes. But this kind of analysis is challenging, requiring a critical evaluation of various measures of tax rates as suitable markers of corporate taxation in gauging their effects on trade flows. Moreover, the application of this analysis to the practicalities of actual tax planning is, for the most part, left for readers to explore on their own in order to discern the relevant issues and their interaction (although the 2007 OECD paper examines various common tax-planning scenarios that are implicated in this kind of analysis).

Professor Zodrow brings a measured and accessible evaluation of the economic analysis relevant to the taxation of capital income generally, and in a multinational business environment more particularly, to bear on his examination of tax rate measures that may be used in understanding investment decisions that are affected by taxation. His article subsumes the kind of analysis tackled by the OECD, but in a succinct way that allows non-economists to connect tax policy and its economic antecedents to matters underlying practical planning. Interestingly, he incorporates in his very lucid analysis comments on international tax planning and tax avoidance, and the degree to which a corporate tax that is borne by enterprises in any particular jurisdiction may affect the migration of tax bases. A necessary component of his discussion is a consideration of the effect of interest allocation rules on the measurement of foreign income and creditable foreign tax.

These aspects of Professor Zodrow's article provide a welcome catalyst and a point of departure for economics initiates (and even those who are more adept) to understand and participate in the debate with which the advisory panel examining Canada's international tax system must be grappling. Some of these issues came to the fore in the June 2008 conference, "International Tax Reform: Canada Confronts the Challenge," sponsored by the Canadian Tax Foundation and the Canadian Branch of the International Fiscal Association as part of this debate. There was speculation at the conference about whether international tax planning engaged in by multinational enterprises, including that of the sort that is sometimes impugned by tax authorities around the world, is simply a self-help device by which multinational businesses effectively self-select tax rates comparable to observable international levels, hard as that may be to verify empirically. In a sense, the fact that this planning occurs, but that meaningful taxation of multinational enterprises still results, is possibly modest, though casual, evidence directionally of what some may consider an "appropriate" degree of corporate income tax with international competitive pressures in view—a little like water finding its own level not because the lake is being drained but more by force of tendencies occasioned by the larger environment and landscape. One wonders what location decisions would be made if domestic tax rates were reduced to the point where the marginal residual benefit of this planning to change locations declined considerably. Inevitably, a system that allows self-selection of this kind, rather than undertaking a more systematic and broad-based reassessment of the degree of its corporate income taxation on business income, risks diffraction of its tax policy and administration, and the concomitant unevenness and unfairness.

Professor Zodrow's analysis will spark thinking in this area, but in a fashion that even those of us without the time, patience, or in some cases resources to plumb the depths of economic and tax policy analysis can absorb. As well, as the June 2008 conference revealed, the elephant in the room is the need, as part of the international review process, to consider whether and to what extent domestic interest and other expense deduction limitations are required to reinforce or be consistent with a coherent system for taxing (or not taxing) international business income, and indeed measuring that income relative to the domestic component. To some extent the Competition Policy Review Panel has forced the hand of the Advisory Panel on

Canada's System of International Taxation to address this event, though strictly speaking it is not within the second panel's mandate and might well be surprising to see mentioned in the work of the first. This tie-in, too, figures in Professor Zodrow's analysis.

We hope that this is a timely and engaging contribution to the debate for which the report of the Advisory Panel on Canada's System of International Taxation no doubt will be a platform and framework.

Scott Wilkie
Editor