2024 ■ VOLUME 72, Nº 1

# CANADIAN TAX JOURNAL
# REVUE FISCALE CANADIENNE


## PEER-REVIEWED ARTICLES

The Pivotal Role of Capital Gains in Efficient and Progressive Tax Reform — *Jonathan Rhys Kesselman*

False Statement or Omission Penalties in Canadian Tax Law — *Mark Stevens*

## POLICY FORUM

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Canadian Tax Foundation Regional Student-Paper Awards / Prix régionaux du meilleur article par un étudiant de la Fondation canadienne de fiscalité

Best Newsletter Article by a Young Practitioner Award / Prix pour le meilleur article de bulletin par un jeune fiscaliste

Canadian Tax Foundation Lifetime Contribution Award / Prix de la Fondation canadienne de fiscalité pour une contribution exceptionnelle


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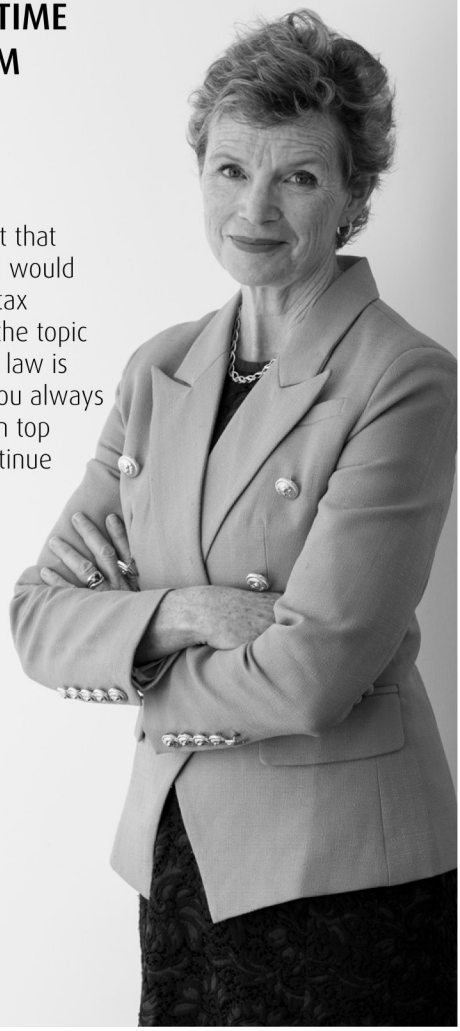
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Since its inception in 1945, the Foundation has published many books and articles on a wide range of subjects within its areas of interest. The Foundation seeks proposals for research projects that will

- result in a book on a single topic of interest in the area of taxation or public finance;
- be undertaken by an experienced researcher who has expertise in an area of taxation or public finance; and
- be carried out within a time frame that is reasonable, given the nature of the project.

Projects selected by the Foundation may qualify for its full or partial financial support of the research and for its underwriting of the publication costs. The Foundation retains the absolute right at its sole discretion to choose whether to support a given proposal or to publish a project.

Interested parties should send a brief written outline of a proposal, for initial consideration by the Foundation, to:

Heather Evans
Executive Director and Chief Executive Officer
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8

hevans@ctf.ca

For further information, please contact the director, as indicated above, or the co-chairs of the Canadian Tax Foundation Research Committee:

Mark Woltersdorf
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
c/o Canadian Tax Foundation / Fondation canadienne de fiscalité

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Depuis sa fondation en 1945, la FCF a publié de nombreux livres et articles sur divers sujets dans ses champs d'intérêt. La FCF souhaite obtenir des propositions de projets de recherche qui :

- mèneront à la rédaction d'un livresur un sujet unique d'intérêt en fiscalité ou en finances publiques;
- seront dirigés par un chercheur chevronné ayant une expertise dans un domaine de la fiscalité ou des finances publiques;
- seront effectués dans un délai raisonnable, compte tenu de la nature du projet.

Les projets qui seront sélectionnés par la FCF pourront être partiellement ou totalement admissibles à une aide financière pour la recherche et les frais de publication. La FCF se réserve le droit absolu, et à sa seule discrétion, d'appuyer une proposition particulière ou de publier un projet.

Toute personne intéressée doit faire parvenir un bref sommaire de la proposition pour examen initial par la FCF à :

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Pour plus d'information, veuillez communiquer avec le directeur, tel qu'il est mentionné plus haut, ou avec les co-présidentes du comité de recherche de la Fondation canadienne de fiscalité :

Mark Woltersdorf
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

Kim Brooks
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

## ■ Recent and Upcoming Events*
## ■ Activités récentes et à venir*

**JOURNÉE D'ÉTUDES FISCALES**
le 30 mai 2024, Montréal

**PRAIRIE PROVINCES TAX CONFERENCE AND LIVE WEBCAST**
Saskatoon and via Webcast, June 3-4, 2024

**BRITISH COLUMBIA TAX CONFERENCE AND LIVE WEBCAST**
Vancouver and via Webcast, September 16-17, 2024

**ONTARIO TAX CONFERENCE AND LIVE WEBCAST**
Toronto and via Webcast, October 21-22, 2024

**ATLANTIC PROVINCES TAX CONFERENCE**
Halifax, November 1-2, 2024

**76TH ANNUAL TAX CONFERENCE**
Vancouver, December 1-3, 2024

* For further details on upcoming events, please visit the Canadian Tax Foundation website at www.ctf.ca. / Pour plus de renseignements, veuillez consulter le site Web de la Fondation à www.fcf-ctf.ca.

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# ■ Canadian Tax Journal

## INVITATION TO SUBMIT

The *Canadian Tax Journal* publishes research in, and informed comment on, taxation and public finance, with particular relevance to Canada. To this end, the journal invites interested parties to submit manuscripts for possible publication as peer-reviewed articles, and it especially welcomes work that contributes to the analysis, design, and implementation of tax policies.

Articles may be written in English or French and should present an original analysis of the topic. Submitted work, or any substantial part or version thereof, must not have been previously published, either in print or online, and it must not be submitted or scheduled for publication elsewhere. The journal welcomes shorter submissions (from 4,000 to 8,000 words) focused on specific topics as well as longer submissions that analyze issues in depth.

## PEER REVIEW

Submitted articles are subject to a double-blind peer review; authors' identities are not known to reviewers, and reviewers' identities are not known to authors. (Non-peer-reviewed contributions may appear elsewhere in the journal.) Final decisions on the publication of articles are made by the editors—Kim Brooks, Kevin Milligan, and Daniel Sandler—on the advice of reviewers. Reviewers are experts in the area who are chosen by the editors to provide an opinion on the publishability of the submission and to make suggestions for improvement. Submissions may be (1) accepted outright; (2) accepted if recommended revisions are made; (3) revised by the authors, as requested by the editors on the advice of reviewers, and resubmitted for further review; or (4) rejected with reasons. The time from submission to the first editorial decision is usually two months or less.

## SUBMISSION DETAILS

Prospective contributors should submit a copy of the manuscript to the journal's editorial department. The preferred method of submission is by e-mail with an attached Word document. E-mail inquiries are welcome: write to CTFeditorial@ctf.ca. Contributors are responsible for providing complete and accurate citations to sources, a detailed abstract (200 to 400 words), and up to six keywords for indexing purposes.

Manuscripts accepted for publication are to be prepared in the prescribed format. For details, see the Foundation's Style and Format Guide.

Because all articles are subject to double-blind review, a separate cover page should accompany each submission. The cover page should include the author's name, e-mail and postal addresses, telephone number, and fax number. Authors should take care not to identify themselves directly or indirectly in their articles.

## POLICY FORUM CONTRIBUTIONS

The Policy Forum section includes both articles commissioned by the journal editors and articles proposed by prospective authors. All articles should aim for short and rigorous analysis (3,000 to 5,000 words) and be written for an audience of policy makers, tax practitioners, and students of fiscal and tax policy. Articles may be based on original research, or they may synthesize and apply established research findings to a particular policy context.

Calls for proposals for upcoming Policy Forum sections appear on the Foundation's website and Twitter feed and are circulated by e-mail. To receive these e-mails, please contact CTFeditorial@ctf.ca and ask to have your name added to the mailing list. Proposals will be reviewed by the journal editors, and authors whose proposals are selected will be invited to prepare articles.

All Policy Forum articles are reviewed by the journal's editors prior to publication.

## ACCESSING THE JOURNAL

The full text of all articles that have appeared in the *Canadian Tax Journal* since its first issue in 1953 can be found in the Canadian Tax Foundation's TaxFind database and, with a minimum one-year delay, in HeinOnline, ProQuest, and EBSCO's Business Source Ultimate database. Also, peer-reviewed articles since 1991 are publicly available on the *Canadian Tax Journal*'s Issues Index web page.

The *Canadian Tax Journal* is also indexed in LegalTrac, EconLit, Wolters Kluwer Canada's Canadian Income Tax Research Index, Carswell's Income Tax References, Canadian Periodicals Index, and Scott's Index to Canadian Legal Periodical Literature.

# ■ Revue fiscale canadienne

## Invitation à soumettre

La *Revue fiscale canadienne* publie des articles de recherches et des commentaires éclairés sur la fiscalité et les finances publiques, qui sont particulièrement pertinents pour le Canada. À cette fin, la Revue invite les personnes intéressées à soumettre des articles, qui seront évalués par des pairs, pour une éventuelle publication et elle accueille plus particulièrement les écrits qui contribuent à l'analyse, à la conception et à la mise en œuvre des politiques fiscales.

Les articles peuvent être rédigés en anglais ou en français et doivent présenter une analyse inédite du sujet. L'article soumis, ou toute partie ou version substantielle de celui-ci, ne doit pas avoir été publié antérieurement, que ce soit sous forme papier ou numérique, et il ne doit pas avoir été soumis ou prévu d'être publié ailleurs. La Revue accueille les soumissions plus courtes (de 4 000 à 8 000 mots) axées sur des sujets précis et également les soumissions plus longues qui analysent des problèmes en profondeur.

## Révision par les pairs

Les articles soumis font l'objet d'une révision anonyme par les pairs; l'identité des auteurs n'est pas connue des réviseurs, et l'identité des réviseurs n'est pas connue des auteurs. (Les propositions non évaluées par des pairs peuvent être publiées ailleurs dans la Revue.) Les décisions concernant la publication des articles sont prises par les rédacteurs — Kim Brooks, Kevin Milligan et Daniel Sandler — à partir des conseils des réviseurs. Ces derniers sont des experts établis en la matière, ils sont choisis par les rédacteurs pour donner leur avis en ce qui concerne le bien-fondé de publier la soumission et formuler des suggestions d'amélioration. Les soumissions peuvent être 1) acceptées sans réserve; 2) acceptées sous réserve des changements recommandés; 3) révisées par les auteurs, en fonction des exigences des rédacteurs qui suivent les conseils des réviseurs, et soumises à nouveau pour une révision supplémentaire; ou 4) rejetées avec motifs. Le délai entre la soumission et la première décision de la rédaction est généralement de deux mois ou moins.

## Préparation de la soumission

Les contributeurs potentiels doivent soumettre une copie de leur article à la rédaction de la Revue. La méthode de transmission privilégiée est le courriel avec un document Word en pièce jointe. Toutes demandes de renseignements par courriel sont les bienvenues : vous pouvez contacter le CTFeditorial@ctf.ca. Les contributeurs ont l'entière responsabilité de fournir les références complètes et précises des documents qu'ils citent, un résumé détaillé (200 à 400 mots) et jusqu'à six mots-clés qui seront utilisés à des fins d'indexation.

Les articles acceptés pour publication doivent être préparés selon le format prescrit. Pour en savoir plus, se rapporter au Guide de rédaction et de présentation de la Fondation.

Puisque tous les articles font l'objet d'une révision anonyme par deux personnes, une page couverture séparée doit accompagner chaque article. Sur la page couverture, inclure le nom de l'auteur, l'adresse courriel et l'adresse postale, le numéro de téléphone et le numéro de télécopieur. Les auteurs doivent s'assurer qu'il est impossible de les identifier de manière directe ou indirecte dans leur article.

## CONTRIBUTIONS AU FORUM DE POLITIQUES

La section Forum de politiques comprend à la fois des articles commandés par les rédacteurs en chef de la Revue et des articles proposés par des auteurs potentiels. Tous les articles doivent présenter une analyse courte et rigoureuse (3 000 à 5 000 mots) et être rédigés pour un auditoire de décideurs, de fiscalistes et d'étudiants en politique fiscale. Les articles peuvent être fondés sur des recherches originales, ou ils peuvent synthétiser et appliquer les résultats de recherche établis dans un contexte politique particulier.

Les invitations à soumettre des propositions pour les prochaines sections du Forum de politiques sont publiées sur le site Web de la Fondation, sur le fil Twitter, et elles sont également envoyées par courriel. Pour recevoir ces courriels, veuillez communiquer avec CTFeditorial@ctf.ca et demander que votre nom soit ajouté à la liste de diffusion. Les propositions seront examinées par les rédacteurs en chef de la Revue, et les auteurs des propositions retenues seront invités à rédiger des articles.

Tous les articles du Forum de politiques sont révisés par les rédacteurs en chef de la Revue avant leur publication.

## ACCÈS À LA REVUE

L'intégralité de tous les articles parus dans la *Revue fiscale canadienne* depuis son premier numéro en 1953 se trouve dans la base de données TaxFind de la Fondation canadienne de fiscalité et, après un délai minimal d'un an, dans HeinOnline, ProQuest et dans la base de données Business Source Ultimate d'EBSCO. De plus, les articles révisés par les pairs depuis 1991 sont accessibles au public sur la page Web de l'Index des numéros de la *Revue fiscale canadienne*.

La *Revue fiscale canadienne* est également indexée dans LegalTrac, EconLit, dans la section de recherche en fiscalité canadienne de Wolters Kluwer Canada, dans la section de références de Carswell, dans le Canadian Periodicals Index et dans le Scott's Index to Canadian Legal Periodical Literature.

# ■ Canadian Tax Foundation

The Canadian Tax Foundation is Canada's leading source of insight on tax issues. The Foundation promotes understanding of the Canadian tax system through analysis, research, and debate, and provides perspective and impartial recommendations concerning its equity, efficiency, and application.

The Canadian Tax Foundation is an independent tax research organization and a registered charity with over 12,000 individual and corporate members in Canada and abroad. For more than 70 years, it has fostered a better understanding of the Canadian tax system and assisted in the development of that system through its research projects, conferences, publications, and representations to government.

Members find the Foundation to be a valuable resource both for the scope and depth of the tax information it provides and for its services, which support their everyday work in the taxation field.

Government policy makers and administrators have long respected the Foundation for its objectivity, its focus on current tax issues, its concern for improvement of the Canadian tax system, and its significant contribution to tax and fiscal policy.

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Membership in the Foundation is open to all who are interested in its work. Membership fees are $417.00 a year, except that special member rates apply as follows: (a) $210.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) $210.00 for persons on full-time teaching staff of colleges, universities, or other educational institutions; (c) complimentary for students in full-time attendance at a recognized educational institution; and (d) $180.00 for persons who have reached the age of 65 and are no longer actively working in tax. Memberships are for a period of 12 months dating from the receipt of application with the appropriate payment.

Applications for membership are available from the membership administrator for the Canadian Tax Foundation: facsimile: 416-599-9283; Internet: www.ctf.ca; e-mail: ctfmembership@ctf.ca.

## ■ Fondation canadienne de fiscalité

La Fondation canadienne de fiscalité est un organisme indépendant de recherche sur la fiscalité inscrit sous le régime des œuvres de charité. Elle compte environ 12 000 membres au Canada et à l'étranger. Depuis plus de 70 ans, la FCF favorise une meilleure compréhension du système fiscal canadien et aide au développement de ce système par le biais de ses projets de recherche, conférences, publications et représentations auprès des gouvernements.

Les membres considèrent l'étendue et le détail de l'information offerte par la FCF comme une importante ressource. Ils apprécient également les autres services de la FCF qui facilitent leur travail quotidien dans le domaine de la fiscalité.

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Il est possible de se procurer les demandes d'adhésion auprès de l'administratice responsible de l'adhésion à la FCF : télécopieur : 514-939-7353; Internet : www.fcf-ctf.ca; courriel : adminmtl@ctf.ca.

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# Jonathan Rhys Kesselman

It is with sadness that we announce the passing, after a short illness, of Jonathan Rhys Kesselman. He will be deeply missed by his wife and partner, Kathleen Maiman; his sister Penny and his brother-in-law David Medley; and the colleagues and students who had the privilege of knowing and working with him.

Rhys was a prolific and valuable contributor to the Canadian tax community, and his work was foundational, strongly influencing diverse areas of tax policy. He was passionate about issues in public finance that affected working people and their families, and his work in this area combined sound economic analysis with shrewd policy prescriptions. Rhys was not only a highly accomplished academic but also a public intellectual; he sought to ensure that the public debate was well informed, and he was strongly committed to sharing his ideas, in public forums and op eds, with governments and with his many students. Many of his policy ideas were developed through writing for the Canadian Tax Foundation. In addition to the 17 articles he contributed to the *Canadian Tax Journal* (an 18th appears in this issue), he published two monographs with the Foundation. His exemplary work was highly celebrated, twice receiving the Canadian Tax Foundation's Douglas J. Sherbaniuk Distinguished Writing Award (2002 and 2015) and once being recognized with the Canadian Economics Association's Doug Purvis Memorial Prize (1998).

Canada has lost a consummate scholar and a public policy giant. Rhys Kesselman's work will long endure through its beneficial impact on the lives of Canadians and on the efficiency and fairness of the Canadian tax system.

# Jonathan Rhys Kesselman

C'est avec tristesse que nous vous informons du décès de Jonathan Rhys Kesselman. Il nous a quittés à la suite d'une courte maladie. Il sera profondément regretté par son épouse et partenaire, Kathleen Maiman; sa sœur Penny et son beau-frère David Medley; ainsi que les collègues et étudiants qui ont eu le privilège de le connaître et de travailler avec lui.

Contributeur prolifique et précieux pour la communauté fiscale canadienne, le travail de Rhys a été fondamental, entre autres, par la grande influence qu'il a exercée dans divers domaines de la politique fiscale. Les questions de finances publiques touchant les travailleurs et leurs familles le passionnaient, et dans ce domaine, son travail alliait une analyse économique solide avec des recommandations politiques astucieuses. Rhys n'était pas seulement un universitaire notable, mais aussi un intellectuel public; il cherchait à s'assurer que le débat public soit judicieux, et il était fortement engagé à partager ses idées avec les gouvernements et avec ses nombreux étudiants, dans les forums publics et les éditoriaux. C'est en écrivant pour la Fondation canadienne de fiscalité qu'il a élaboré un grand nombre de ses idées stratégiques. En plus des 17 articles qu'il a rédigés pour la *Revue fiscale canadienne* (un 18e paraît dans ce numéro), il a publié deux monographies avec la Fondation. Son travail remarquable a été très salué, il a reçu à deux reprises le Prix d'excellence en rédaction Douglas J. Sherbaniuk de la Fondation canadienne de fiscalité (2002 et 2015) et il a été récompensé par le Prix commémoratif Doug Purvis de l'Association canadienne d'économie (1998).

Le Canada perd un érudit accompli et un géant des politiques publiques. Grâce à l'impact bénéfique de son travail sur la vie des Canadiens et sur l'efficacité et l'équité du régime fiscal canadien, l'œuvre de Rhys Kesselman résistera au temps.

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# The Pivotal Role of Capital Gains in Efficient and Progressive Tax Reform

Jonathan Rhys Kesselman*

**PRÉCIS**

Une imposition accrue et ciblée des gains en capital est essentielle pour rendre l'impôt sur le revenu des particuliers plus progressif et peut également contribuer à rendre le système plus efficace. Cet article évalue un impôt sur les gains en capital à deux niveaux qui appliquerait un second taux d'inclusion plus élevé pour les gains dépassant un seuil déterminé. Par rapport à une augmentation générale du taux d'inclusion — largement préconisée par les analystes fiscaux — un système à deux niveaux se concentrerait sur les contribuables à revenu élevé et fortunés, renoncerait à des recettes limitées et serait plus acceptable pour le public et plus viable sur le plan politique. Par rapport aux réformes de l'impôt minimum de remplacement (IMR), le système à deux niveaux serait plus simple, engloberait davantage de contribuables, générerait plus de recettes et serait plus conforme à la notion voulant que « les riches paient leur juste part ». L'article explique comment les gains en capital forment un amalgame des facteurs capital et travail comportant souvent des rendements au-dessus de la normale qui constituent une cible efficace pour une imposition accrue. De plus, l'article expose en détail la forte concentration de gains en capital récurrents importants dans les tranches de revenus les plus élevées et évalue avec un regard critique les arguments couramment avancés contre l'augmentation du taux d'inclusion des gains. Il établit également les mesures qu'il serait souhaitable de mettre en œuvre en complément d'un impôt sur les gains à deux niveaux, notamment le rétablissement de l'étalement du revenu sur les années suivantes ainsi que l'abolition de la tranche d'imposition supérieure fédérale de 33 pour cent et de l'IMR lui-même. En bref, la déduction actuelle de 50 pour cent des gains en capital sert de porte d'entrée à une infinité de stratagèmes visant à minimiser l'impôt et à créer une distorsion de l'économie. Fermer cette porte, ne serait-ce qu'en partie, pour ceux qui sont les plus enclins à s'engager dans ce type de planification, serait essentiel pour rendre le système fiscal canadien à la fois plus efficace et plus progressif.

* Professor emeritus, School of Public Policy, Simon Fraser University, Vancouver (e-mail: kesselman@sfu.ca). A previous version of this article was prepared for the C.D. Howe Institute's Tax Reform Conference held in Toronto on June 14-15, 2023. I thank Jeffrey Trossman, Alex Laurin, Robin Boadway, Len Burman, conference participants, and journal reviewers for helpful comments but assume full responsibility for all findings and any errors. I hold a diversified portfolio of publicly traded equities and fixed-income securities, and could be adversely affected by proposals described in this article.

**ABSTRACT**

Increased, targeted taxation of capital gains is key to making the personal income tax more progressive, and it can also contribute to a more efficient system. This article assesses a two-tier capital gains tax that would apply a second, higher inclusion rate for gains above a specified threshold. Relative to a general increase in the inclusion rate—widely promoted by tax analysts—a two-tier scheme would focus on high-income, high-wealth taxpayers, forgo limited revenue, and be more publicly acceptable and politically viable. Relative to reforms to the alternative minimum tax (AMT), the two-tier scheme would be simpler, cover more taxpayers, capture more revenue, and conform more closely to the notion that "the rich pay their fair share." The article explains how capital gains are an amalgam of capital and labour inputs, often containing supernormal returns that are an efficient target for increased taxation. The article further details the high concentration of recurrent large capital gains at top income levels and critically assesses arguments commonly made against raising the gains inclusion rate. It also identifies desirable companion measures for a two-tier gains tax—including restoration of income averaging and abolition of the federal 33 percent top tax bracket and the AMT itself. In short, the current 50 percent capital gains deduction serves as a gateway for endless tax-minimizing and economy-distorting stratagems. Closing that gate even partway for those most prone to enter into such planning would be pivotal in making Canada's tax system both more efficient and more progressive.

**KEYWORDS:** CAPITAL GAINS ■ TAX REFORM ■ ALTERNATIVE MINIMUM TAX ■ TAX AVOIDANCE ■ DEFERRAL METHOD ■ CANADA-US

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## INTRODUCTION

Capital gains are a form of income with important distinguishing attributes relative to other income sources. These attributes are critical to understanding capital gains' role in the generation of high-end incomes and wealth as well as in formulating efficient and progressive tax policies. Most individuals with very high income and/or wealth will have achieved that status (other than by way of inheritance) through financial assets, privately held businesses, or real property that appreciated at a high rate—not merely a normal rate of return to capital. Moreover, unlike the sharp distinction in standard economic theory between the returns to capital and to labour, these supernormal returns typically are an amalgam of financial or real capital enhanced by the efforts, skills, ideas, reputation, connections, or personality of their owner—that is, they are in part a return to attributes of labour. That melding of capital and labour returns has essential implications for taxation policy, which conventionally treats capital and labour incomes very differently.

Moreover, taxing capital gains at concessionary rates renders the responsiveness of top earners to variations in their marginal tax rates much higher than for most taxpayers. That, in turn, makes raising top-bracket tax rates increasingly costly in efficiency terms, so that broadening the tax base to constrain the scope for tax avoidance will reduce the economic cost of the overall tax system. This conclusion is consistent with a long-established maxim for good tax policy: "Broaden the base, lower the rate."[1] The resultant efficiency gains from improved taxation policies can be garnered in various ways. Existing revenue levels can be generated at lower efficiency cost, with decreased marginal tax rates, while simultaneously increasing the effective progressivity of the tax system. Or revenues can be increased with increased marginal tax rates yet at a reduced efficiency cost and with heightened progressivity. Regardless of one's position on the political spectrum, the potential for reducing the tax system's efficiency costs should be appealing.[2]

This article investigates the issues as follows. First, it summarizes the latest findings about the patterns and concentration of taxable capital gains (TCGs) in Canada. Second, it characterizes the combined capital and labour aspects of capital gains and explains why their *jointness* is key to understanding the evolution of very high income and wealth levels. In the process, it exposes how traditional economic analysis and its tax policy implications have ignored the critical combination of the two components. Third, the article assesses how the tax system differentially treats various types of personal savings and investment holdings, and the implications for concentration

1 See Jack M. Mintz, *The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform*, C.D. Howe Institute Commentary no. 239 (Toronto: C.D. Howe Institute, 2006), at 25, for one expression of this view: "Tax bases should be broadened, not just rates lowered, in order to improve efficiency, fairness and simplicity in the tax system."

2 A detailed plan for broadening Canada's personal income tax base is set out in Jonathan Rhys Kesselman, "Toward a Broader Base for Personal Taxation: Reconciling Equity with Efficiency," in Jinyan Li, J. Scott Wilkie, and Larry F. Chapman, eds., *Income Tax at 100 Years: Essays and Reflections on the Income War Tax Act* (Toronto: Canadian Tax Foundation, 2017), 6:1-40.

of income and wealth. Fourth, it offers a critical review of factors that have commonly been used to justify the concessionary tax treatment of capital gains, such as inflation, asset lock-in, and risk taking. All of these arguments are found to be either deficient or remediable through straightforward companion reforms.

The article then assesses methods for broadening the personal tax base to include more capital gains.[3] It sketches a range of options for increasing the inclusion rate for capital gains on a targeted or "two-tier" basis that would affect only taxpayers above a specified threshold based on total gains and/or total income. This approach would broaden the base of the regular income tax and could pave the way for abolition of the alternative minimum tax (AMT). It would leave the great majority of taxpayers who receive capital gains unaffected and thus optimize public support while addressing the concentration of very high incomes and wealth owing to current capital gains tax treatment. In short, a reform along these lines would make the tax system simultaneously simpler, more efficient, *and* more progressive. The article concludes with a critique of the AMT reforms announced in the 2023 federal budget that focus on capital gains. It finds that those reforms would increase the tax system's complexity and worsen transparency of investment incentives while raising limited new revenues. Thus, the AMT reforms offer little scope for reduced tax rates with improved efficiency and increased overall tax progressivity, and they are shown to compare unfavourably with more direct reforms of capital gains taxation.

Before proceeding, several notes are in order. My illustrations in this article refer to the current top federal tax rate of 33 percent, although one way to exploit the efficiency gains of my proposed reforms would be to eliminate that rate or to raise the income threshold at which it applies. I do not refer to the income tax rates imposed at the provincial/territorial levels, but my proposed reforms would alter the taxable income base applicable in those jurisdictions and thus would directly affect those rates. My analysis refers to the "effective tax rate" on capital gains as the inclusion rate multiplied by the marginal tax rate for the individual. However, if the investor holds profitable investments beyond one year, this ignores the benefits of tax deferral relative to an accrual-based income tax, which would require further discounting of the effective tax rate to reflect the time value of money.[4] Finally, I do not examine

3 Note that capital gains tax policy has also played a role in the debate over taxing wealth holdings directly. Jackson and Sanger reject raising the general gains inclusion rate as politically challenging because many taxpayers would be affected, and they dismiss "graduated" gains inclusion rates as being unduly complex. See Andrew Jackson and Toby Sanger, "Policy Forum: The Case for an Annual Net Wealth Tax" (2020) 68:3 *Canadian Tax Journal* 835-50, at 844, note 37. In contrast, Boadway and Pestieau assess reform of the capital gains tax (along with a new inheritance tax) as superior to the introduction of a new wealth tax. See Robin Boadway and Pierre Pestieau, "The Wealth Tax and the Tax Mix" (2020) 70, supplement *Canadian Tax Journal* S185-208, at S201-4.

4 Bailey suggested an alternative adjustment for the effective gains rate, namely, multiplying by the share of total accrued gains that are realized and become taxable in a given year. See Martin J. Bailey, "Capital Gains and Income Taxation," in Arnold C. Harberger and Martin J. Bailey, eds., *The Taxation of Income from Capital* (Washington, DC: Brookings Institution, 1969), 11-49, at 46-49.

the possible companion measure of raising the gains inclusion rate for corporations and other entities, which would generate substantial additional revenues.[5]

## TAXABLE CAPITAL GAINS: CONCENTRATION AND PATTERNS

It has long been known that TCGs are concentrated among taxfilers at the top income and wealth levels, on account of their larger resources and the tax benefits accorded to gains. However, because earlier analyses were based on annual data, they tended to overstate the degree of concentration at top incomes, and the lumpiness of the gains further exaggerated this when incomes were measured inclusive of the gains.[6] Those findings also led to assertions that TCGs are frequently received by taxpayers at moderate income levels and that raising the inclusion rate would be burdensome for irregular recipients of modest gains. More recent analyses have accessed longitudinal data on taxfilers over a span of years, which reveal the true extent to which gains are received on a recurrent basis and in far larger amounts by persons with normally very high incomes. One study tracking 33.5 million distinct taxfilers over the 10-year period 2009-2018 found that 80.7 percent never reported a TCG.[7] It further found that

5 Smart and Jafry offer estimates of the added revenues from corporations. The 75 percent gains inclusion rate was applied to entities including corporations, partnerships, and trusts in the 1990s. Similar measures would be needed, at least for Canadian-controlled private corporations (CCPCs), to prevent new avoidance routes with an increased inclusion rate for individual taxpayers. Michael Smart and Sobia Hasan Jafry, "Policy Forum: Inequity and Inefficiency in the Tax Treatment of Capital Gains" (2021) 69:4 *Canadian Tax Journal* 1157-74.

6 Studies employing this earlier, now superseded, methodology include Herbert G. Grubel, *Unlocking Canadian Capital: The Case for Capital Gains Tax Reform* (Vancouver, BC: Fraser Institute, 2000); Vincent Thivierge and Alex Laurin, "Capital Gains Widely Enjoyed, Not Just by Top Earners," *Intelligence Memos*, March 17, 2017 (www.cdhowe.org/sites/default/files/blog_Alex%20and%20Vincent%202_0223_0.pdf); Alexandre Laurin, "Who Pays the Capital Gains Tax and How Much More Tax Revenue Can Be Raised?" (2021) 2:3 *Perspectives on Tax Law & Policy* 7-9; and Alex Whalen and Jason Clemens, "Correcting Common Misunderstandings About Capital Gains Taxes," *Fraser Research Bulletin*, January 2021 (revised) (www.fraserinstitute.org/sites/default/files/correcting-common-misunderstandings-about-capital-gains-taxes.pdf). Even back in 2000, Grubel bemoaned the lack of panel data to provide a more accurate picture of the income distribution of capital gains receipts (Grubel, supra, at 38). Laurin (supra, at 7) also acknowledged the need to use longitudinal data for a clear picture of gains distribution. Such data have been available for Canada for more than a decade. More than three decades ago, Feenberg and Summers found similar results for the concentration and patterns of capital gains using panel data on income taxes in the United States. See Daniel Feenberg and Lawrence Summers, "Who Benefits from Capital Gains Tax Reductions?" (1990) 4:37 *Tax Policy and the Economy* 1-24.

7 Excluding any years in which filers received less than $500 in TCGs, this figure rises to 85.9 percent. The figures cited are from Kesselman, for which the results were generated by Gagné-Dubé et al. See Jonathan Rhys Kesselman, *Pathways to Reform of Capital Gains Taxation in Canada*, FON commentaries, vol. 3, no. 5 (Toronto: Finances of the Nation, March 2023), at 57, table 1 (https://financesofthenation.ca/wp-content/uploads/2023/03/Capital-Gains-Tax-Canada-Version-FON-6.2.pdf); and Tommy Gagné-Dubé, Matis Allali, Luc Godbout, and Antoine Genest-Grégoire, "Policy Forum: The Real Concentration of Capital Gains in Canada—A Longitudinal Analysis" (2021) 69:4 *Canadian Tax Journal* 1175-92.

most gains (56.4 percent) were received by filers reporting gains in four or more years. The average income for those reporting no (or trivial) gains in all years was $32,500 versus $85,900 for those with non-trivial gains in any year(s). Total TCGs for those reporting gains in a single year averaged $26,800 versus 12 times that sum at $328,300 for those reporting gains in all 10 years.

The findings on concentration of capital gains and the associated tax benefits are even starker when taxpayers are classified *by incomes* using longitudinal data.[8] One study used that approach over the five years 2014-2018 with filers ordered by their census family incomes inclusive of TCGs, since it is relatively easy for capital gains to be split among family members. The top 0.01 percent of such families reported average TCGs of $6.1 million per year; the top 0.1 percent to 0.01 percent had average annual TCGs exceeding $1 million; and the top 1 percent to 0.1 percent had average annual TCGs of $174,000. In total, the top 1 percent garnered 57 percent of all TCGs, and the top 10 percent received 82 percent. When the families were classified by incomes excluding their TCGs, the respective average annual TCGs for the three groups were $990,000, $350,000, and $87,000, with the total share for the top 1 percent being 24 percent and the top 10 percent being 49 percent. The concentration of capital gains in the total economic incomes of the very highest earners is most striking if viewed for a single year.[9] In 2018, gross capital gains (before the 50 percent gains deduction) accounted for just 0.8 of 1 percent of incomes by the bottom 50 percent but rose to 33 percent for those with incomes between 99.9 percent and 99.98 percent, and 55 percent for those between 99.995 percent and 100 percent.

The concentration of TCGs at the highest incomes has important implications for tax policy beyond simple observations about the role of capital gains taxation in income distribution. Estimates of how reported taxable incomes respond to variations in the effective tax rate, called the elasticity of taxable income (ETI), display marked differences by taxpayers' income level.[10] As a general finding, these studies

8 Smart and Jafry (supra note 5, at 1160) note that they converted dollar values to 2018 figures using the consumer price index.

9 The figures cited are from Kevin Milligan, "How Progressive Is the Canadian Personal Income Tax? A Buffett Curve Analysis" (2022) 48:2 *Canadian Public Policy* 211-24, at 218. Annual data on TCGs will overstate the amounts received at top incomes owing to some unusual large realizations (such as decedents' estates) but also fail to count the large accruing gains on assets held by the very wealthy.

10 This point is true for both the US and the Canadian income tax systems. For the former, see Emmanuel Saez, Joel B. Slemrod, and Seth H. Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review" (2012) 50:1 *Journal of Economic Literature* 3-50. For the latter, see Canada, Department of Finance, *Tax Expenditures and Evaluations 2010* (Ottawa: Department of Finance, 2010), at 45-65, under the heading "The Response of Individuals to Changes in Marginal Income Tax Rates"; and Kevin Milligan and Michael Smart, "Taxation and Top Incomes in Canada" (2015) 48:2 *Canadian Journal of Economics* 655-81. These studies typically include capital income but not capital gains, given the high year-to-year volatility of gains, lagged responses, and changes in tax treatment over time. Saez et al. (supra, at 32-33) discuss the methodological issues relating to the use of capital gains in the estimation process.

conclude that the ETI is very high for the top 1 percent of filers by income and much lower for the rest of the population. How much capital gains contribute to a high ETI is not revealed in the studies, since they typically exclude gains for methodological reasons. However, the responses of tax accounting and business tax "innovation" to changes in capital gains tax provisions suggest that they play an important role. Moreover, a high ETI is associated with a large efficiency cost from higher tax rates, so that broadening the tax base to include more TCGs from top earners would yield a decrease in the efficiency cost of the tax system.[11] TCG concentration at top incomes further supports a two-tier approach to raising the gains inclusion rate.

## CAPITAL GAINS: AN AMALGAM OF CAPITAL AND LABOUR

A long tradition in economic theory and the tax policy implications that flow from it is to characterize capital and labour as distinct, separable factors of production.[12] Capital is conventionally deemed to be a tangible entity—such as machinery, structures, research and development (R & D), and inventory—yielding a normal rate of return plus a risk premium. Capital can also yield a supernormal return that reflects proprietary techniques, patents, locational advantages, R & D, and monopolistic conditions. In contrast, an individual's labour is deemed to earn the competitive market value of their skills, experience, connections, special knowledge or talents, locale, and willingness to accept various job conditions such as workplace (un)safety and degree of autonomy. Supernormal returns that accrue to various forms of capital (real or financial) attributable to the attributes or behaviour of the individual who works with, oversees, enables, or owns that capital have been neglected in classical economic theory.

More recent empirical and theoretical research has paid increasing attention to the causes, patterns, and tax policy implications of heterogeneous capital returns.[13]

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11 See Martin Feldstein, "Tax Avoidance and the Deadweight Loss of the Income Tax" (1999) 81:4 *Review of Economics and Statistics* 674-80, for the original analysis; also see Raj Chetty, "Is the Taxable Income Elasticity Sufficient To Calculate Deadweight Loss? The Implications of Evasion and Avoidance" (2009) 1:2 *American Economic Journal: Economic Policy* 31-52, and studies cited therein.

12 Economic theory focuses on labour in the aggregate and thus fails to assess how the differential abilities of individuals can generate supernormal returns from capital. For this reason, it typically attributes all of these supernormal returns to capital, although this is dependent on measurement practices.

13 See Andreas Fagereng, Luigi Guiso, Davide Malacrino, and Luigi Pistaferri, "Heterogeneity and Persistence in Returns to Wealth" (2020) 88:1 *Econometrica* 115-70. Also see Aart Gerritsen, Bas Jacobs, Alexandra V. Rusu, and Kevin Spiritus, *Optimal Taxation of Capital Income with Heterogeneous Rates of Return*, CESifo Working Paper no. 8395 (Munich: Center for Economic Studies and Ifo Institute for Economic Research, 2020), at 1-2, for a listing of studies that assess sources of this heterogeneity. An earlier extensive review of factors relevant to designing the direct tax base touched on these kinds of considerations. See James Banks and Peter Diamond, "The Base for Direct Taxation," in James A. Mirrlees, Stuart Adam,

Various findings relate to individual-specific factors, such as richer persons' greater financial literacy, risk tolerance, access to expert advice, savings rates, and ability to diversify holdings. One study found annual average rates of return on wealth ranging from less than 4 percent for the 20th to 90th percentiles of wealth holders to 8.3 percent for the top 1 percent. This finding was explained by the groups' differing portfolios of asset holdings, with the highest returns accruing to private businesses, which obviously reflect a blend of labour and capital inputs.[14] Other studies point to wealthier persons' greater entrepreneurial talents and holding onto assets longer and thereby benefiting from greater tax-deferred compounding of capital gains.[15] Thus, higher rates of return on financial, business, and real capital can be seen as being intimately related to the characteristics of the associated individuals—a true amalgam of capital and labour. As one tax law scholar expressed it, "[w]hat taxpayers report as capital gains income is often a form of labor income in disguise. This is especially true at the very top of the income distribution."[16] Economic theorists have not been far behind in elaborating on the implications of these heterogeneous returns for optimal taxation. One such study concludes that realistic return heterogeneity implies that "optimal taxes on capital income are positive, economically significant, and increasing in capital income."[17]

An example will illustrate the issues of disentangling capital and labour incomes and how they are taxed. Take a hypothetical, multi-talented person, Jack, with sharp skills in all the managerial, financial, entrepreneurial, technical, and inventive domains. If Jack pursues his invention as an employee or partner in a startup, he will be compensated by salary (labour income) and possibly stock options (capital gains). As an unincorporated business, he will be taxed fully on net income (including any supernormal returns) as labour income. As an incorporated business owner, he can choose

Tim Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, eds., *Dimensions of Tax Design: The Mirrlees Review* (Oxford: Oxford University Press, 2010), 548-648.

14 Inês Xavier, "Wealth Inequality in the US: The Role of Heterogeneous Returns" (February 2022) (https://carey.jhu.edu/sites/default/files/2022-05/inês-xavier-xavier-ines_0.pdf).

15 Andreas Fagereng, Martin Blomhoff Holm, Benjamin Moll, and Gisle Natvik, *Saving Behavior Across the Wealth Distribution: The Importance of Capital Gains*, NBER Working Paper no. 26588 (Cambridge, MA: National Bureau of Economic Research, 2019).

16 Victor Fleischer, "Alpha: Labor Is the New Capital" (2015) draft version 1.3, at 2 (https://ostromworkshop.indiana.edu/pdf/seriespapers/2015f_c/fleischerpaper.pdf).

17 Gerritsen et al., supra note 13, at 28. Other optimal tax analyses that consider these factors include Peter Diamond and Johannes Spinnewijn, "Capital Income Taxes with Heterogeneous Discount Rates" (2011) 3:4 *American Economic Journal: Economic Policy* 52-76; Casey Rothschild and Florian Scheuer, "Optimal Taxation with Rent-Seeking" (2016) 83:3 *Review of Economic Studies* 1225-62; and Florian Scheuer and Joel Slemrod, "Taxation and the Superrich" (2020) 12:1 *Annual Review of Economics* 189-211.

18 For a detailed description of the design and operational issues for a DIT, how each of the Nordic countries has addressed these issues, and the implications for Canada, see Peter Birch Sørensen, "The Nordic Dual Income Tax: Principles, Practices, and Relevance for Canada" (2007) 55:3 *Canadian Tax Journal* 557-602.

among salary, dividends, and capital gains on sale of the business. As an independent investor, he will be taxed as a business (fully taxable on net income but with losses offsetting other income), or as a hobby investor (taxed on net capital gains but with capital losses offsetting only capital gains), or as a pension or hedge fund manager, compensated by a salary, bonuses, stock options, and possibly capital gains. In short, any supernormal returns that Jack generates in his activities will be measured and taxed in different ways depending on his choices.

Dual income tax (DIT) systems employed in the Nordic countries[18]—and as mooted for Canada[19]—graphically illustrate the issues and challenges of distinguishing between capital and labour returns. In essence, a DIT seeks to apply a low flat rate to the normal returns to capital and progressive rates to labour-type incomes plus supernormal returns to capital. However, in practice DIT schemes have faced problems in distinguishing between the two, with supernormal capital returns such as those embedded in capital gains potentially accessing the lower flat-tax treatment.[20] The DIT's very structure incentivizes higher earners to shift or recharacterize incomes to exploit the flat tax. Evidence of this behaviour has been found in countries that adopted a DIT system.[21] This shift, along with the high concentration of capital gains and dividends among the highest earners, implies that Canada's adoption of a DIT would reduce the progressivity of the personal tax system.[22]

## CAPITAL GAINS: DIFFERENTIAL TAX TREATMENT

Capital gains realized outside registered accounts have both innate properties and tax attributes that make them uniquely suited for accumulating very high wealth by

19 Canadian economists who have proposed a DIT include Robin Boadway, "Income Tax Reform for a Globalized World: The Case for a Dual Income Tax" (2015) 16:6 *Journal of Asian Economics* 910-27; Kevin Milligan, *Benefactors Lecture*, *Tax Policy for a New Era: Promoting Economic Growth and Fairness* (Toronto: C.D. Howe Institute and CPA Canada, 2014); and Mintz, supra note 1. The Quebec Taxation Review Committee, *Focusing on Québec's Future*, *Volume 1: Québec Tax Reform* (Quebec: Quebec Taxation Review Committee, March 2015), also recommended study of the DIT.

20 For example, Milligan's proposed DIT for Canada would apply the flat rate to capital gains and dividends (Milligan, supra note 19, at 27); this would raise the effective tax rates for capital gains of low and moderate earners as well as forgo the option of increased taxation of the capital gains of higher earners.

21 For evidence for Finland, see Jukka Pirttilä and Håkan Selin, "Income Shifting Within a Dual Income Tax System: Evidence from the Finnish Tax Reform of 1993" (2011) 113:1 *Scandinavian Journal of Economics* 120-44; and for Denmark, see Henrik Jacobsen Kleven and Esben Anton Schultz, "Estimating Taxable Income Responses Using Danish Tax Reforms" (2014) 6:4 *American Economic Journal: Economic Policy* 271-301.

22 This would be consistent with Bert Brys, Sarah Perret, Alastair Thomas, and Pierce O'Reilly, *Tax Design for Inclusive Economic Growth*, OECD Taxation Working Paper no. 26 (Paris: Organisation for Economic Co-operation and Development, 2016), at 52, finding that, on the basis of OECD experience, the shift to DIT systems contributed to greater concentrations of income and wealth at the top.

individuals able to generate supernormal returns. To explain these factors, table 1 compares the key features that affect the potential for garnering supernormal returns. All forms of registered savings accounts—registered retirement savings plans (RRSPs), registered pension plans (RPPs), and tax-free savings accounts (TFSAs)—limit both the amounts of contributions and the kinds of assets they can hold. Because they use tax-deferred methods, RRSPs and RPPs expose any supernormal returns fully to tax, and their contribution caps and restricted types of holdings further limit potential supernormal returns. Using the tax-prepaid method, TFSAs allow any supernormal returns to escape tax, but their dollar contribution caps constrain the potential magnitude.[23] The inability of registered accounts to hold the types of assets with the highest potential returns—founders' shares, private businesses, and real and residential properties—further limits them. It has been estimated that use of registered accounts allows the great majority of Canadian taxpayers to undertake all savings on a consumption-type basis.[24] This is not the case for those at the highest income and wealth levels, who must hold any additional assets outside registered accounts.

Table 1 also lists non-registered savings vehicles and the much broader class of assets they can hold—including private business shares, real properties, and principal residences—with no limits on the amounts held beyond the individual's personal savings and wealth. These are asset types with the potential to generate the largest supernormal returns.[25] Private businesses and property developers can leverage their returns through bank borrowing, share issuance, and retained earnings. Homeowners can achieve high leverage through the collateral value of their houses and high rates of appreciation in major urban centres; they further enjoy untaxed in-kind housing services. These types of assets are treated on a tax-prepaid basis, with the principal residence exemption (PRE) rendering realized gains 100 percent tax-free and the capital gains deduction for most other assets yielding a 50 percent tax concession along with the deferral of taxes. The lifetime capital gains exemption (LCGE) permits qualifying small businesses owners to fully exempt from tax (in conjunction with the capital gains deduction) a cumulative lifetime limit of $1 million of gains from the sale of company shares. These tax preferences facilitate the accumulation of high wealth levels by individuals able to generate supernormal returns. Only fixed-value assets held in non-registered accounts (shown at the bottom of table 1), such as savings and guaranteed investment certificates, yield interest income that is fully taxed annually with no tax-deferral benefit.

23 For discussion of the ex ante versus ex post views of equity relating to tax-prepaid versus tax-postpaid methods of applying a consumption tax base, see Benjamin Alarie, "Assessing Tax-Free Savings Accounts—Promises and Pressures" (2009) 57:3 *Canadian Tax Journal* 505-32; and Jonathan Rhys Kesselman, "Tax-Free Savings Accounts in a Consumption-Based Personal Tax" (2009) 57:3 *Canadian Tax Journal* 533-62.

24 Robin Boadway, "Rationalizing the Canadian Income Tax System" (2019) 67:3 *Canadian Tax Journal* 643-66, at 648.

25 Most US billionaires' fortunes are based on the appreciation of founders' stock, which will be free of capital gains tax if held until death under the basis step-up provision (Fleischer, supra note 16, at 22).

**TABLE 1 Taxation Attributes of Various Savings Vehicles**

| Vehicle and type | Tax treatment | Permissible assets | Tax treatment | Limit on contribution amount | Supernormal returns |
|---|---|---|---|---|---|
| Registered accounts | | | | | |
| RRSP . . . . . | Tax-deferred | Financial market | Deferral until funds withdrawn | Earnings and dollar cap | Fully taxable |
| RPP . . . . . | Tax-deferred | Financial market | Deferral until funds withdrawn | Earnings and dollar cap | Fully taxable |
| TFSA . . . . . | Tax-prepaid | Financial market | No tax | Dollar cap | 100% tax-free |
| Non-registered assets | | | | | |
| Variable value: capital gains . . . | Tax-prepaid | Financial, business, tangible, or real property | Deferral until asset sold | No legal limit | 50% tax-free |
| | Tax-prepaid | Principal residences | No tax on sale | No legal limit | 100% tax-free |
| | Tax-prepaid—Lifetime capital gains exemption | Shares of a QSBC[a] | Deferral until shares sold | Lifetime limit: $1 million on gains | 100% tax-free on first ~ $1 million of gains |
| Fixed value . . . . . | Tax-prepaid | Savings, GICs, bonds | No deferral | No legal limit | (none) Fully taxable |

GIC = guaranteed investment certificate; QSBC = qualified small business corporation; RPP = registered pension plan; RRSP = registered retirement savings plan; TFSA = tax-free savings account.

a Usually a Canadian-controlled private corporation. In combination with the capital gains deduction (50 percent exclusion of gains), this provision provides lifetime cumulative indexed tax-free amounts up to $971,190 for businesses and $1 million for farming and fishing properties in 2023.

## RATIONALES FOR CONCESSIONARY TAX TREATMENT

The taxation of capital gains in Canada and elsewhere has a long history both of varying practices and of financial and economic arguments relating to the appropriate tax treatment of gains.[26] More than half a century ago, capital gains were described

26 Boadway reviews and critically assesses some of the arguments. Robin Boadway, "Options for the Reform of Capital Gains Taxation" (2021) 2:3 *Perspectives on Tax Law & Policy* 1-4.

by an economist as "one of the most controversial facets of the tax structure."[27] Of particular interest here is a series of assertions that have been advanced for concessionary tax treatment of gains and against increases in the effective tax rate on gains. The topic is a relatively complex one and has led to multiple changes in tax provisions for capital gains, often spearheaded more by political pressures from affected interest groups than by solid economic evidence. Before pursuing increased tax on gains, even if targeted to a relatively small tranche of taxpayers, we should consider the most common arguments against raising the personal tax on capital gains. Most of these arguments will be shown to be unfounded or overstated, and some concerns could be mitigated by companion reforms to tax provisions.

## Taxing the Inflation Component

One recurrent argument for taxing capital gains at a preferential rate, such as the current 50 percent inclusion rate, is that part of the realized gain reflects inflation over the asset holding period.[28] In an "ideal" income-based personal tax, the inflation component should not be subject to tax; otherwise, even an asset with a small nominal gain that lagged the inflation rate would bear tax. The putative solution is to allow indexation of the cost base and then subject only the *real* gain to tax, albeit with 100 percent tax inclusion. Australia used this procedure between 1985 and 1999 before abandoning cost-base indexation and shifting to a 50 percent tax inclusion rate.[29] Aside from the added complexity of indexing capital gains, this approach would further bias the Canadian income tax toward capital gains if indexation were not simultaneously implemented for interest income, deductible interest expense, and business taxation, and accompanied by an increase in the inclusion rate.[30] Investors holding assets for the longest periods are most affected by lack of indexation, and they are typically the wealthiest, reaping the largest gains and the greatest deferral benefits.[31]

27 Bailey, supra note 4, at 11.

28 Lack of indexation in the taxation of capital gains was cited by the Technical Committee on Business Taxation as a reason to retain the then-current 75 percent inclusion rate. See Canada, *Report of the Technical Committee on Business Taxation* (Ottawa: Department of Finance, April 1998), at 7.17. For analysis of the inflation component in gains for holdings of Toronto Stock Exchange shares over various periods and assessment relative to a 75 percent tax inclusion rate, see Melville McMillan, "Policy Forum: Inflation Indexation and Capital Gains Tax Reform" (2023) 71:2 *Canadian Tax Journal* 415-28. Smart and Jafry (supra note 5) contend that the advantages of deferring gains tax until realization far outweigh the burden of taxing gains on a nominal basis.

29 John Minas, Youngdeok Lim, Chris Evans, and François Vaillancourt, "Policy Forum: The Australian Experience with Preferential Capital Gains Tax—Possible Lessons for Canada" (2021) 69:4 *Canadian Tax Journal* 1213-30, at 1218-19.

30 For similar observations, see Robert Couzin, "Capital Gains: Tax Alternatives" (1995) 21, supplement *Canadian Public Policy* S225-41, at S228.

31 US data on the relation between actual asset holding periods and the size of realized gains indicate this kind of pattern; see Janette Wilson and Pearson Liddell, "Sales of Capital Assets

If the tax inclusion rate for gains were calibrated as a rough offset to the long-run inflation rate, it would need to be higher than the current 50 percent rate. To illustrate this, take the Bank of Canada's long-run 2 percent inflation target and experience over the past couple of decades, and assume that inflation will return to the target rate. Next, take the 20-year historical average total return for the S&P 500 index (including dividends) of 10.326 percent to the end of February 2023 and the associated rate of 7.606 percent adjusted for inflation.[32] Raising the gains inclusion rate to 75 percent and taxing only the real gain over this period would constitute an approximate inflation offset (versus 7.606/10.326 = 73.6, or 74 percent). Moreover, for asset holdings that yield supernormal returns, this would be an overly generous tax treatment even if one were to ignore the additional tax savings from deferral of tax over the asset holding period.

### Inefficient Lock-In and Tax Deferral

Another common argument against increasing the gains tax inclusion rate is that it would exacerbate the locking-in of asset holdings and thereby reduce economic efficiency. This phenomenon arises on account of taxing gains only when an asset is sold and tax can no longer be deferred. The investor might thus be induced to hold onto an asset even when alternatives with superior prospective returns are available. Often cited is the example of a shareholder with accrued gains on stock in company X who is discouraged by the tax that would be due on its sale from shifting funds into stock in a company Y with a higher anticipated return.[33] While this might constitute a drag on better portfolio diversification for that investor, it hardly constitutes inefficiency for the real economy. Someone must be holding both companies' shares at any time, and their relative prices will be determined by the market as a whole, with investors having bought at varying prices and times with varying accrued gains or losses. Moreover, the real capital underlying corporate shares is fixed in form and cannot be transformed by shares being shifted between investors.

In contrast, the lock-in associated with the direct holding of tangible assets—such as structures, land, or a business—can constitute real economic inefficiency insofar as

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Data Reported on Individual Tax Returns, 2007-2012" (2016) 35:3 *Internal Revenue Service Statistics of Income Bulletin* 63-155.

32 Cory Mitchell, "Historical Average Stock Market Returns for S&P 500 (5-Year to 150-Year Averages)," *Trade That Swing*, October 24, 2023 (https://tradethatswing.com/average-historical-stock-market-returns-for-sp-500-5-year-up-to-150-year-averages/).

33 This form of lock-in was assessed empirically in Adam M. Lavecchia and Alisa Tazhitdinova, *Permanent and Transitory Responses to Capital Gains Taxes: Evidence from a Lifetime Exemption in Canada*, NBER Working Paper no. 28514 (Cambridge, MA: National Bureau of Economic Research, 2021), which found little support for an impact of the effective tax rate on long-run capital gains realizations. McKenzie suggests that this low responsiveness supports raising the gains tax inclusion rate to 67 percent or 75 percent without incurring significant efficiency losses. See Ken McKenzie, "The Taxation of Capital Income in Canada—Part III: Bringing It All Together," *Finances of the Nation*, December 11, 2020 (https://financesofthenation.ca/2020/12/11/the-taxation-of-capital-income-in-canada-part-iii-bringing-it-all-together).

an alternative owner could put the asset to more productive use. For such assets, an increase in the effective tax rate on realized gains could be adverse to the economy, and provision could be made for favourable tax treatment on "like-kind" exchanges. An example would be a farmer selling a plot of land to a developer and using the proceeds to purchase another agricultural plot. Current provisions in Canada for like-kind exchanges are very limited but could be expanded along the lines of US provisions.[34] One possible approach would be to allow tax deferral on half of the realized gains if reinvested in a replacement property, with those taxes being deferred until the replacement property was sold. With a broader provision for like-kind exchanges, this could reduce the effective tax rate and the lock-in effect even with an increase in the inclusion rate.[35] The existing provisions for capital gains reserves can also mitigate liquidity and lock-in concerns for asset sales in certain situations.

An often-proposed remedy to the lock-in effect of taxing gains only upon realization is to tax the gains as they accrue, such as on an annual basis.[36] This reform could readily be implemented for publicly traded securities, using mark-to-market year-end values as reported on stock exchanges.[37] In fact, that method was employed for shares held in an indexed securities investment plan (ISIP), which operated from 1983 until supplanted by the LCGE in 1985. As an offset to limited accrual taxation, the short-lived ISIP offered the benefit of indexation for account holdings. However, accrual taxation of gains is infeasible for assets such as private businesses and real estate, for which annual or even periodic valuations would be costly and unreliable. To handle such assets, a formula that imputes the interest value of tax deferral could be used; that would dampen the lock-in effect, albeit by increasing the effective tax rate on gains (very sharply for long-held assets).[38]

34 Section 1031 of the US Internal Revenue Code of 1986, as amended, permits tax-deferred like-kind exchanges of certain types of property other than principal residences. Section 44 of Canada's Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended, permits tax-deferred like-kind exchanges only if the original property has been stolen, destroyed, or publicly expropriated, and/or used to generate business income other than rental income.

35 For example, if the inclusion rate were increased to 75 percent, half of the gain were deferred, and a top personal tax rate of 33 percent applied, the effective tax rate on the gain would be reduced to 12.375 percent from the current 16.5 percent.

36 Arnold makes an effective argument for accrual taxation in the Canadian context, although practical aspects such as valuation and liquidity are likely barriers to its adoption. See Brian J. Arnold, "Accrual Taxation of Capital Gains: An Idea Whose Time Has Come," *The Arnold Report* posting no. 221, January 5, 2022 (www.ctf.ca/ctfweb/EN/Publications/Newsletters/Arnold_Report/EN/Newsletters/The_Arnold_Report/BArnold_Archive.aspx).

37 Year-to-year volatility in valuations and the associated liquidity issues would need to be addressed through some form of averaging or posting of security with the tax authority.

38 Auerbach proposed such a retrospective method for taxing gains only upon realization. See Alan Auerbach, "Retrospective Capital Gains Taxation" (1991) 81:1 *American Economic Review* 167-78.

## Risk-Taking Incentives

Yet another frequently used rationale for preferential taxation of capital gains and against increasing the inclusion rate relates to putative adverse effects on risk taking. As with many arguments against an increased inclusion rate, empirical evidence on this point is lacking. It is well established in economic theory that if gains and losses are treated symmetrically, increasing a proportionate tax rate will *increase* the holding of risky assets in a portfolio. The reason is that the government shares in both profit and loss from the investment, reducing the variance of the returns and thereby rendering risk taking *more* attractive. With a progressive rate structure or the two-tier gains inclusion rate proposed here, the symmetry between gains and losses or variations in annual gains may be impaired. A remedy is to restore general income-averaging provisions[39] or at least to provide generous carryover or averaging provisions for capital gains within a two-tier gains structure.

Capital gains played a role in the analysis supporting the early development of income-averaging schemes for tax.[40] Recent analysis of Canadian taxpayers found that "[t]hose who experienced capital gains are . . . among the top percentile of [tax] penalty-payers" owing to high year-to-year variance of gains receipts combined with the absence of tax-averaging provisions.[41] In fact, persons with high wealth and large investment portfolios (whether real or financial) are best able to diversify their holdings and to stabilize their annual TCGs (as well as defer taxes) by "loss harvesting" among their holdings. The restoration of provisions for general income averaging would be most beneficial to less wealthy investors who have less ability to diversify their holdings and thus undertake discretionary sales of both their winners and their losers so as to minimize their long-run tax liabilities.

The notion that special risk attaches to owners of capital, necessitating preferential tax treatment for gains, is peculiar in that it ignores the risk borne by workers on their human capital. Labour earnings are fully subject to income tax without comparable concessions to reflect their risk. Yet, by pursuing education, training, or work experience in a particular occupation, profession, industry, or skill, the individual takes on a risk that the associated human capital can become obsolete, devalued, or unemployed through events beyond the individual's control. Moreover, unlike with an investment portfolio in real or financial assets, few individuals are able to diversify their human capital into a portfolio of disparate skills or occupations. Regardless

39 Canada abolished general forward income averaging in 1988 coincident with its flattening of the federal tax rate schedule. Increased rate progressivity introduced since then at both the federal and provincial levels has renewed the need for averaging provisions.

40 Vickrey was motivated in part by concern over the income fluctuations from gains. See William Vickrey, "Averaging of Income for Income-Tax Purposes" (1939) 47:3 *Journal of Political Economy* 379-97.

41 Daniel V. Gordon and Jean-François Wen, *A Question of Fairness: Time To Reconsider Income-Averaging Provisions*, C.D. Howe Commentary no. 494 (Toronto: C.D. Howe Institute, 2017), at 17.

of their level of human capital, most individuals face more extreme income risk than do most holders of large financial or real capital.

### The Lumpy Nature of Gains

The lumpy nature of some capital sales in combination with the progressive tax rate schedule can produce penal rates of tax for some individuals. This situation might arise with respect to a real asset that is indivisible and large relative to the total portfolio, or possibly a financial asset with large accrued gains that is divisible but that the investor deems should be sold quickly in its entirety. As argued above, a restoration of general income-averaging provisions and carryover provisions in the proposed two-tier capital gains tax would be effective remedies. Existing tax provisions for capital gains reserves can also be useful in spreading the taxable gains over a period of years. The proposed expanded coverage of properties eligible for partial tax deferral through like-kind exchanges would further assist in achieving this goal. However, it is notable that most realized capital gains arise for taxpayers who are usually or always in the top tax bracket, so that variations in their TCGs do not have an impact on their effective marginal tax rates.

### Tax Avoidance and Evasion

A commonly expressed argument against increasing tax rates of any kind is concern over raising the incentives for tax avoidance and evasion. However, in hiking the effective tax rate on capital gains, the presumption with respect to avoidance incentives runs strongly in the other direction. The current 50 percent capital gains deduction poses strong incentives for taxpayers (and their advisers) to recast financial and business arrangements to exploit this benefit. These strategies range from vanilla approaches that are clearly legal ways to take advantage of the capital gains preference (such as flowthrough shares) but stretch to surplus stripping and dispersing shares of Canadian-controlled private corporations (CCPCs) to non-owners to multiply use of the LCGE—phenomena that require ongoing official monitoring, court challenges, and on occasion legislative curbs.[42] Raising the tax inclusion rate to 75 percent, at least for large gains recipients, would reduce the returns to these extant and emerging strategies by half or more and thereby reduce tax avoidance with its associated revenue losses, inefficient resource distortions, and waste of human talent in tax advising.[43]

42 A recent example relates to surplus stripping: see Allan Lanthier, "UPDATE: Surplus Stripping and the New, Costly Tax Loophole for Intergenerational Transfers," *Finances of the Nation*, July 28, 2021 (https://financesofthenation.ca/2021/07/28/surplus-stripping-and-the-new-costly-tax-loophole-for-intergenerational-transfers); and Allan Lanthier, "Surplus Stripping: We Need To Fix Canada's Tax Rules," *Finances of the Nation*, July 29, 2021 (https://financesofthenation.ca/2021/07/29/surplus-stripping-we-need-to-fix-canadas-tax-rules/).

43 For a top-bracket taxpayer in Ontario in 2023, surplus stripping would currently save about $210,000 in taxes for shares worth $1 million with the 50 percent inclusion rate; raising the inclusion rate to 75 percent would reduce the savings to $61,000 or a decrease of 71 percent.

Raising the tax inclusion rate for capital gains would unavoidably increase incentives for the targeted taxpayers to evade tax through non-reporting of their asset dispositions. However, with respect to their domestic asset holdings, all the major categories—such as real estate, financial assets, businesses, and even yachts—are now officially registered, so that sales are unlikely to escape scrutiny. Moreover, pricey artworks are most likely to be sold through dealers or auctions to achieve the best liquidity and to maintain their provenance, so that sale values are officially reported. Some persons who trade privately in smaller items, such as stamp collections or antiques, are beyond external scrutiny and may be induced by higher gains tax rates to cease reporting their gains, but likely many of these persons are already evading at current tax rates. For assets located and held outside the country by Canadian tax residents, the potential for gains tax evasion is clearly higher, especially in less developed countries. Foreign real estate is particularly vulnerable to such evasion, but whether the rate of evasion would increase much beyond current levels is unknown.[44]

### Potential Adverse Economic Impacts

The common presumption is that raising any tax rate will distort behavioural incentives and thus be adverse to the economy.[45] However, if there are pre-existing tax distortions, raising some tax rates could counterbalance the biases and in this way improve economic efficiency.[46] Thus, an increase in the gains tax inclusion rate could create a better balance among the varied ways in which savings are allocated and investments are structured. This point is exemplified by inflationary pressures on housing prices that stem from the PRE,[47] which in turn diverts bank lending to home mortgages and away from loans for productive business investments.[48] Eliminating the PRE would therefore reduce this crowding out of lending to businesses and thereby improve the economy's overall productivity.

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44 Canada's requirement to report foreign assets exceeding $100,000 on CRA form T1135 ("Foreign Income Verification Statement") excludes real estate so long as it is a personal-use property.

45 Exceptions could include taxes or fees to correct for externalities such as environmental ones.

46 This point is an illustration of the well-known "theory of second-best" in economics.

47 Globerman and Emes document Canada's unusually large share of all capital formation devoted to housing, and they remark that "it is possible that the relatively favourable treatment of capital gains on owner-occupied dwellings compared to the treatment of capital gains on business-related investments is contributing to the changing distribution of investment across asset categories." No empirical study linking the PRE to home inflation in Canada is available. See Steven Globerman and Joel Emes, "An International Comparison of Capital Expenditures," *Fraser Research Bulletin*, August 2021 (www.fraserinstitute.org/sites/default/files/international-comparison-of-capital-expenditures.pdf), at 8, 11, and 14.

48 Chakraborty et al. establish this crowding-out effect in US bank lending behaviour. See Indraneel Chakraborty, Itay Goldstein, and Andrew MacKinlay, "Housing Price Booms and Crowding-Out Effects in Bank Lending" (2018) 31:7 *Review of Financial Studies* 2806-53 (https://doi.org/10.1093/rfs/hhy033).

There exists an extensive body of theoretical and empirical research on the economic impacts of capital gains taxation.[49] The findings are somewhat diverse, but essentially the only areas where increased taxation of capital gains might have significant impacts on the economy are venture capital firms, business startups, and employees in those firms incentivized by stock options. Special carefully designed carve-outs from the gains tax increases could mitigate these impacts, and could possibly be patterned in part after some US provisions. But the reported impacts are not all adverse; for example, higher gains taxation was found to modestly reduce the volume of venture capital but to increase its efficiency by focusing funds on startups that proved to be more successful.[50]

What do we know about the likely long-run impact on the aggregate economy from an increase in the rate of capital gains taxation?[51] Canada had a natural experiment that could shed some light on the answer, but thus far no pertinent research of this episode has been undertaken. Beginning in 1990 and stretching to 2000, the gains inclusion rate was increased from 50 percent to 75 percent and held at that rate for that decade. The growth rate of Canada's gross domestic product over this period was not notably different than in adjacent decades, but of course this hardly constitutes proper causal analysis in view of the myriad varying macroeconomic, fiscal and monetary policy, trade, and energy price influences. Drawing reliable inferences about the aggregate economic impact of a higher capital gains inclusion rate from this experience would be a challenging task.

### Tax Competitiveness with the United States

A concern often raised about prospective changes to the Canadian tax system relates to the impact on "competitiveness" with the tax system of the United States on account of the two countries' geographical, business, financial, and labour proximities. For corporate and business taxation generally, it is important that Canadian rates and practices not get far out of line with their American (and other foreign) counterparts. However, because personal taxes apply only to persons who are resident in each country—and foreign tax credits and tax treaties mostly eliminate double taxation—differences in capital gains taxes have much less salience. They might be relevant for persons considering their target destination country, but if the threshold for higher gains tax rates is set sufficiently high, even a large gains tax differential is unlikely to deter many prospective immigrants. It could affect out-migration incentives for very high earners, but this would be moderated by the deemed realization of gains on departure.

49 Kesselman (supra note 7, at 8-17); available studies draw heavily on US experience.

50 Carolin Bock and Martin Watzinger, "Capital Gains Tax: A Curse but Also a Blessing for Venture Capital Investment" (2019) 57:4 *Journal of Small Business Management* 1200-31.

51 Mintz and Wilson asserted that capital gains taxation was injurious to entrepreneurship, savings, investment, and economic growth, but the study offered and cited little empirical evidence. See Jack M. Mintz and Thomas A. Wilson, *Capitalizing on Cuts to Capital Gains Taxes*, C.D. Howe Institute Commentary no. 137 (Toronto: C.D. Howe Institute, February 2000).

Keeping in mind my caveat about the limited pertinence of Canada-US differences in effective rates of gains tax for top earners, table 2 presents interesting comparisons. Given the modest interprovincial and the larger interstate differences in tax rates, it is important to make jurisdictional distinctions. Panel A of the table distinguishes between the three most populous, higher-tax provinces and two lower-tax provinces. With the current top federal personal tax rate of 33 percent and 50 percent gains inclusion rate, capital gains face a top rate of 27 percent in the former provinces and 24 percent in the latter. Panel B distinguishes between long-term tax treatment for assets held for more than one year and short-term tax treatment for other assets in the United States; it also distinguishes among the states with no income tax, the majority of states with fairly low top rates of around 6 percent, and the few states with top rates around 13 percent.

For long-term gains, which are key for our analysis, the zero-rate states with a total top rate of 24 percent are fully matched by the two lower-tax Canadian provinces. The medium-tax states at total rates of 30 percent are undercut at 27 percent by the three most populous provinces, and the top-tax states at 37 percent exceed by 10 percentage points the top-tax provinces. Total rates for short-term gains in any of the states far exceed any rates in Canada. Panel A also shows the counterfactuals for Canada if it shifted to a 75 percent inclusion rate offset by reducing the top federal personal tax rate to 29 percent; the top total rate would then rise to 37.5 percent, barely above the 37 percent now applied in the top-tax US states, and the resulting 33 percent rate in the lower-tax provinces would not be much out of line with many states' top rates.

On the other side of the ledger, for assets held at death, the United States provides a step-up in cost basis that effectively eliminates all capital gains tax (though an estate tax on the largest estates may apply) and also more generous provisions for capital gains related to like-kind exchanges, venture capital, startups, and employee stock options. The United States does not have a direct equivalent to the flowthrough shares whereby Canadians can exploit the capital gains preference. There is no way to aggregate these differences for a clear ranking, but one could conclude that generally the two countries do not diverge radically in how heavily they tax most top recipients of capital gains. However, an important difference is that the top federal tax rates on capital gains in the United States typically apply beginning at much higher income thresholds than those for top rates in Canada.[52] This difference is suggestive for the choice of a high threshold for a two-tier gains tax in Canada.

## Relative Efficiency of Tax Bases

A recurrent assertion among tax policy analysts is that taxing consumption or labour income is economically more efficient than taxing capital income; this view derives

52 The 20 percent US federal rate for long-term gains applies above a threshold for non-investment income of US$492,000 for single filers and US$554,000 for joint filers. A 0 percent rate applies for single filers with incomes below US$44,600 and for couples with incomes below US$89,000, though few at those income levels report significant capital gains.

**TABLE 2 Comparative Top Marginal Tax Rates (MTRs) on Capital Gains, Canada and the United States, 2023**

Panel A Canada, 2023

| Scenario assumed | | Top MTR including provincial tax | |
|---|---|---|---|
| Inclusion rate | Top federal MTR | British Columbia, Ontario, and Quebec | Alberta and Saskatchewan |
| | | *percent* | |
| 50 | 33 | 27 | 24 |
| 75 | 29 | 37.5 | 33 |

Panel B United States, 2023

| Type of gain | State rate 0% | State top rate 6% | State top rate 13% |
|---|---|---|---|
| | | *percent* | |
| Long-term | 24 | 30 | 37 |
| Short-term | 41 | 47 | 54 |

Notes: Most MTR figures are rounded to the nearest percentage point. For US figures, long-term gains are for assets held for more than one year; total MTRs include the 20 percent top federal rate on long-term gains; all figures include a 3.8 percent net investment income tax; states typically treat gains as fully taxable irrespective of the holding period; federal tax on assets held for one year or less (short-term) face full statutory rates (up to a top rate of 37 percent).

from various theoretical and quantitative studies. Several aspects of this body of research weaken its general validity and its relevance to the Canadian context.[53] In particular, these findings derive from analysis of the much more closed US economy, and they neglect the implications of the openness of Canada's economy. The most-often cited study relating to the comparative efficiency costs of alternative tax bases for Canada is a 2004 working paper from the Department of Finance.[54] Yet, the authors of that study caution:

> [Our] model assumes that, by and large, the taxable domestic resident is the marginal investor. If instead the marginal investor is a tax exempt foreign investor then the potency of personal capital income tax cuts would diminish while that of corporate income tax cuts would rise. . . . In fact, on inspecting [our] results, one sometimes gets the impression that we are modelling a quasi-closed economy.[55]

53 Kesselman and Spiro provide an extensive survey of the research literature and a critique of its rigid assumptions and limited applicability to the Canadian economy. See Jonathan Rhys Kesselman and Peter S. Spiro, "Challenges in Shifting Canadian Taxation Toward Consumption" (2014) 62:1 *Canadian Tax Journal* 1-41. Also see Jonathan Rhys Kesselman, "Role of the Tax Mix in Tax Reform," in John G. Head, ed., *Changing the Tax Mix* (Canberra: Australian National University, Australian Tax Research Foundation, 1986), 49-94, for a critique of arguments that have been employed to support a shift in the tax mix.

54 Maximilian Baylor and Louis Beauséjour, *Taxation and Economic Efficiency: Results from a Canadian CGE Model*, Working Paper no. 2004-10 (Ottawa: Department of Finance, 2004).

55 Ibid., at 30.

As a consequence, the study's finding that personal capital income taxes carry marginal efficiency costs that are among the highest of all the tax bases must be called into question.

The assumption that the marginal investor is a taxable domestic individual also affects the relevance to Canada of other studies on the impacts of personal capital gains taxation. For Canada, the marginal investor is more typically a non-taxable domestic entity, a foreign entity, or an investor in a tax-sheltered savings scheme—none of which are affected by the domestic personal tax on capital gains. One study posits a causal impact of personal capital gains tax on corporate investment operating through lock-in effects; the study is purely theoretical without any empirical testing or verification.[56] Another such study posits that lock-in effects of individual investors impede corporate acquisition activity.[57] Since many investors pay no tax or defer tax, they will be unaffected by lock-in, so that market equilibrium prices for these shares should also be relatively unaffected by lock-in.

For a highly open economy with mobile capital such as Canada's, the corporate tax burden falls substantially on labour rather than capital, achieving equilibrium based on net-of-tax returns relative to the international rate of return.[58] Even if aggregate domestic savings were responsive to the net rate of return for domestic investors—a hypothesis that studies strongly reject—capital flows from abroad would fill any void. Moreover, the theoretical and empirical studies tend to ignore the distinction between taxes on capital income at the personal and corporate levels. Taxes applied at the personal level such as those on capital gains affect only domestic tax-resident investors and do not affect the equilibrium net rates of return required by foreign investors.[59] Thus, any concerns over the impacts on domestic capital formation should be addressed through reforms or relief for corporate taxes.

## A TWO-TIER GAINS TAX INCLUSION RATE

Given the high concentration of capital gains among groups with the highest incomes and their significant incentives and abilities to pursue tax avoidance, a "two-tier" hike in the gains inclusion rate would be an attractive reform. Elsewhere, I have detailed

56 David A. Weisbach, "Capital Gains Taxation and Corporate Investment" (2017) 70:3 *National Tax Journal* 621-42.

57 Benjamin C. Ayers, Craig E. Lefanowicz, and John R. Robinson, "Capital Gains Taxes and Acquisition Activity: Evidence of the Lock-in Effect" (2007) 24:2 *Contemporary Accounting Research* 315-44.

58 McKenzie and Ferede find empirical support for the open-economy prediction that most of the Canadian corporate tax burden is shifted onto labour rather than borne by capital. See Kenneth J. McKenzie and Ergete Ferede, "The Incidence of the Corporate Income Tax on Wages: Evidence from the Canadian Provinces" (2017) 10:7 *SPP Technical Paper* [University of Calgary School of Public Policy] 1-26.

59 Boadway and Bruce provided this important insight for a small open economy, which is relevant for large public companies in Canada but not necessarily CCPCs. See Robin Boadway and Neil Bruce, "Problems with Integrating Corporate and Personal Income Taxes in an Open Economy" (1992) 48:1 *Journal of Public Economics* 39-66.

the principal options and considerations in designing and pursuing such a targeted strategy,[60] and I sketch its main features and design options here. In advocating that the rate hike be targeted on top earners and gains recipients, I depart from other tax policy analysts who have promoted an across-the-board increase in Canada's gains inclusion rate. Even those affected by a two-tier hike in their gains inclusion rate would remain subject to the 50 percent inclusion rate for their gains below any scheme's specified threshold. I illustrate a targeted scheme with a 75 percent rate for the upper tier, although both that rate and the optimal level for the relevant threshold should be subject to quantitative analysis on impacts and factors such as political palatability and public acceptance.

The three basic choices for design of the threshold in a two-tier capital gains inclusion rate are the following. First, the threshold could be based on the filer's total capital gains independent of the filer's income level. Second, the specified threshold could be based on the filer's income, with only the capital gains component of the total income exceeding the threshold subject to the upper-tier inclusion rate.[61] Third, the threshold could be specified in terms of lifetime cumulative capital gains received by the filer, with indexation for both the threshold and the counted gains. Of course, a combined method with threshold criteria including both the income level and the amount of gains could be implemented. Moreover, any option other than the lifetime threshold should offer provisions for multi-year carryover of gains exceeding the annual threshold, or alternatively some more general averaging provision. Restoring general averaging for all taxpayers would ease the inequities and distortions of the increased marginal tax rates of recent years for a diverse group; it would also increase the public appeal of the total reform package.[62]

A raft of other issues arise in designing a two-tier inclusion rate capital gains tax reform. First, whether and how to integrate the existing LCGE into the scheme should be considered.[63] In a modified form, it could most naturally be fitted within

60 Kesselman (supra note 7). Also see Rhys Kesselman, "Challenge for the Upcoming Budget: Capital Gains Tax Reform," *National Newswatch*, March 10, 2023 (www.nationalnewswatch.com/2023/03/10/challenge-for-the-upcoming-budget-capital-gains-tax-reform); Rhys Kesselman, "Opinion: It's Past Time To Reform Capital Gains Tax. But How Exactly?" *Financial Post*, March 15, 2023 (https://financialpost.com/opinion/reform-canada-capital-gains-tax); and Rhys Kesselman, "A Better Alternative to the Alternative Minimum Tax," *Globe and Mail*, April 19, 2023 (www.theglobeandmail.com/investing/personal-finance/household-finances/article-a-better-alternative-to-the-alternative-minimum-tax).

61 Even with some form of carryover or averaging, an annual threshold for the upper-tier rate would incentivize taxpayers with large accrued gains to accelerate realizations in order to exploit the lower-tier inclusion rate; this could generate additional tax revenues.

62 As noted above, general averaging provisions were revoked in 1988 coincident with the flattening of tax rates. In subsequent years, the gradient of tax rate schedules has steepened at both the federal and provincial levels. See Gordon and Wen, supra note 41.

63 Murphy et al. attributed 80 percent of the federal tax expenditure of $560 million for the LCGE for small business shares in 2011 to the top 1 percent of earners. See Brian Murphy, Mike Veall, and Michael Wolfson, "Top-End Progressivity and Federal Tax Preferences in Canada: Estimates from Personal Income Tax Data" (2015) 3:3 *Canadian Tax Journal* 661-88, at 671.

the lifetime cumulative gains option.[64] An increase in the gains inclusion rate, even if limited to a small number of taxpayers, would exacerbate the inequities, inefficiencies, and diversion of capital from the productive business sector arising from the PRE for housing, which carries a tax expenditure cost approaching that for the capital gains deduction itself.[65] Various proposals for easing transition to taxation of gains on the sale of homes have been advanced (and some employed in the United States), and these warrant careful consideration.[66] Aspects of integration with corporate taxes[67] and possible provisions to address lock-in, venture capital, and startups would also need to be addressed, as has been foreshadowed in my prior discussion, with potentially useful guidance from US practices.

One way of structuring the second design option for a two-tier gains tax would be to mimic the US net investment income tax (NIIT), which operates as a surtax on capital gains and dividends for incomes above a threshold.[68] In this way, Canada could extend the levy to the receipt of eligible dividends on the shares of large corporations to limit the related tax credits. Dividend tax credits (DTCs) disproportionately benefit very high earners and wealth holders, on account of their heavy ownership of shares.[69] Given the high degree of international capital mobility for large corporations in Canada, DTCs likely have limited impact on domestic corporate investment, determined mainly by reference to the internationally competitive rate of return. As a result, the DTC principally affects the proportion of corporate equities held by tax

64 Keep in mind the distinction between the LCGE and the use of a lifetime cumulative *threshold* for the upper-tier inclusion rate. The Technical Committee on Business Taxation had recommended the abolition of the LCGE and its replacement by an enhanced RRSP allowance for affected farm and small business owners; see *Report of the Technical Committee on Business Taxation*, supra note 28, at 7.18. The Quebec Taxation Review Committee, supra note 19, echoed this recommendation.

65 The Department of Finance projects the following federal tax expenditures for 2023: non-taxation of gains on principal residences at $8.8 billion; the capital gains deduction in the personal tax at $11.0 billion; and the capital gains deduction in the corporate tax at $10.5 billion. See Canada, Department of Finance, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2023* (Ottawa: Department of Finance, 2023).

66 See Hugh Woolley, "The Principal-Residence Exemption: Potential Reforms" (2021) 2:3 *Perspectives on Tax Law & Policy* 12-14; and Kesselman, supra note 7, at 45.

67 See preliminary analysis of this issue in Michael Smart, "It's Time To Increase Taxes on Capital Gains," *Finances of the Nation*, January 7, 2021 (https://financesofthenation.ca/2021/01/07/its-time).

68 The NIIT was implemented in 2013 as a measure to partially finance the Affordable Care Act. Its 3.8 percent rate applies above thresholds of US$200,000 for single filers and US$250,000 for joint filers. A major deficiency of the NIIT is that it offers no provisions for carryover or averaging, and it is not eligible for foreign tax credits by dual citizens of Canada and the United States.

69 The Department of Finance (supra note 65) projects a federal tax expenditure for 2023 totalling $6.0 billion, though this figure does not distinguish between DTCs for eligible and ineligible dividends. Murphy et al. (supra note 63, at 671) attributed 48 percent of the federal tax expenditure of $3.8 billion for the DTC in 2011 to the top 1 percent of earners.

residents, and several tax economists have supported abolition of the DTC on eligible dividends.[70] Alternatively, the DTC could be capped at some level based on an income threshold separate from the two-tier gains tax.

## ALTERNATIVE MINIMUM TAX

### Reform of the AMT

The 2023 federal budget outlined the provisions for the first substantive reform of the AMT since it was first introduced in 1986. In the words of the finance minister, the reform was intended to ensure that the very wealthy "pay their fair share of taxes."[71] The reform raised the AMT's flat rate from 15 percent to 20.5 percent, increased its exemption more than fourfold to about $174,000, and broadened its base by increasing inclusions and decreasing deductions. Key changes in coverage were increases from 80 percent to 100 percent of capital gains (aside from those eligible for the LCGE) and employee stock options.[72] Key changes in allowable deductions for AMT were capital loss and non-capital loss carryforwards and losses from business investment and limited partnerships; all were reduced from previous allowances of 80 percent or 100 percent to 50 percent. Fifty percent of numerous deductions and non-refundable tax credits will be disallowed for AMT. The reformed AMT does not apply in the year of death (unchanged from the previous version), which is likely to be a time when some decedents' returns face large deemed gains.

The AMT reform has been heralded both officially and in media reporting as a major hit to the wealthy.[73] The Finance documents accompanying the 2023 budget did not make clear exactly how modest the increases imposed by the AMT reform would be for most of the affected taxpayers; no tables were included showing statistics on the average impacts at various income levels. However, some figures on both projected total revenue gains and aggregate impacts for various groups were provided in the pre-budget lockup.[74] The estimated annual revenue gains are about $700 million

70 Boadway and Bruce, supra note 59; Peter S. Spiro, "Can a Dividend Tax Credit Be Justified in a Small Open Economy?" (2013) (http://dx.doi.org/10.2139/ssrn.2268791); Peter S. Spiro, *Tax Exemptions for Investment Income: Boon or Bane?* Mowat Research no.143 (Toronto: University of Toronto, School of Public Policy & Governance, Mowat Centre, 2017); Kesselman and Spiro, supra note 53; Robin Boadway and Jean-François Tremblay, *Modernizing Business Taxation*, C.D. Howe Commentary no. 546 (Toronto: C.D. Howe Institute, 2016); and Boadway, supra note 24. It is notable that Canada's AMT disallows the DTC.

71 Canada, Department of Finance, 2023 Budget, March 28, 2023; remarks by the deputy prime minister and minister of finance.

72 Murphy et al. (supra note 63, at 671) attributed *all* of the federal tax expenditure of $725 million for the employee stock option deduction in 2011 to the top 1 percent of earners.

73 For example, a *Globe and Mail* reporter simply asserted that the AMT reform would expose "Canada's top earners . . . [to] a steep hike to their tax bills." See Sean Silcoff, "Federal Budget 2023: Ottawa Targets High-Income Earners with Increased Minimum Tax," *Globe and Mail*, March 28, 2023 (www.theglobeandmail.com/business/article-federal-budget-minimum-tax).

74 Some of the figures referred to in the text were released in the pre-budget lockup but were not included in the budget papers. See 2023 Budget, Budget Plan, supra note 71, at 188-89 and 192.

over the forecast period beginning with 2024 when the reform becomes effective; that is just one-third of 1 percent of all personal tax collected by the federal government. Finance estimated that more than 99 percent of the AMT will be paid by 32,000 filers with annual incomes above $300,000 and 80 percent by 8,200 filers with incomes above $1 million. If those millionaires had an average income of, say, $2 million (including the 50 percent of gains not counted in their income), their average increase in tax from the AMT would be $70,000 or just over 3 percent of their income.[75]

The mammoth component of the AMT reform—accounting for about 80 percent of its increased revenue—stems from the new 100 percent gains inclusion rate combined with the new 20.5 percent AMT rate.[76] Together these changes imply a federal effective gains tax rate of 20.5 percent for taxpayers affected by the AMT (that is, 1.00 × 20.5%). This figure represents an increase from the current top federal tax rate on gains of 16.5 percent (that is, 0.50 × 33%) for top-bracket filers not subject to the AMT. However, it falls below the prospective top effective rate on gains under a 75 percent inclusion rate for regular tax, which is 24.75 percent (that is, 0.75 × 33%) or 21.75 percent if the top federal rate were reduced to 29 percent, as proposed later in this article; so the increase in the inclusion rate combined with the AMT reform would bridge just under half the difference. Even before the reform, capital gains treatment was always the most prominent component of Canada's AMT, with its many other provisions playing lesser roles.

How would the AMT revenues from the increased capital gains tax compare with those that would accompany various forms of a two-tier gains rate in the regular tax?[77] The annual federal AMT revenue gain associated with capital gains is about $560 million ($700 million × 79%). In contrast, simulated revenue gains under various formulations of two-tier gains taxes are much larger. For example, an annual threshold based on TCGs of $50,000 with an upper-tier inclusion rate of 75 percent would yield more than $5 billion annually or nine times the revenue gain from AMT reform.[78] More than half of the burden would fall on the top 1 percent of filers on

75 However, Bowman and Winters estimate that for filers with extremely large receipts of capital gains without offsetting large receipts of other types of income, the total tax on gains could increase by as much as 5 or 6 percentage points owing to the combined federal-provincial AMT. See Stephen W. Bowman and John (Jay) A. Winters, "The Alternative Minimum Tax Goes Mainstream," *Canadian Accountant*, May 2, 2023 (www.canadian-accountant.com/content/practice/alternative-minimum-tax-mainstream).

76 Laurin and Dahir reach this estimate based on the SPSD/M (social policy simulation database and model) relative to the ordinary 50 percent inclusion rate; they also forecast 92 percent of AMT payers reporting capital gains and 79 percent of filers reporting capital gains exceeding $500,000 to be subject to the AMT reform. See Alexandre Laurin and Nicholas Dahir, *Capital Gains and Charitable Donations: The Silent Targets of AMT Federal Reforms*, C.D. Howe Institute E-Brief (Toronto: C.D. Howe Institute, 2023), at 10.

77 Smart (supra note 67) also provides estimates based on 2017 data for the much larger revenue gains from a 75 percent inclusion rate applied without a threshold and including the gains to provincial revenues: $7.8 billion for personal tax plus $8.0 billion for corporate tax.

78 Jafry and Smart's simulator offers a choice of gains thresholds from $0 to $50,000 and upper-tier inclusion rates from 50 percent to 80 percent. It also offers a choice of annual or five-year

the basis of their average income. At its root, the difference stems from the divergent structures and objectives of the AMT and reform of the regular tax. The AMT is designed to catch a small number of individuals with very large incomes who are paying relatively little regular tax. In contrast, a reform of capital gains in the regular tax would aim to cover the greater number of filers with large total incomes (including all gains) who are paying taxes at levels that are not commensurate with what one might expect in a progressive tax system. The latter view would seem to be more consistent with what constitutes a "fair share."

I briefly consider the substantive provisions of the AMT reform and assess their attributes. Most notable are the reform's disallowance of various expenses and losses associated with the earning of incomes that are included in its base. This violates a basic principle in an income-based tax: We tax income net of expenses, not some of what is spent to earn it. In particular, the allowed deduction of only 50 percent of loss carryovers means that an investor or proprietor who earns a given amount in one year and loses the same amount in the next year could be liable for AMT even though the total (or average) for the two years was no more than break-even (and with capital loss carryovers being fully allowed in the regular tax, the filer might owe no regular tax). The provision allowing AMT payers to recover their AMT in future years when their regular tax exceeds their AMT would not necessarily remedy this situation, thus penalizing some filers with highly variable incomes.

Some items that the AMT reform will disallow as deductions are merely curious and will clutter the associated tax schedules without a substantive rationale. The AMT base will disallow 50 percent of deductions for disability supports, workers' compensation, social assistance, and the guaranteed income supplement. Given the high exemption level that is provided in the AMT reform, virtually no one above that income level would be receiving any of those types of income for which the deductions are being restricted.

All of the AMT changes will further complicate an already complex tax, although the higher exemption level will relieve some filers of the need to concern themselves with the tax.[79] The existing federal tax schedule T691 is an eight-page behemoth, and it will need to be expanded to reflect the reforms. Moreover, each province applies its own AMT and will need to undertake revisions to accommodate the federal reforms. Individuals with items covered by the AMT, such as proprietors, businesses, investors,

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average incomes; I chose the latter for this example to allow for averaging in the scheme. The simulator does not provide a choice for the income threshold, which implicitly is zero, but longitudinal data show that filers at low and moderate incomes received only a minor share of aggregate TCGs. See Sobia Jafry and Michael Smart, "A Capital Gains Tax Reform Simulation Model," *Finances of the Nation*, April 4, 2023 (https://financesofthenation.ca/2023/04/04/a-capital-gains-tax-reform-simulation-model).

79 With their added complexity, the AMT reforms have already evoked advice and strategies for wealthy taxpayers to mitigate their exposure. See Vasilly Vorobiev and Nikolas Letellier-Chabot, "New AMT Rules—Is the Alternative Minimum Tax a Paper Tiger with New Fangs?" Personal Tax Planning feature (2023) 71:3 *Canadian Tax Journal* 877-84, and websites of all the major Canadian tax accounting firms.

and employees with stock options, will need to anticipate whether and when they might become liable to AMT. The investment incentives of various tax provisions will be obscured, thus dampening their effectiveness in achieving legislated objectives. In short, much of the AMT reform's fine tuning may be accomplishing little that is constructive, while also addressing the concentration of top incomes less effectively than would simpler reform of the regular tax focusing on capital gains.

### Commentary on the AMT

In several instances, tax experts in Canada and the United States assessing the AMT approach have offered critical comments. The economist John Bossons, who had served as a research supervisor for the Carter Royal Commission on Taxation, asserted in 1984, prior to Canada's implementation of an AMT,

> [A]lthough the minimum tax sounds simple, it is in fact complex. Its introduction would be a move away from tax simplification. It would mean setting up a second personal income tax, with a separate set of rules, alongside the income tax that we now have. This duplication would necessarily make tax planning more complex. . . . [I]t is hard to be sanguine about the effects of a minimum tax. At worst, a minimum tax is ineffective, in which case it would increase the complexity of the tax system without any real change in equity.[80]

Other analysts critiqued Canada's original AMT as "add[ing] more complexity, more confusion, and more compliance measures to an income tax system already overburdened with these attributes" while recovering little revenue, and dubbed it "the political tax."[81]

As Canada formulated its major tax reforms of the latter 1980s, including the increased gains tax inclusion rates, the tax adviser William Strain urged, "Repeal the alternative minimum tax. With the base-broadening measures of tax reform, there is no need for the AMT, particularly if the capital gains exemption is repealed."[82] With several years of the federal and Quebec AMTs to observe, two tax analysts offered this biting assessment in 1994: "[T]he AMT as structured in Canada is a tax that imposes genuine hardships on few of the taxpayers it targets. . . . If we are not willing to sharpen the tiger's teeth, we should have the political courage to dispatch it promptly."[83]

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80 John Bossons, "Alternative Designs for a Minimum Tax," in *Report of Proceedings of the Thirty-Sixth Tax Conference*, 1984 Conference Report (Toronto: Canadian Tax Foundation, 1985), 917-924, at 917 and 924.

81 Robert E. Beam and Karen Wensley, "Alternative Minimum Tax—The Political Tax," Personal Tax Planning feature (1986) 43:1 *Canadian Tax Journal* 174-202, at 175.

82 William J. Strain, David A. Dodge, and Victor Peters, "Tax Simplification: The Elusive Goal," in *Report of Proceedings of the Fortieth Tax Conference*, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 4:1-63, at 4:20.

83 Gilles N. Larin and Marie N. Jacques, "Is the Alternative Minimum Tax a Paper Tiger?" (1994) 42:3 *Canadian Tax Journal* 804-42, at 842.

Analysts of the American AMT have been no kinder in their critiques, often stressing the "political optics" that drive legislators to pursue this method without addressing the basic underlying deficiencies in the regular tax. One veteran tax scholar wrote:

> [M]inimum taxes have serious drawbacks, and generally make sense (if at all) only if otherwise superior options must be ruled out for reasons of optics or political economy. . . . [A]ny such use should generally be contingent, reluctant, and based on understanding their structural deficiencies. . . . A broader takeaway is that optical effects on perceived tax burdens may tend to be inherently unstable and unpredictable. However, making the overall tax system more complex, and even less transparent than it might otherwise be, is not in general a formula for creating better outcomes.[84]

Another seasoned US tax analyst commented more acerbically in an interview:

> I had actually put forward the idea of using a surtax as a replacement for the alternative minimum tax. The idea was that the alternative minimum tax is an incredibly stupid tax with really undesirable policy consequences, and it's incredibly complicated. We can replace it with a slightly less stupid tax, . . . on AGI [adjusted gross income], which at very low rates might not do too much damage and would be simpler than the AMT.[85]

The surtax proposal put forward by that analyst foreshadowed the later creation of the US NIIT, which is a form of the two-tier gains inclusion scheme proposed for Canada in this article. However, the US AMT remains in place alongside the NIIT.

## PRECEDENTS AND POLITICS

Proposals to raise the gains tax inclusion above its current 50 percent rate are not novel for Canada; there are several precedents. The 1966 Carter commission recommended that realized capital gains be fully taxed—a 100 percent inclusion rate for all gains recipients.[86] It further recommended that after a transition period, the accruing gains on publicly traded securities be periodically valued and taxed.[87] Canada shifted to a 75 percent inclusion rate for the taxation of gains for the 1990s decade, albeit accompanied by reduced tax rates for top incomes. In 1998, the Technical Committee on Business Taxation endorsed retention of the 75 percent inclusion rate in view of the absence of cost-basis indexation for inflation.[88] Subsequently, in 2015,

84 Daniel Shaviro, "What Are Minimum Taxes, and Why Might One Favor or Disfavor Them?" (2021) 40:2 *Virginia Tax Review* 395-452, at 398 and 420.

85 Interview of Leonard Burman, an expert on capital gains taxation. See Sam Young, "Conversations: Leonard E. Burman" (2009) 124:4 *Tax Notes* 325-30, at 327.

86 Canada, *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1967), at 357 and 381.

87 Ibid., at 344 and 378. See the discussion of and advocacy for accrual taxation of capital gains in Arnold, supra note 36.

88 *Report of the Technical Committee on Business Taxation*, supra note 28, at 7.17.

the Quebec Taxation Review Committee recommended the adoption of a 100 percent gains inclusion rate accompanied by indexation for cost bases, but only concomitant with the rest of Canada adopting parallel tax policy changes.[89]

Capital gains tax reform has also been an active issue in Canada over the past two years. For example, publications of the Canadian Tax Foundation have featured more than 15 articles by, collectively, more than 20 authors representing tax policy experts from the academic, practitioner, and think tank communities.[90] While the contributors' views vary, and some caution that further research is needed, the majority lean strongly in favour of increased gains taxation. The present article concurs with that recommendation but diverges in framing the reform as a two-tier scheme with an increase in the inclusion rate targeted on taxpayers with gains or incomes above specified thresholds.

The advantages of a two-tier gains structure relative to a general inclusion rate are several. A two-tier structure focuses on larger recipients of gains while forgoing only modest revenues, thereby enhancing effective tax progressivity. It would not disrupt the investing or lifetime savings plans for retirement of most Canadians. This structure also targets taxpayers for whom sophisticated tax, investment, and business planning often centres on ways to exploit the current capital gains deduction. It leaves intact the existing incentives for entrepreneurs and investors in earlier stages of building their fortunes while capturing more supernormal returns of those who are already well off. The joint restoration of income averaging for tax would benefit investors at moderate incomes as well as many proprietors, self-employed individuals, and workers in cyclically volatile industries. But perhaps the greatest advantage of a two-tier structure for increased taxation of capital gains lies in its prospects of being adopted.

Public acceptance and political viability are crucial prerequisites for any tax reform, and an across-the-board hike to the gains inclusion rate would face barriers on these counts. Recall that over a 10-year period, 19 percent of taxfilers reported TCGs in one or more years, and even when those whose annual gains never exceeded $500 were excluded, the figure was 14 percent. With a two-tier gains tax and a suitably high threshold, only a small subset of those taxpayers would ever bear the higher gains inclusion rate. Canadians have expressed their desire for heavier taxation on top earners, but few are eager to pay more themselves. Public opinion polling on issues related to taxation and inequality reveals strong and widespread support for the

89 Quebec Taxation Review Committee, supra note 19.

90 They included four articles in the *Canadian Tax Journal*'s Policy Forum: Smart and Jafry, supra note 5; Gagné-Dubé et al., supra note 7; Minas et al., supra note 29; and Arun Advani, "Policy Forum: The Taxation of Capital Gains—Principles, Practice, and Directions for Reform" (2021) 69:4 *Canadian Tax Journal* 1231-50. Additionally, seven articles were published in (2021) 2:3 *Perspectives on Tax Law & Policy* 1-19; and several appeared in *The Arnold Report* (for example, Arnold, supra note 36, and Brian J. Arnold, "Reforming the Taxation of Capital Gains," *The Arnold Report* posting no. 257, May 1, 2023 (www.ctf.ca)) and in *Finances of the Nation* (affiliated with the Canadian Tax Foundation) in 2021-2023.

proposition that the wealthy currently pay less than their "fair share" and for the closing of "loopholes" used primarily by the wealthy to lower their overall tax rates.[91] Regardless of whether the capital gains deduction is properly termed a "loophole," it is the most salient tax provision by which the highest earners are able to reduce their tax liabilities.[92]

Previous legislative episodes in both the United States and Canada when the gains inclusion rate was increased suggest a kind of political compromise that might secure the acquiescence, if not the support, of some higher earners. The Reagan tax reforms of 1986 combined an increase to 100 percent taxation of capital gains with major cuts to upper-bracket tax rates.[93] Similarly, the 1987 Canadian tax reforms combined a staged increase in the gains inclusion rate to 75 percent with a major flattening of the tax rate schedule. This experience suggests that movement to a two-tier gains tax be accompanied by the elimination of the federal top-rate bracket of 33 percent. The institution of that rate in 2016 has been estimated to yield less than one-third of forecast revenues for the federal government (and losses for the provinces) as a result of tax planning and avoidance activities.[94] The package approach to gains tax reform recommended here would provide a better balance between capital and labour incomes, improved incentives for work in well-paid jobs and self-employment, and reduced incentives for tax avoidance. It would also restore top total marginal tax rates to levels below 50 percent in most provinces.

## SUMMARY AND CONCLUSIONS

This article explores the potential of a two-tier capital gains inclusion rate to fill the most important gap in the personal tax base that reduces top-end progressivity. Critics will cite concerns over the possible adverse economic impacts of increasing taxes on the capital gains of the largest recipients. Typically, they will recite arguments that

91 These results are based on a national random survey in mid-2021 by Abacus Data; see "Income Inequality: Tax Fairness, Public Policy & Politics in Canada," *Broadbent Institute*, August 4, 2021 (www.broadbentinstitute.ca/tax_fairness_survey). Notably, a majority of respondents who intended to vote for the Conservative Party of Canada agreed with both of these positions.

92 Milligan (supra note 9, at 218, figure 4) finds that instituting a new top federal tax rate of 40 percent on incomes above $350,000 would have much less impact on top-end progressivity compared to taxing 100 percent of capital gains and dividend receipts. The study reports that in 2018 total capital gains accounted for more than half of all income (including total gains) for the top sliver of earners.

93 Burman describes the tradeoff in the US Senate Finance Committee: raising the tax inclusion rate for long-term gains to 100 percent to secure the support of high-income taxpayers for reduced upper-bracket tax rates. A similar tradeoff was likely at play in Canada's tax reform. See Leonard E. Burman, *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed* (Washington, DC: Brookings Institution, 1999), at 23.

94 See the analysis and findings in Alexandre Laurin, *Shifting the Federal Tax Burden to the One-Percenters: A Losing Proposition*, C.D. Howe Institute E-Brief (Toronto: C.D. Howe Institute, 2015); and Alexandre Laurin, *Unhappy Returns: A Preliminary Estimate of Taxpayer Responsiveness to the 2016 Top Tax Rate Hike*, C.D. Howe Institute E-Brief (Toronto: C.D. Howe Institute, 2018).

have been made in support of concessionary taxation of capital gains, which this article has critically assessed and determined to be unfounded or at least overstated. A review of the relevant economic literature also casts doubt on most of the feared economic impacts.[95] Moreover, the two-tier gains tax could enhance the economy's efficiency in several ways. It would reduce incentives for tax avoidance and the associated inefficient distortion of economic resources, including the wastage through tax planning. It would capture more of the supernormal returns associated with the capital gains of high-income, high-wealth recipients. If accompanied by a phased extension of gains tax to owner-occupied housing, it would reduce the diversion of capital away from productive business investment. And if accompanied by elimination of the top federal tax bracket, it would improve incentives for productive activities by higher-earning persons in all sectors of the economy.

The analytical and policy exercises in this article are consistent with a long tradition in tax policy of broadening the bases subject to tax in order to reduce the tax rates needed to meet a revenue goal. Increasing the gains inclusion rate—at least for the group receiving a disproportionate share of gains—would also be consistent with a key premise of modern tax analysis, namely, to broaden the base in order to reduce the elasticity of taxable income, a key determinant of efficiency costs. As stated by some leading tax economists,

> the elasticity depends on the tax system. A tax system with a narrow base and many deductions and avoidance opportunities is likely to generate high elasticities and hence large efficiency costs. . . . [B]roadening the tax base and eliminating avoidance opportunities, such as to reduce the elasticity is likely to be more efficient and equitable than altering tax rates within the old system.[96]

Therefore, it is economically efficient to tax more heavily sources of income that reflect supernormal returns as manifested in capital gains. Thus, the current practice of taxing capital gains more lightly than labour earnings runs contrary to both efficiency and equity.

The 2023 federal budget's announcement of the first major changes to the AMT since 1986 opens the door to broader discussion of ways to reform the tax system to address top-end inequalities. Public opinion polls have displayed wide support for such policy initiatives. However, while the AMT reforms are targeted most heavily on capital gains, they are relatively timid moves toward more progressive taxation. The AMT reform's modest increment to revenue tells us that official policy is continuing to

95 For an extensive critical review of this research, see Kesselman, supra note 7. The study also considers companion reforms that could mitigate the few adverse economic impacts.

96 Saez et al., supra note 10, at 4-5. For the observation that the ETI is a function of tax structure, administration, and enforcement, and thus is a key focus for tax policy, see Joel Slemrod, "Fixing the Leak in Okun's Bucket: Optimal Tax Progressivity When Avoidance Can Be Controlled" (1994) 55:1 *Journal of Public Economics* 41-51. This also explains Denmark's ability to efficiently raise large income tax revenues (Kleven and Schultz, supra note 21).

pay lip service to the mantra that the rich should be paying their fair share. Similar to the government's added 33 percent tax bracket on high incomes in 2016, the projected revenue increases are small and likely overstated. Relative to the projected revenues and impacts on top-end incomes of a two-tier gains inclusion rate, the AMT reform is again soft-pedalling the goal of getting the rich to pay a fair share. In contrast to a simpler and more transparent two-tier gains tax scheme, the AMT reform is again confirming the longstanding view of tax policy critics that the AMT approach is inferior to undertaking needed and overdue reforms to the regular tax.

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# False Statement or Omission Penalties in Canadian Tax Law

Mark Stevens*

**PRÉCIS**

Cet article examine l'interprétation judiciaire du paragraphe 163(2) de la Loi de l'impôt sur le revenu, qui pénalise un contribuable qui, « sciemment » ou dans des circonstances équivalent à une « faute lourde », fait un faux énoncé ou une omission. L'article se concentre plus particulièrement sur la décision de la Cour d'appel fédérale dans l'affaire *Canada c. Paletta*, et soutient que les tribunaux ont indûment élargi la portée de la doctrine de l'aveuglement volontaire tout en n'abordant pas suffisamment l'aspect de la faute lourde. L'auteur préconise une application plus restreinte de l'aveuglement volontaire, conforme à d'autres domaines du droit, et une interprétation élargie de la faute lourde. Cette approche, incorporant un cadre composé d'un « ensemble d'idées », offrirait plus de certitude et d'équité aux contribuables, aux fiscalistes et à l'Agence du revenu du Canada dans la détermination de la culpabilité en cas de faux énoncés et d'omissions.

L'auteur propose un cadre analytique original pour l'interprétation du paragraphe 163(2), qui tient compte de facteurs tels que le risque et les conséquences, l'intention délibérée, l'inadvertance coupable et le manquement à une norme de diligence. Ce cadre vise à guider les tribunaux dans l'évaluation de la conduite des contribuables en adoptant une approche plus équilibrée et plus conforme à l'intention du législateur. Enfin, l'auteur souligne l'importance de maintenir une distinction claire entre l'aveuglement volontaire et la faute lourde en droit fiscal, estimant que cette clarté renforcera la compétitivité et la prévisibilité du système fiscal canadien et guidera mieux les contribuables dans la gestion des risques fiscaux.

**ABSTRACT**

This article examines the judicial interpretation of subsection 163(2) of the Income Tax Act, which penalizes taxpayers for false statements or omissions arising from "knowledge" or "gross negligence." The article specifically focuses on the Federal Court of Appeal's decision in *Canada v. Paletta*, arguing that courts have inappropriately broadened the scope of the wilful blindness doctrine while

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insufficiently addressing the aspect of gross negligence. The author advocates for a narrower application of wilful blindness, consistent with other areas of law, and an expanded interpretation of gross negligence. This approach, through the incorporation of a "cluster of ideas" framework, would provide greater certainty and fairness for taxpayers, tax practitioners, and the Canada Revenue Agency in determining culpability for false statements and omissions.

The author proposes a novel analytical framework for the interpretation of subsection 163(2), considering factors such as risk and consequences, wilful intent, culpable inadvertence, and departure from a standard of care. This framework is designed to guide courts in assessing taxpayers' conduct with a more balanced approach that more closely aligns with Parliament's legislative intent. Finally, the author underscores the importance of maintaining a clear distinction between wilful blindness and gross negligence in tax law, suggesting that this clarity will enhance the competitiveness and predictability of Canada's tax system, and better guide taxpayers in managing tax-related risks.

**KEYWORDS:** CIVIL PENALTIES ■ GROSS NEGLIGENCE ■ KNOWLEDGE ■ NEGLIGENCE ■ PENALTIES ■ TAX RISK

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## INTRODUCTION

Subsection 163(2) of the Income Tax Act[1] can impose significant penalties on taxpayers if false statements or omissions are made in a tax return "knowingly, or under circumstances amounting to gross negligence." Unfortunately, for some taxpayers, courts have struggled to consistently apply the principles underlying "knowledge" and "gross negligence" within the context of subsection 163(2).

The Federal Court of Appeal's decision in *Paletta*[2] highlights the increasingly problematic jurisprudence surrounding subsection 163(2). This article argues that courts apply an excessively broad wilful blindness standard to the "knowingly" element and ignore the protections for conduct assessed under the "gross negligence" element. A solution lies with courts narrowing the wilful blindness standard, consistent with other areas of law, and broadening the "gross negligence" element to incorporate and develop the cluster of ideas that can identify gross negligence in a tax context. The benefit of this approach is greater certainty for taxpayers, tax practitioners, courts, and the Canada Revenue Agency (CRA) with respect to the application of subsection 163(2).

## THE PENALTY IMPOSED UNDER SUBSECTION 163(2), AND THE PALETTA CASE

Subsection 163(2) states, in part:

> (2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return . . . is liable to a penalty.

The phrase "knowingly, or under circumstances amounting to gross negligence," appears several times in the Act.[3] The analysis in *Paletta* demonstrates the current approach that courts use to assess whether a taxpayer acted either knowingly or under circumstances amounting to gross negligence.[4]

1 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.

2 *Canada v. Paletta*, 2022 FCA 86; leave to appeal to the Supreme Court of Canada dismissed March 16, 2023. The Federal Court of Appeal referred to the penalties as "gross negligence" penalties, but this article retains the statutory language, "false statement or omission" penalties.

3 See, for example, subsections 15.2(5), 110.6(6), 162(10), 163(2), and 227(8).

4 *Paletta*, supra note 2, at paragraphs 63 to 93.

## Paletta

### *The Decision of the Tax Court of Canada*[5]

The Tax Court found that Mr. Paletta entered into a plan to generate non-capital losses using forward foreign exchange contracts to defer indefinitely his tax liability.[6] A basic version of the plan consisted of Mr. Paletta entering into two equal yet offsetting exchange contracts, one "long" contract that increased in value with an exchange rate increase (the gain leg) and one "short" contract that would create an equal decrease in value (the loss leg).[7] Mr. Paletta sold the loss leg before December 31 of year 1 to generate a non-capital loss. He then sold the gain leg early in year 2 to recover from the loss leg's actual loss.[8] These transactions created a non-capital loss in year 1 and income in year 2 of roughly equal value.[9] In year 2, Mr. Paletta had taxable income equal to the gain created from the start of the year plus his regular income. To continue the plan, he needed a year 2 loss with twice the value of the year 1 loss.[10] Mr. Paletta aimed to create losses large enough to offset each year's taxable income.

The minister disallowed Mr. Paletta's claim of business losses and applied gross negligence penalties under subsection 163(2) in respect of the returns filed for the 2000 to 2006 taxation years.[11]

The court, however, reasoned that the "commerciality" of the transactions constituted a business.[12] The court further reasoned that the Supreme Court of Canada's precedent on a similar case stood for "the proposition that straddle traders may report the results of their trades for tax purposes on a basis that does not reflect the true economic results of such trades."[13] Ultimately, the court accepted Mr. Paletta's scheme, allowed the claimed losses, and eliminated the subsection 163(2) penalties assessed in respect of those losses.[14]

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5 *Paletta Estate v. The Queen*, 2021 TCC 11.

6 Ibid., at paragraph 1.

7 Ibid., at paragraphs 2 to 6. In the alternative event, where the exchange rate decreased, the two contracts would function similarly but with reversed gain and loss legs.

8 Ibid. As the court explained, more complexity was involved in reaching the precise "target loss" desired, but the basic idea remained the same. *Paletta*, supra note 5, at paragraphs 80 to 94.

9 Ibid., at paragraph 92. The court described how Mr. Paletta created a trading loss that appeared to be worth $2.8 million for tax purposes but was an economic loss of only $18,000: ibid., at paragraph 91.

10 Ibid., at paragraph 6. Mr. Paletta would need three times the year 1 loss in year 3, and four times the loss in year 4. This pattern could continue indefinitely, with losses growing each year to offset all of the previous year's gains.

11 *Paletta*, supra note 5, at paragraph 9.

12 Ibid., at paragraphs 162 to 163, referring to *Stewart v. Canada*, 2002 SCC 42.

13 *Paletta*, supra note 5, at paragraph 191, referring to *Friedberg v. Canada*, [1993] 4 SCR 285.

14 The court did agree that a false statement or omission penalty was assessable for one taxation year, but only because Mr. Paletta failed to report one year's gain leg as income. The court accepted the overall tax plan.

### *The Decision of the Federal Court of Appeal*

The Federal Court of Appeal took the opposing view, holding that no source of income existed, and disallowed the losses.[15] Although the court's reasons as to why a source of income did not exist are interesting, they are not the focus of this article. Instead, what remains in focus is the court's agreement that the minister properly assessed a subsection 163(2) penalty.

To reach this conclusion, first, the court considered the statutory text "knowingly, or under circumstances amounting to gross negligence," and found that these elements were present in *Paletta* "either directly or constructively, through a demonstration of wilful blindness."[16] In other words, the court recognized that the knowledge element could be met through wilful blindness.[17] Second, the court noted that gross negligence under subsection 163(2) "imposes a higher threshold"[18] than that required for a finding of "neglect" or "carelessness" under subparagraph 152(4)(a)(i).[19] This statement is consistent with *Venne*, the leading tax decision in Canada on gross negligence, which held that

> "[g]ross negligence" must be taken to involve greater neglect than simply a failure to use reasonable care. It must involve a high degree of negligence tantamount to intentional acting, an indifference as to whether the law is complied with or not.[20]

15 Driving these opposite conclusions were the differing interpretations by the two courts of the Supreme Court of Canada's decisions in *Stewart* (supra note 12) and *Friedberg* (supra note 13). First, the Tax Court interpreted *Stewart* to mean that any activity without a personal element was commercial. The Federal Court of Appeal understood *Stewart* as requiring a commercial activity to demonstrate at least some intention to make a profit. Second, the Tax Court understood the decision in *Friedberg* as broadly allowing all forms of straddle trading. In contrast, the Federal Court of Appeal applied a narrower interpretation and held that only straddle-trading strategies realized in the course of a taxpayer's ordinary trading activities are acceptable. In *Friedberg*, the taxpayer was already trying to profit from speculative gold futures and used the timing of those existing future contracts to generate gains and losses when desired. Mr. Paletta, in contrast, was not trying to profit from his foreign exchange contracts, nor was he already in the business of foreign exchange trading.

16 *Paletta*, supra note 2, at paragraph 66, quoting from *Wynter v. Canada*, 2017 FCA 195, at paragraph 16.

17 Practitioners may have a tendency to read "recklessness" and "wilful blindness" into the wording of subsection 163(2). However, as discussed below, these words have distinctly different meanings (see the text accompanying note 31, infra).

18 *Paletta*, supra note 2, at paragraph 68.

19 As stated in *Paletta*, supra note 2, at paragraph 3, before considering the application of the penalties in subsection 163(2), the court had to determine whether the minister could reassess the taxation years outside the normal reassessment period pursuant to subparagraph 152(4)(a)(i). The latter provision is discussed further in the text below at note 57 and following.

20 *L Venne v. The Queen*, [1984] CTC 223, at 234 (FCTD). This case is discussed in detail in the text below at note 63 and following.

The estate of Mr. Paletta advanced six defences to rebut a finding of wilful blindness or gross negligence.[21] The defences were that Mr. Paletta

1. relied on the advice of his accountants;
2. obtained the verbal opinion of three tax lawyers that confirmed the validity of the plan;
3. put faith in that advice;
4. received written legal opinions on similar forward foreign exchange trading plans, although the letters were not addressed to him;
5. relied on a 2004 CRA audit that looked at the same tax plan and concluded that no action was required; and
6. reasonably believed that he had a source of income, as did the Tax Court of Canada.

Ultimately, the Federal Court of Appeal dismissed these defences and found that Mr. Paletta's conduct was sufficiently blameworthy to attract a subsection 163(2) penalty.[22] The court found that Mr. Paletta was a "knowledgeable business person" who should have engaged tax lawyers to obtain a formal legal opinion on the risks inherent in his plan.[23] Since he did not obtain a legal opinion, and since his sophistication heightened his subjective awareness of the risks in his plan, the court found that Mr. Paletta was wilfully blind.[24] The court then held that wilful blindness is a

21 *Paletta*, supra note 2, at paragraphs 71 and 83. Mr. Paletta died a few months before the Tax Court heard his appeal. One may speculate as to whether either court might have reached a different conclusion if Mr. Paletta had testified directly and perhaps provided additional evidence supporting his defence, or alternatively strengthening the case for the Crown.

22 *Paletta*, supra note 2, at paragraph 93. The defences advanced by Mr. Paletta's estate largely rested on the information that Mr. Paletta received from third parties, including the CRA's 2004 audit concluding that his reporting method was accurate, and three tax lawyers who informally advised that his plan was permissible under *Friedberg* (supra note 13). Even though the Federal Court of Appeal examined Mr. Paletta's individual characteristics, the nature of the underlying foreign exchange transactions, and the reporting method on Mr. Paletta's return, it granted no relief based on any advice or information that he received. The implication for taxpayers is that they may now have to concern themselves with assessing the quality of the advice that they receive and the nuanced conclusions of that advice. That is, it may no longer be sufficient that taxpayers receive advice from a competent source; rather, they may have to take steps to ensure that they receive competent *advice*. Unfortunately, it may be impossible for many taxpayers to make an informed assessment regarding the quality of the technical tax advice provided by experts, not least because technical tax opinions typically use cautious wording, frequently avoiding definitive words such as "will" and instead using words and phrases such as "should" or "more likely than not."

23 *Paletta*, supra note 2, at paragraph 85. While the decision is not explicit on this point, presumably the court would have expected Mr. Paletta to comply with any recommendations in such a formal opinion.

24 This is an important point and will be revisited multiple times in this article. The issue is partly that acting despite a subjective awareness of risk may be reckless, but it is unlikely to constitute wilful blindness, as McIntyre J held in *Sansregret*, infra note 32.

substitute for knowledge under subsection 163(2), and thus it was appropriate for the minister to assess a penalty.

To be clear, the court based this conclusion solely on the wilful blindness doctrine and not on the gross negligence element.[25] It did not compare Mr. Paletta's conduct with the standard that a reasonable taxpayer would have demonstrated in order to determine whether he acted with gross neglect. Nor did the court find that Mr. Paletta actually knew that he had made a false statement or omission. Instead, the court focused exclusively on Mr. Paletta's constructive knowledge under the wilful blindness doctrine, with the underlying analysis resting on his subjective awareness of the risks in his filing position.

While it is not at all unusual for the Federal Court of Appeal to overturn a decision of the Tax Court, it is concerning that the court took the next step and found that a subsection 163(2) penalty applied to a plan that the Tax Court had almost entirely accepted. In the sections of the article that follow, I argue that the fundamental issue is the court's attribution of an overly expansive scope to the doctrine of wilful blindness, such that it improperly encompasses reckless behaviour and subjective awareness of risk. I then argue that this broad wilful blindness standard ought to be replaced with a comprehensive gross negligence analysis that more accurately captures Parliament's legislative intent as to what constitutes culpable conduct. To assist with the statutory interpretation of subsection 163(2), I propose a "cluster of ideas" approach along with an analytical framework that courts could apply to specific fact patterns. Finally, I address why a clear distinction between gross negligence and wilful blindness is important from a tax policy perspective.

## THE SCOPE OF THE WILFUL BLINDNESS DOCTRINE

### Knowledge in Criminal Law and the Narrow Application of Wilful Blindness

Actual knowledge—or, more correctly, a lack thereof—is a protective concept that shields individuals from criminal culpability or civil liability when important facts about a situation are unknown.[26] The Supreme Court of Canada has held that knowledge consists of truth and belief, defining truth as objective reality and belief as the subjective state of mind about that reality.[27] In some cases, rogue individuals try to

25 Somewhat confusingly, the court stated that "at the very least . . . Mr. Paletta was indifferent or wilfully blind to the legal validity of his plan," but then held that "Mr. Paletta was grossly negligent in portraying his trading losses as business losses." *Paletta*, supra note 2, at paragraphs 92 to 93. However, since the court did not consider whether Mr. Paletta's conduct met, or constituted a marked departure from, a standard of care, the court likely intended to focus solely on the wilful blindness element as a substitute for actual knowledge.

26 See, for example, *Beaver v. The Queen*, [1957] SCR 531, at 541, where the court held that an accused person who possesses heroin but believes that it is baking soda is not culpable for that mistake of fact. The accused's lack of knowledge protects him from criminal sanction.

27 *United States of America v. Dynar*, [1997] 2 SCR 462, at 493.

access this protective measure by deliberately taking steps to avoid learning about relevant and important truths or objective facts. The case law has therefore developed the wilful blindness doctrine to recognize the moral blameworthiness associated with deliberately avoiding subjective belief in the search for improper protection.

The first English criminal case to introduce the wilful blindness doctrine did so to create an exception to the mens rea ("guilty mind") element for an offence requiring knowledge.[28] In *Sleep*, the court held that lacking knowledge would not serve as a defence if the accused kept his eyes "wilfully and deliberately shut to the truth."[29] Thus, the origin of the doctrine of wilful blindness is closely related to the doctrine's modern form, as a "substitute for actual knowledge."[30]

Using wilful blindness to substitute for actual knowledge can be the cause of inconsistent judicial application because it requires courts to maintain a distinction in their analysis between four overlapping concepts: knowledge, wilful blindness, recklessness, and negligence. Within this group, recklessness seems to be the most challenging to keep analytically separate from wilful blindness and negligence.[31] One reason why these concepts are difficult to keep distinct is that, with the exception of knowledge, they involve an element of what an individual *did not do* in the circumstances. Negligence connotes the absence of proper action; wilful blindness, the deliberate avoidance of knowledge; and recklessness, the non-avoidance of risk.

In *Sansregret v. The Queen*, a decision of the Supreme Court of Canada in a criminal matter, McIntyre J described the distinction between wilful blindness and recklessness as follows:

> [W]hile recklessness involves knowledge of a danger or risk and persistence in a course of conduct which creates a risk that the prohibited result will occur, wilful blindness arises where a person who has become aware of the need for some inquiry declines to make the inquiry *because he does not wish to know the truth. He would prefer to remain ignorant.* The culpability in recklessness is justified by consciousness of the risk and by proceeding in the face of it, while in wilful blindness it is justified by the accused's fault in *deliberately failing to inquire* when he knows there is reason for inquiry.[32]

Another way to understand McIntyre J's distinction is by comparing the level of certainty needed before recklessness becomes wilful blindness. Recklessness requires less certainty in an individual's mind because it involves the mere *awareness* of a potential risk and the willingness to act despite that awareness. Wilful blindness requires more certainty because the individual has identified the need for inquiry

28 *R v. Sleep* (1861), Le & Ca 44, 169 ER 1296.

29 Ibid., at 1302.

30 *R v. Briscoe*, 2010 SCC 13, at 21.

31 The challenge with recklessness is discussed further below, under "Recklessness and Risk in Tax Law: Subsection 163(2) and Subparagraph 152(4)(a)(i)."

32 [1985] 1 SCR 570, at paragraph 22 (emphasis added).

but deliberately acts to avoid learning the truth. The individual *already knows* that there is something incriminating to learn, but tries to improperly protect himself or herself by deliberately not knowing that fact. In other words, the key difference between recklessness and wilful blindness is the degree of certainty about the risk and how the person deals with that knowledge. McIntyre J emphasized the narrow scope of the concept of wilful blindness and the high degree of certainty required for a finding of wilful blindness:

> The rule that wilful blindness is equivalent to knowledge is essential, and is found throughout the criminal law. It is, at the same time, an unstable rule, because judges are apt to forget its very limited scope. *A court can properly find wilful blindness only where it can almost be said that the defendant actually knew.* He suspected the fact; he realized its probability; but he refrained from obtaining the final confirmation because he wanted in the event to be able to deny knowledge. This, and this alone, is wilful blindness. It requires in effect a finding that the defendant [i]ntended to cheat the administration of justice. Any wider definition would make the doctrine of wilful blindness indistinguishable from the civil doctrine of negligence in not obtaining knowledge.[33]

The wilful blindness doctrine should apply only when the individual does not know something because he or she does not want to know. A secondary analysis is thus required, in the absence of actual knowledge, that asks whether the individual took deliberate action not to know. Only in this narrow application should courts not respect the individual's lack of knowledge, find the high level of certainty that such lack of knowledge requires, and attribute moral responsibility to the individual's conduct on the basis of the wilful blindness doctrine.[34]

The Supreme Court of Canada's decision in *Briscoe*[35] reinforces this understanding of wilful blindness from *Sansregret*. In *Briscoe*, the accused was involved with several people who murdered a young girl.[36] The accused helped in some respects but took deliberate steps to maintain his ignorance of what others planned to do.[37] The trial judge did not consider the issue of wilful blindness, causing the Supreme Court to order a new trial and to explain the application of the doctrine:

> Wilful blindness does not define the *mens rea* required for particular offences. Rather, it can substitute for actual knowledge whenever knowledge is a component of the *mens rea*. The doctrine of wilful blindness imputes knowledge to an accused whose

33 Ibid., quoting from Glanville Williams, *Criminal Law: The General Part*, 2d ed. (London, UK: Stevens, 1961), at 159 (emphasis added).

34 See, for example, *Khanna v. Canada*, 2022 FCA 84, where the court correctly and narrowly applied the wilful blindness doctrine in a tax context.

35 *Briscoe*, supra note 30.

36 Ibid., at paragraphs 4 to 6.

37 Ibid., at paragraph 10.

> suspicion is aroused to the point where he or she sees the need for further inquiries, but *deliberately chooses* not to make those inquiries. . . . As Sopinka J. succinctly put it . . . "[a] finding of wilful blindness involves an affirmative answer to the question: Did the accused shut his eyes because he knew or strongly suspected that looking would fix him with knowledge?"[38]

Here the court invokes the imagery in *Sleep*, where an accused was said to have kept his eyes "wilfully and deliberately shut to the truth."[39] In *Briscoe*, the court went on to emphasize that "the concept of wilful blindness is of narrow scope" and, like actual knowledge, "involves no departure from the subjective focus on the workings of the accused's mind."[40]

The Supreme Court of the United States has arrived at a similarly narrow application for the wilful blindness doctrine in civil cases. In *Global-Tech Appliances v. SEB SA*, a patent dispute case, the court adopted the same two basic requirements for a finding of wilful blindness: "First, the defendant must subjectively believe that there is a *high probability* that a fact exists. Second, the defendant must take *deliberate actions to avoid learning of that fact*."[41] The "high probability" component of the test approximates the high level of certainty required by Canadian courts to substitute wilful blindness for actual knowledge. The "deliberate actions" component corresponds to a virtually identical requirement recognized by Canadian courts. The US Supreme Court was also careful to specify that the wilful blindness doctrine is of a "limited scope that surpasses recklessness and negligence."[42]

The critical takeaway from the case law is that wilful blindness is a narrow and specific doctrine; it becomes relevant only when an individual shuts his or her eyes in order to avoid knowing something that he or she strongly suspects to be true. Another way to think of the wilful blindness doctrine is that it can void the protection that lack of actual knowledge gives to all individuals who do not possess the mens rea required to be held morally culpable for their conduct.

Complex tax-planning situations can have many fact-specific uncertainties that informed and reasonable minds could disagree on. In such situations, these uncertainties make it far less likely that taxpayers know with certainty that their filing position contains a false statement or omission. This difficulty in possessing actual knowledge makes finding its substitute equally problematic, especially in light of the principles that have emerged to establish the legal limits of acceptable tax planning.

38 Ibid., at paragraph 21 (emphasis in original).

39 *Sleep*, supra note 28, at 1302.

40 *Briscoe*, supra note 30, at paragraph 24, quoting from Don Stuart, *Canadian Criminal Law: A Treatise*, 5th ed. (Toronto: Thomson/Carswell, 2007), at 241.

41 563 US 754 (2011), at 756 (emphasis added). The court justified the application of a doctrine developed in criminal law to a civil lawsuit on the basis of its "long history" and "wide acceptance in the Federal Judiciary." Ibid.

42 Ibid.

## Knowledge in Tax Law and the Duke of Westminster Principle

The *Duke of Westminster* principle permits taxpayers to legally arrange their affairs to minimize tax.[43] Often taxpayers face uncertainty and risk within their filing position in making legitimate efforts to minimize their tax liability. Perhaps there are conflicting authorities, new legislation that has no accompanying case law, or other ambiguity in how the law will apply to the taxpayer's facts. It is not always clear when anti-avoidance rules apply or, as in *Paletta*, whether a source of income exists.[44] Reasonable minds frequently disagree on fundamental points, and with the complexity of Canada's tax system, there are many points on which to disagree. As a result of these uncertainties and risks, taxpayers may file tax returns with incorrect or incomplete information, and may realize only with the benefit of hindsight that these returns contain false statements or omissions. In other words, there may be situations where it is practically impossible for taxpayers to know ex ante how courts will interpret certain provisions and thus whether a tax return contains a false statement or omission.

Being aware of risks that might create false statements or omissions in a tax return, yet failing to mitigate those risks *sufficiently*, may constitute reckless or negligent conduct. However, once a taxpayer begins to address a known risk, even if this is only partially attempted, that conduct cannot be considered to constitute wilful blindness. On the basis of McIntyre J's definition of recklessness in *Sansregret*,[45] potential examples of recklessness in the context of tax filing might include taking a poorly risk-mitigated position on whether a fact-specific anti-avoidance provision applies,[46] whether an uncertain fact-dependent definition is met,[47] or whether trading in forward foreign exchange contracts is a source of income.[48] Nearly all tax returns with semi-complex filing positions involve the taxpayer's accepting risk but filing the return regardless—or, as McIntyre J put it, "consciousness of the risk and . . . proceeding in the face of it."[49] It is probably impossible in many complex tax-planning scenarios to avoid taking *any* risk of a false statement or omission, and the wilful blindness doctrine should not operate to penalize such risk taking.

43 See *Inland Revenue Commissioners v. Duke of Westminster*, [1936] AC 1 (HL).

44 As discussed above, in *Paletta*, supra notes 2 and 5, the courts disagreed as to whether a source of income existed.

45 *Sansregret*, supra note 32, at paragraph 22.

46 See, for example, section 120.4, dealing with the tax on split income. This is a complex anti-avoidance provision that includes many technical definitions and exclusions. The risk for taxpayers is that they may file a tax return without properly reporting any split income.

47 Tax practitioners frequently debate whether their clients meet fact-dependent definitions. For example, subsection 110.6(1) defines "qualified farm or fishing property." A requirement under the definition in subsection 110.6(1.3) is that the property was "used principally in the course of carrying on the business of farming." There are many fact-specific nuances that reasonable minds could disagree on in deciding whether a particular asset was "used principally" or not.

48 *Paletta*, supra note 2.

49 *Sansregret*, supra note 32, at paragraph 22.

As will be discussed more fully below, filing with a significant or unmitigated risk is best assessed under the gross negligence element of subsection 163(2). A gross negligence analysis can incorporate finer concepts to help courts to decide whether taxpayers accept risks with gross neglect. What must be clear, however, is that using the narrow wilful blindness doctrine to assess improper risk taking is incorrect in law.

The Federal Court of Appeal has not always kept wilful blindness strictly confined to the knowledge element of subsection 163(2). Instead, it has described the doctrine in a way that begins to overlap with the gross negligence element. For example, in *Strachan v. Canada*, the Federal Court of Appeal misplaced wilful blindness, including it in its gross negligence analysis:

> Gross negligence may be established where a taxpayer is willfully blind to the relevant facts in circumstances where the taxpayer becomes aware of the need for some inquiry but declines to make the inquiry because the taxpayer does not want to know the truth.[50]

There is some ambiguity in the court's assertion that "[g]ross negligence may be established"; that is, it is not clear whether the court meant to refer generally to the subsection 163(2) penalty or to refer exclusively to the gross negligence element. Assuming the latter in a strict interpretation, the analysis is incorrect: it is *knowledge*, not gross negligence, that may be *substituted*, rather than established, where a taxpayer is wilfully blind. The concern is that in later decisions, courts may pick up on this language and perpetuate the apparent conflation of concepts. But as noted above and discussed in more detail later in this article, it is important that courts separate the two elements in assessing taxpayer conduct.

Cases in which courts have correctly found wilful blindness have involved taxpayers who have claimed inexplicably large losses on their tax return, signed a tax return prepared by another person without reviewing the return, or failed to inquire when a promoter of a tax-saving scheme offered the taxpayer an exceptionally large tax refund. Such facts occurred in *Wynter*, where the taxpayer failed to ask why she was receiving large refunds resulting from fictitious losses claimed by the promoter (or his surrogate) on her tax return.[51] The trial judge found that the taxpayer was aware that the refund claimed was much larger than her previous refunds, was determined not to inquire and thereby jeopardize her ability to receive the refund, was aware of suspicious circumstances surrounding how the promoter prepared her tax return, and deliberately chose not to review the return.[52] The Federal Court of Appeal correctly applied the wilful blindness doctrine insofar as the taxpayer knew of the need to inquire about her filing position but deliberately chose not to ask.

50 2015 FCA 60, at paragraph 4, citing *Canada (Attorney General) v. Villeneuve*, 2004 FCA 20, at paragraph 6; and *Panini v. Canada*, 2006 FCA 224, at paragraphs 41 to 43.

51 *Wynter*, supra note 16, at paragraph 4.

52 Ibid., at paragraphs 4 and 24 to 25, summarizing the findings at trial (2016 TCC 103).

A comparison of the decisions in *Wynter* and *Paletta* highlights the problematic wilful blindness analysis in *Paletta*, where the Federal Court of Appeal improperly interpreted Mr. Paletta's subjective awareness of risk as equivalent to a deliberate failure to inquire.[53] The court's analysis focused on the "warning about the plan" that Mr. Paletta received, the "multi-million dollar tax exposure," the characterization of Mr. Paletta as a "knowledgeable business person," and the gap between the CRA's acceptance of the "reporting method" that he used and the assertion that "his trading activities could legitimately be portrayed as a business."[54] These factors, at least arguably, speak to Mr. Paletta's subjective awareness of the risk in his filing position. They do not speak to whether he was wilfully blind to making a false statement or omission—that is, whether he deliberately chose not to confirm that he was entitled to claim business losses. On the contrary, several factors revealed Mr. Paletta's willingness to inquire, including, for example, his oral consultation with three lawyers and his reliance on third-party written opinions.[55] The Federal Court of Appeal should have limited its analysis to asking whether Mr. Paletta deliberately chose not to inquire. Given the evidence to the contrary, the court would then have been precluded from a finding of wilful blindness.

For taxpayers and tax practitioners, the Federal Court of Appeal's blurring of the distinction between recklessness and wilful blindness is problematic because it degrades the taxpayer protection typically granted under a knowledge element. There is now some uncertainty as to whether a subsection 163(2) penalty may apply to conduct that is merely reckless. Moreover, if the CRA perceives that the bar for the application of subsection 163(2) has been lowered, it may be motivated to assess subsection 163(2) penalties more often, subjecting taxpayers to legislated sanctions outside Parliament's intent.

## Recklessness and Risk in Tax Law: Subsection 163(2) and Subparagraph 152(4)(a)(i)

Recklessness and risk have a critical role in relation to taxpayer penalties, and it is important to be precise when conceptualizing their relationship to these provisions. As discussed above, the Supreme Court of Canada has generally defined recklessness as involving "knowledge of a danger or risk and persistence in a course of conduct which creates a risk that the prohibited result will occur."[56] In a tax context, recklessness may involve the subjective awareness of a risk that false statements or omissions exist in a tax return and persistence in filing despite that risk. Interestingly, the Act

53 As discussed above, supra note 25, the Federal Court of Appeal did not refer to the standard of care that a reasonable taxpayer would exercise in circumstances such as Mr. Paletta's and did not refer to a departure from that standard of care. Instead, the court focused on Mr. Paletta's subjective awareness of the risks.

54 *Paletta*, supra note 2, at paragraphs 76, 84 to 85, and 90.

55 *Paletta*, supra note 5, at paragraphs 62 to 65.

56 *Sansregret*, supra note 32, at paragraph 22.

uses the word "reckless" only once: it is part of the definition of "culpable conduct" in subsection 163.2(1), in respect of misrepresentations made by third parties on tax matters. Notably, Parliament did not explicitly include recklessness in subsection 163(2). Recall the wording of the preamble, reproduced earlier in this article:

> (2) Every person who, knowingly, or under circumstances amounting to gross negligence, has made or has participated in, assented to or acquiesced in the making of, a false statement or omission in a return . . . is liable to a penalty.

Parliament also did not include recklessness in subparagraph 152(4)(a)(i), which states:

> (4) The Minister may at any time make an assessment . . . after the taxpayer's normal reassessment period in respect of the year only if
>
> (a) the taxpayer or person filing the return
>
> (i) has made any misrepresentation that is attributable to neglect, carelessness or wilful default or has committed any fraud in filing the return or in supplying any information under this Act.[57]

Since neither subsection 163(2) nor subparagraph 152(4)(a)(i) explicitly uses the word "reckless," but it is used in subsection 163.2(1), there is a potential gap as to how Parliament intended recklessness to apply in the assessment of taxpayer penalties. Where gaps exist and the legislative scheme is potentially underinclusive, courts are generally reluctant to fill the gap by inserting their own interpretation.[58] However, the combination of the words "neglect" and "carelessness" in subparagraph 152(4)(a)(i) and "gross negligence" in subsection 163(2) provides a broad spectrum of taxpayer conduct and likely encompasses the conduct described as recklessness. Therefore, arguably, the legislative scheme in subsection 163(2) and subparagraph 152(4)(a)(i) is not underinclusive because it implicitly captures reckless conduct. Accordingly, despite not being explicitly mentioned in these provisions, recklessness is still subject to judicial interpretation in the context of taxpayer penalties.[59]

The criminal law has properly removed recklessness from the wilful blindness doctrine,[60] and this removal ought to be reflected in tax law. Further, since reckless conduct might normatively be understood as a precursor to gross negligence, it may

57 The courts regularly use this subparagraph to inform their application of subsection 163(2) penalties. See, for example, *Paletta*, supra notes 2 and 5.

58 Ruth Sullivan, *The Construction of Statutes*, 7th ed. (Markham, ON: LexisNexis Canada, 2022), at 372, noting that courts are "generally unwilling" to "cure under-inclusion [because that] is considered amendment and must be left to the legislature."

59 This conclusion is reinforced by *Guindon v. Canada*, 2015 SCC 41, at paragraph 61, where the court accepted that the standard for culpable conduct under subsection 163.2(1) "must be at least as high as gross negligence under s. 163(2)." Since "reckless" is part of the definition of "culpable conduct," gross negligence likely encompasses recklessness.

60 See *Sansregret*, supra note 32.

be more appropriate to consider reckless conduct exclusively under the gross negligence element for subsection 163(2) penalties. The new difficulty lies in determining how reckless conduct fits into the complex relationship between ordinary negligence and gross neglect. In addition, since recklessness is a subjective awareness of risk, gross negligence has its own unique relationship to risk, and risk itself is highly contextual, it is important to find an appropriate way to address risk in the context of taxpayer penalties. These issues are explored in the next section.

## THE INTERPRETATION OF "GROSS NEGLIGENCE"

### Parliament's Intention: Degrees of Negligence

The Act uses the concept of negligence in two contexts:

1. in subparagraph 152(4)(a)(i), a procedural provision[61] that allows the CRA to assess and collect tax beyond the normal reassessment period when there is a "misrepresentation that is attributable to neglect, carelessness or wilful default"; and
2. in punitive provisions, such as subsection 163(2), that allow the CRA to assess penalties when a false statement or omission arises "knowingly, or under circumstances attributable to gross negligence."

Courts have interpreted the use of the concept in these two distinct contexts as indicating Parliament's intention to recognize different degrees of negligence, rather than different types or kinds of negligence.[62]

Strayer J recognized these different degrees of negligence and analyzed the distinction between ordinary and gross negligence in *Venne*,[63] a decision of the Federal Court Trial Division. In that case, a taxpayer failed to report significant business and interest income because he overlooked problems in his bookkeeping that "a reasonable man of even limited education and experience . . . should have noticed."[64] The minister reassessed seven taxation years, four of which were outside the normal reassessment period, and added subsection 163(2) penalties in respect of all seven years.[65] Strayer J agreed with the Crown that the taxpayer was ordinarily negligent,

61 See *College Park Motor Ltd. v. The Queen*, 2009 TCC 409, at paragraph 20, where Bowie J emphasized the procedural nature of this provision.

62 See, for example, *Paletta*, supra note 2, at paragraph 68. The focus of this article is on the problematic judicial interpretation of the phrase "knowingly, or under circumstances attributable to gross negligence," which stems in part from Parliament's intention to recognize different degrees of negligence. As discussed below, infra notes 159 and 160, an alternative solution may be to amend or clarify this phrase, which, as noted above, is also used elsewhere in the Act (see supra note 3).

63 *Venne*, supra note 20.

64 Ibid., at 299.

65 Ibid., at 225-26.

and that the reassessment of statute-barred years under subparagraph 152(4)(a)(i) was appropriate, but disagreed that there was gross neglect.[66]

In analyzing the concept of ordinary negligence, Strayer J held that a taxpayer will be negligent if he "has not exercised reasonable care."[67] The combination of the words "neglect" with "carelessness" and "wilful default" in subparagraph 152(4)(a)(i) led Strayer J to conclude that "the term 'neglect' involves a lesser standard of deficiency akin to that used in other fields of law such as the law of tort."[68] Strayer J found that the taxpayer's conduct constituted ordinary neglect for two reasons: first, the taxpayer admitted that he "did not read his tax returns before signing them";[69] and second, the taxpayer's experience as a "successful businessman" meant that the errors were sufficiently obvious that he ought to have noticed them.[70]

Strayer J described gross negligence as involving "greater neglect than simply a failure to use reasonable care."[71] There must be a high degree of negligence, "tantamount to intentionally acting," and "an indifference as to whether the law is complied with or not."[72] The taxpayer's conduct did not constitute the greater neglect that Strayer J required for subsection 163(2) penalties to apply to the omitted business and interest income. For the business income, Strayer J readily recognized that the bookkeeping errors might not have "sprung out" to the taxpayer, and he could have overlooked them.[73] For the interest income, Strayer J accepted the taxpayer's explanation for his confusion, which was at least partly understandable in the view of the court.[74] Importantly, Strayer J found that subsection 163(2) penalties are punitive and must be construed strictly, taking into account subjective factors such as intelligence, education, and experience.[75] Ultimately, Strayer J rejected the minister's assessment under subsection 163(2).[76]

66 Ibid., at 234.

67 Ibid., at 228.

68 Ibid.

69 Ibid., at 229. The Federal Court of Appeal in *Wynter*, supra note 16, included the taxpayer's failure to review her tax return as part of its wilful blindness analysis. As courts continue to point out, there can be an overlap between a wilful blindness analysis and a gross negligence analysis for the same conduct.

70 *Venne*, supra note 20, at 229.

71 Ibid., at 234.

72 Ibid.

73 Ibid.

74 Ibid., at 235.

75 Ibid., at 236. Strayer J took these subjective factors to also mean that a mistake of law was an acceptable defence for the penalties assessed under subsection 163(2). Mistake of law can also be a defence to an allegation of tax evasion under subsection 239(1). See, for example, *R v. Klundert*, 2004 CanLII 21268, at paragraph 55.

76 *Venne*, supra note 20, at 236.

Strayer J's analysis is cited in many decisions to begin the analysis for the false statement or omission penalty, partly because it implicitly, yet helpfully, recognizes Parliament's intention that the minister and the courts consider degrees of negligence in applying the law. The challenge, however, lies in finding a principled basis that the courts can use to distinguish ordinary and gross negligence, as Strayer J tried to do in *Venne*. This task can be more easily approached with an understanding of the recognition of degrees of negligence in the historical development of the law.

## Degrees of Negligence in Roman Law, Bailment Law, and Tort Law

The view that different degrees of negligence exist has roots in Roman law.[77] Writers generally have distinguished Roman law concepts of culpa levis (failure to act as a reasonable person), culpa lata (failure to show any reasonable diligence or care), and levissima culpa (slight neglect).[78] The basis for this differentiation had less to do with concrete rules and more with general morality or common sense.[79] In assessing whether an individual's conduct was grossly negligent (culpa lata), a magistrate would "have had some norm or standard in his mind" that was informed by many factors, such as "foreseeability," a "broad basis of good faith," and the "not doing of that which [the individual] ought to have done."[80] Notably, the distinction was one of degree, not of kind. In other words, the distinction lies along a spectrum rather than being of a different nature altogether.

Lord Holt's decision in *Coggs v. Bernard*[81] brought certain Roman concepts of negligence into English common law. *Coggs* was a bailment case in which the bailee damaged and spilled the bailor's brandy barrels.[82] Lord Holt described various types of bailments and explained the circumstances for each type on the basis of which the bailee would be charged "to answer for the goods if they are stolen" or damaged.[83]

77 Cecil A. Wright, "Gross Negligence" (1983) 33:2 *University of Toronto Law Journal* 184-265, at 185.

78 Daniel O. Howard, "An Analysis of Gross Negligence" (1954) 37:4 *Marquette Law Review* 334-42, at 335-36. Howard analyzes gross negligence in the context of American tort and contract law, and describes the historical development of the term. Precisely how Roman law separated degrees of negligence is the subject of another debate: writers such as Sir William Jones argue that a tripartite division of negligence existed, and writers such as M. Le Brun argue that only two degrees existed. See William Jones, *The Law of Bailments* (Philadelphia: Hogan and Thompson, 1836), at 25-26. Regardless of whether Roman law had two or three degrees of negligence, the mere identification of negligence according to a difference in degree rather than a difference in kind affected the development of English common law.

79 Wright, supra note 77, at 188.

80 Ibid., at 189.

81 (1703), 92 ER 107.

82 Ibid., at 109.

83 Ibid., at 110.

A concern arising from Lord Holt's obiter dicta was the unfairness in the treatment of a gratuitous bailee who performed "a friendly act for his friend" and was then held to the same rigorous standard as a bailee for reward, and faced the same liability, "without [evidence of] an apparent gross neglect."[84] In contrast, a bailee for reward would fairly face liability for ordinary negligence because he was "bound to the utmost diligence" arising from his reward.[85] A gross negligence standard for gratuitous bailees thus protected them against the broader liability imposed under ordinary negligence standards. In other words, gross negligence serves to limit what would otherwise be an overly expansive scope of ordinary negligence. Wright describes this idea as

> one of the chief apologies for gross negligence . . . viewing the more ethical features of liability as depending on the mind of the defendant . . . [the creation of] another classification that will not be so "harsh" and will truly make liability follow only from a true "breach of faith" as opposed to a breach of an artificial external standard.[86]

Other statutes in Canada, in addition to the federal Income Tax Act, address the same concern and use gross negligence, for example, to limit the liability of municipalities for injury related to snow, ice, or slush on sidewalks,[87] or to limit the liability of medical professionals providing assistance during emergencies.[88] Whether the purpose of the legislation is to protect municipalities from "too great a risk of liability" or doctors from being "deterred from coming to the aid of those in dire need," the underlying concern is that the meaning of "negligence" can be too broad, and substituting the term "gross negligence" is often the solution adopted to narrow its scope.[89]

The use of gross negligence as a threshold for liability offers insight as to why Parliament chose to separate the degrees of negligence in the Act. By imposing subsection 163(2) penalties only on grossly negligent taxpayers, Parliament protects ordinarily negligent taxpayers from the punitive effect of the provision. As Wright points out, there is a recurring theme in the history of gross negligence to make the "reasonable person" standard more flexible, to alleviate the harshness of artificial external standards, and to allow courts to consider the subjective qualities of the defendant. These safeguards are reflected in the language of subsection 163(2).

## The Challenge in Separating Degrees of Negligence

The protective purpose inherent in the application of different degrees of negligence may help in framing the reasons for Parliament's choice; however, it does not provide

84 Ibid. A gratuitous bailee is a bailee without reward.

85 *Coggs*, supra note 81, at 111-12.

86 Wright, supra note 77, at 212.

87 See, for example, Municipal Government Act, RSA 2000, c. M-26, section 531(1).

88 See, for example, Emergency Medical Aid Act, RSA 2000, c. E-7, section 2.

89 G.H.L. Fridman, *The Law of Torts in Canada*, 3d ed. (Toronto: Carswell, 2010), at 381.

much clarity in separating ordinary negligence from gross negligence. Wright aptly describes this challenge as "[a] case of a minimum of law and a maximum of common sense,"[90] and notes that it has existed since "the Roman theory of *culpa*." In modern law, loose concepts such as "morals . . . 'equity,' 'good faith' and 'good conscience'" are central to distinguishing the different degrees of negligence.[91] Jones observes that "there are infinite shades of default or neglect from the slightest inattention or momentary absence of mind to the most reprehensible supineness and stupidity."[92] Among such "infinite shades of default," the impossibility of logically, predictably, and consistently drawing a bright line and binary distinction becomes apparent.

For this reason, many courts and writers reject the existence of different degrees of negligence. Baron Rolph famously quipped that gross negligence is the same thing as ordinary negligence "with the addition of a vituperative epithet."[93] Other writers refer to gross negligence

> as a distinction "vague and impracticable in [its] nature, so unfounded in principle" that it adds only difficulty and confusion to the already nebulous and uncertain standards which must be given to the jury. The prevailing rule in most situations is that there are no "degrees" of care or negligence, as a matter of law; there are only different amounts of care, as a matter of fact.[94]

Some American courts have been equally frustrated and have rejected the idea that degrees of negligence are usefully applied in practice:

> The theory that there are three degrees of negligence, described by the terms slight, ordinary, and gross, has been introduced into the common law from some of the commentators on the Roman law. It may be doubted if these terms can be usefully applied in practice. Their meaning is not fixed or capable of being so. One degree, thus described, not only may be confounded with another, but it is quite impracticable exactly to distinguish them. Their signification necessarily varies according to circumstances, to whose influence the courts have been forced to yield until there are so many real exceptions that the rules themselves can scarcely be said to have a general operation.[95]

As Martin has observed, despite the "judicial and scholarly dissatisfaction with distinguishing between types of negligence," the fact that legislators have differentiated between ordinary and gross negligence requires "decisionmakers to attempt to

90 Wright, supra note 77, at 188.

91 Ibid., at 187.

92 Jones, supra note 78, at 7.

93 *Wilson v. Brett*, 152 ER 737, [1843] 11 M & W 113.

94 W. Page Keeton et al., *Prosser and Keeton on Torts*, 5th ed. (St. Paul, Minnesota: West Publishing, 1984), at 210-11.

95 *The Steamboat New World v. King*, 57 US 469 (1853), at 474.

draw 'satisfactory lines of demarcation.'"[96] Fortunately for taxpayers, the jurisprudence has incorporated protective concepts for conduct close to the grossly negligent side of the spectrum. In *Farm Business Consultants Inc. v. Canada*, Bowman J (as he then was) called for extreme caution "in sanctioning the imposition of penalties under subsection 163(2)."[97] He went so far as to say that courts should "scrutinize the evidence with great care and look for a higher degree of probability," even when applying a civil standard of proof.[98] Further, when the courts are presented with "two viable and reasonable hypotheses, one justifying the penalty and one not, the benefit of the doubt must be given to the taxpayer and the penalty must be deleted."[99]

In *Udell v. MNR*,[100] Cattanach J interpreted former subsection 56(2) similarly. (This was a provision in an earlier version of the Act, akin to subsection 163(2).) The case involved a taxpayer who underreported income owing to his accountant's transposition errors.[101] Commenting on the approach to the assessment of penalties, Cattanach J stated, "I take it to be a clear rule of construction that in the imposition of a tax or a duty, and still more of a penalty if there be any fair and reasonable doubt the statute is to be construed so as to give the party sought to be charged the benefit of the doubt."[102]

One can speculate as to whether Cattanach J and Bowman J interpreted the respective provisions narrowly because they understood the protective threshold that Parliament intended by introducing two degrees of negligence into the Act.[103] But while Cattanach J held that the benefit of the doubt should go to the taxpayer when penalties are involved, he did not explain his reasons for so deciding. Perhaps the lack of explanation is due to the inherent difficulty in articulating those reasons. The truth of the matter is that the concept of gross negligence is attached to many independent and complex ideas, which can frustrate attempts to attribute a clear meaning to the term.[104]

96 Patrick H. Martin, "The BP Spill and the Meaning of 'Gross Negligence or Willful Misconduct'" (2011) 71:3 *Louisiana Law Review* 957-1028, at 959, citing *Erie Railroad Co v. Tompkins*, 304 US 64 (1938).

97 [1994] 2 CTC 2450, at 2457 (TCC); aff'd 96 DTC 6085 (FCA).

98 Ibid. (TCC), at 2457.

99 Ibid. Bowman J did not mean to require proof beyond a reasonable doubt; instead, courts should give the benefit of the doubt to the taxpayer when appropriate.

100 [1970] Ex. CR 176.

101 Ibid., at 178.

102 Ibid., at 192.

103 Alternatively, Cattanach J and Bowman J may have leaned on a conventional judicial principle demanding a strict interpretation of tax statutes. According to this principle, ambiguities are resolved favourably for the taxpayer, given that taxing statutes take property from taxpayers. See *Partington v. Attorney General*, [1869] LR 4 HL 100. The modern remnant of this approach is a residual presumption in favour of the taxpayer. See *Placer Dome Canada Ltd. v. Ontario (Minister of Finance)*, 2006 SCC 20, at paragraph 24.

104 Linguists would agree that gross negligence is a remarkably imprecise classification tool. For an analysis of the linguistic difficulties relating to gross negligence, see Martin, supra note 96,

### Differing Views on What Constitutes Gross Negligence

Canadian courts have described gross negligence from many angles, sometimes in harmony and at other times in opposition.

In *Wynter*, the Federal Court of Appeal described gross negligence as conduct falling "markedly below what would be expected of a reasonable taxpayer."[105] It also distinguished gross negligence from wilful blindness: "Simply put, if the wilfully blind taxpayer knew better, the grossly negligent taxpayer ought to have known better."[106] In other decisions, the focus shifts to risks and consequences as a central concept in describing gross negligence. For example, in *Paletta*, the Federal Court of Appeal focused on the "tax exposure" that generated millions of dollars in tax savings for Mr. Paletta and the fact that Mr. Paletta did "not cover the risk to which he was exposed."[107] In *Hansen v. The Queen*, the Tax Court explained that gross negligence is an objective test in which "personal attributes of a taxpayer should not be taken into account."[108] Yet in *DeCosta v. The Queen*, the Tax Court did consider subjective factors, such as "the taxpayer's education and apparent intelligence,"[109] in finding the line between negligence and gross negligence.

Differences of opinion as to whether gross negligence should be based on a departure from a standard of care, or whether it is a subjective or objective test, are not isolated difficulties. As one author puts it, gross negligence is a "legal Tower of Babel, where many voices are heard, but few are really understood."[110] As each of those voices tries to define gross negligence, the "concept shatters into a kaleidoscopic disarray of terms, elements and subtle graduations of meaning."[111]

The jurisprudence reveals how the courts have struggled with the nebulous and fact-specific nature of gross negligence, appropriately emphasizing certain factors according to the context, but doing so in an unstructured way. This lack of structure reflects the difficulty identified by Wright—that the meaning of gross negligence does not revolve around concrete legal rules and guideposts, but instead around a

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at 967-74. The main point is that the term is pervasively indeterminate, in that it requires "*every* application, every concretization, every instantiation" to take additional supplementary information before the general term is given meaning within the specific case. Martin, ibid., at 972, citing Frederick Schauer, "Formalism" (1988) 97:4 *Yale Law Journal* 509-48, at 514 (emphasis in original).

105 *Wynter*, supra note 16, at paragraph 18.

106 Ibid.

107 *Paletta*, supra note 2, at paragraphs 84 to 85. To be clear, while the court did focus on these factors, it did so under a wilful blindness analysis. Despite this, the court clearly weighed the risks and consequences inherent in Mr. Paletta's plan as part of its judgment.

108 2020 TCC 102, at paragraph 116.

109 2005 TCC 545, at paragraph 11. Other factors could include the "magnitude of the omission in relation to the income declared" and "the opportunity the taxpayer had to detect the error." Ibid.

110 Howard, supra note 78, at 334.

111 Ibid.

looser sense of morality and common sense.[112] Perhaps this difficulty should direct Canadian courts toward a statutory interpretation tool employing a "cluster-of-ideas" approach that better maps onto the "kaleidoscope" of concepts tied to gross negligence.[113]

## A "Cluster-of-Ideas" Approach to the Interpretation of Gross Negligence

The Supreme Court of Canada has held that "[t]he interpretation of a statutory provision must be made according to a textual, contextual and purposive analysis to find a meaning that is harmonious with the Act as a whole."[114] The ordinary meaning is useful when words are "precise and unequivocal," but it "plays a lesser role" when the words can support more than one reasonable meaning.[115] The *Canadian Oxford Dictionary* defines "negligence" as "a lack of reasonable or proper care and attention; carelessness";[116] it does not define "gross negligence." *Black's Law Dictionary*, however, provides the following definition of "gross negligence":

> A lack of even slight diligence or care. The difference between gross negligence and ordinary negligence is one of degree and not of quality. Gross negligence is traditionally said to be the omission of even such diligence as habitually careless and inattentive people do actually exercise in avoiding danger to their own person or property. . . . A conscious, voluntary act or omission in reckless disregard of a legal duty and of the consequences to another party.[117]

There are many concepts within these definitions, and as discussed below, each concept can have subcomponents and other interpretive tensions. As a result, "gross negligence" does not seem to have a simple and ordinary meaning.

Parliament has the power to explicitly define words or terms such as "negligence" and "gross negligence" in a statute, even when these terms have pre-existing meanings. If Parliament intends to assign a different meaning to a term but does not provide a clear definition, it generally gives some sign, either explicit or implied, indicating its intention.[118] In cases where there is neither a statutory definition nor an indication of an alternate meaning, and the pre-existing meaning originated from the common law, the Supreme Court of Canada has held that the word or term will be "understood to have the meaning of [that word or term] under the common law."[119]

112 Wright, supra note 77, at 188.

113 Howard, supra note 78, at 334.

114 *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, at paragraph 10.

115 Ibid.

116 *Canadian Oxford Dictionary*, 2d ed., entry "negligence."

117 *Black's Law Dictionary*, 11th ed., entry "gross negligence."

118 *R v. Holmes*, [1988] 1 SCR 914, at 930.

119 Ibid. See also Sullivan, supra note 58, at 535, stating, "When used in legislation, common law terms and concepts are presumed to retain their common law meaning."

Caution is still necessary when using the common law to interpret legislation, and the presumption may be rebuttable if the common-law definition or meaning is obscure, nebulous, or elusive.[120] However, given that the Act does not define either "negligence" or "gross negligence," there is no overlap between the statute and the common law, so reliance on the common law in this instance is appropriate.[121]

The common law does not always provide a well-defined meaning for a word or term. In such a case, the US Supreme Court has used a cluster-of-ideas approach to interpret statutory text. While this approach has not been explicitly recognized in Canadian jurisprudence, it is nevertheless consistent with the Supreme Court of Canada's textual, contextual, and purposive approach, while equally bringing forward ideas from the common law. As the US Supreme Court has explained,

> [w]here Congress borrows terms of art in which are accumulated the legal tradition and meaning of centuries of practice, it presumably knows and adopts the cluster of ideas that were attached to each borrowed word in the body of learning from which it was taken and the meaning its use will convey to the judicial mind unless otherwise instructed. In such case, absence of contrary direction may be taken as satisfaction with widely accepted definitions, not as a departure from them.[122]

"Gross negligence" is one such term whose meaning derives from centuries of legal tradition and practice.[123] There is a body of learning from which Parliament presumably took the term in framing certain provisions of the Act. Under the cluster-of-ideas approach to statutory interpretation, courts should look to that body of learning to inform the application of subsection 163(2).

## THE CLUSTER OF IDEAS AND A PROPOSED ANALYTICAL FRAMEWORK

It is beyond the scope of this article to summarize the entire body of learning relating to gross negligence; however, certain ideas tend to recur in the jurisprudence. In this section, I describe three of those ideas and propose an analytical framework in which they can be used to test for the existence of gross negligence. The proposed framework parallels the comprehensive analysis that courts undertake in scenarios where "it may be impossible to give a precise definition of the distinction" between two related concepts.[124] The proposed framework is also consistent with an examination

120 See, for example, *All Trans Financial Services Credit Union Limited v. Financial Institutions Commission*, 2018 BCCA 270, at paragraph 139, where the court rejected reliance on a purported common-law definition on the basis that there was no such definition. Some academics and courts have made similar arguments about the degrees of negligence, as discussed above.

121 Sullivan, supra note 58, at 543.

122 *Morissette v. United States*, 342 US 246 (1952), at 263.

123 Wright, supra note 77, at 185.

124 *671122 Ontario Ltd. v. Sagaz Industries Canada Inc.*, 2001 SCC 59, at paragraph 46.

of "all the possible factors . . . bearing on the nature [of the distinction]," recognizing that "not all of these factors will be relevant in all cases, or have the same weight in all cases."[125] One idea alone may sufficiently indicate gross negligence in some fact patterns. In other cases, more than one idea from the cluster will be relevant in finding gross negligence.

### Idea #1: Risk and Consequences

Gross negligence should be found where the risk taken is unjustifiable in light of the actual or potential consequences. Martin recognizes this interpretation of negligence, which is best understood not as "a characteristic of behavior but a reference to the potential consequences of the behavior."[126] He offers as an example a firework that starts a fire where the degree of negligence "will be deemed minor when the injury is limited to a few feet of brush," but may amount to gross negligence if the fire destroys thousands of acres of property.[127] Gross negligence in this sense is not so much a description but rather a conclusion that balances risks and consequences.

However, gross negligence cannot be a straightforward conclusion drawn after assessing the risk and consequences with the benefit of hindsight. As Terry points out, the relationship between risk and consequences is flexible and variable, and whether the risk is reasonable depends on the context in which it occurs:

> A risk is not necessarily unreasonable because the harmful consequence is more likely than not to follow the conduct, nor reasonable because the chances are against that. A very large risk may be reasonable in some circumstances, and a small risk unreasonable in other circumstances.[128]

On the one hand, taxpayers may accept a reasonable degree of risk and find ways to mitigate that risk in a proper and acceptable way. On the other hand, taxpayers may accept an unnecessary risk, fail to take steps to mitigate that risk, and ultimately be reckless in their tax affairs to such an extent as to attract moral blameworthiness.

In both instances, taxpayers will likely have some degree of subjective awareness of the risk inherent in their conduct. Context is therefore critical when assessing risk and consequences to decide whether taxpayer conduct warrants a penalty.[129] The CRA audit manual offers the following non-exhaustive list of factors to be considered in determining whether gross negligence penalties should be applied in the event of a false statement or omission:

125 Ibid., quoting from *Wiebe Door Services Ltd. v. MNR*, [1986] 3 FC 553, at 563.

126 Martin, supra note 96, at 974.

127 Ibid., at 975.

128 Henry T. Terry, "Negligence" (1915) 29:1 *Harvard Law Review* 40-54, at 42.

129 Consideration of the context in which risk occurs is consistent with the Supreme Court of Canada's textual, contextual, and purposive approach. See *Canada Trustco*, supra note 114.

- materiality of the false statement or omission
- taxpayer's history of contact with the CRA
- taxpayer's knowledge of tax matters
- nature of the false statement or omission
- taxpayer's involvement in preparing the return
- misinterpretation of the legislation
- books and records
- number of sources of taxable income
- disclosure of other sources of taxable income
- taxpayer's history of compliance
- signature on the return.[130]

These factors can evolve with new cases that assess risk and consequences.[131]

### Risk and Consequences in the Proposed Analytical Framework

Under idea #1, courts ask whether the risk taken cannot be sensibly justified considering the consequences realized. Drawing on lessons from existing jurisprudence, the CRA audit manual, and new ideas, the proposed factors for this first clustered idea would include

- the cost of mitigating the risk,
- the tax benefit to the taxpayer,
- the understandability of the risk,
- the understandability of the steps necessary to mitigate the risk,
- the availability of alternatives that decrease the risk or consequences, and
- subjective factors that would have indicated to the taxpayer that further action was necessary.

This part of the analysis would likely be most relevant in complex tax-planning scenarios and should recognize that risk taking is not morally culpable in and of itself. The aim should be to determine whether the taxpayer engaged in highly improper risk taking that offends common sense and attracts moral blameworthiness.

130 Canada Revenue Agency, Income Tax Audit Manual, at section 28.4.4 (www.canada.ca/en/revenue-agency/services/tax/technical-information/income-tax-audit-manual-domestic-compliance-programs-branch-dcpb-28.html#28.4.4).

131 See, for example, *Lauzon v. The Queen*, 2016 TCC 71, at paragraph 29; aff'd 2016 FCA 298, where the Tax Court included factors such as the opportunity that the taxpayer had to detect the error, the genuine effort to comply, the taxpayer's education and apparent intelligence, and the magnitude of the omission in relation to the income declared. See also *Torres v. The Queen*, 2013 TCC 380 at paragraph 65; aff'd 2015 FCA 60, where the Tax Court included many of the above factors but also included factors such as the lack of acknowledgment by the tax return preparer in the return itself, unusual requests made by the taxpayer, and incomprehensible explanations by the tax preparer.

### Idea #2: Wilful Intent and Culpable Inadvertence

The position of the courts on the question of whether gross negligence requires wilful intent or culpable inadvertence differs between jurisdictions and areas of law. In Canadian criminal law, McIntyre J described negligence as connoting "the opposite of thought-directed action. . . . What is punished . . . is not the state of mind but the consequences of mindless action."[132] In other words, wilful intent is not a precondition to a finding of negligence.[133] The US Supreme Court has similarly held that negligence means that "the absence of . . . care . . . was necessary under the circumstances."[134]

Courts occasionally strike down the idea that wilfulness has anything to do with either ordinary or gross negligence. The US Federal Court has gone so far as to say that "wilful negligence" is as self-contradictory as "guilty innocence."[135] Similarly, the California Supreme Court held that "whenever the element of knowledge and wilfulness enters into the act, it ceases to be negligence."[136] To the contrary, wilfulness is part of the definition of gross negligence in *Black's Law Dictionary* and a part of gross negligence in certain jurisdictions.[137] For example, the Supreme Court of Wisconsin has held that gross negligence is a different kind of negligence altogether, rather than a difference in degree, with the difference turning on positive intent.[138] This requirement for positive intent seems consistent with the position taken in Canadian tax courts insofar as gross negligence requires something "tantamount to intentional acting."[139]

The case law in Canada tends to accept both culpable inadvertence and wilful intent for a finding of gross negligence. Regarding wilful intent, the Supreme Court of Canada accepts that gross negligence can be found through actions tantamount to intentional conduct.[140] The phrase "tantamount to intentional actions" involves "actions from which an imputed intention can be found such as actions demonstrating 'an indifference as to whether the law is complied with or not.' "[141] For the purposes of subsection 163(2), wilfulness can likely be determined under either the "knowingly" element or the cluster-of-ideas framework, depending on the circumstances.

132 *R v. Tutton*, [1989] 1 SCR 1392, at 1429-30.

133 As J. Andre Rachert correctly points out, caution must be exercised in using criminal negligence cases to shed light on civil gross negligence penalties. The burden of proof in criminal cases is beyond a reasonable doubt; in civil cases, it is a balance of probabilities. The different burden of proof in criminal trials can lead to different results. See J. Andre Rachert, "When Isn't Negligence Gross? Struggles with the Standard of Care," in *2014 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2014), 11:1-46, at 11:13.

134 *Milwaukee and St. Paul Railway Company v. Arms*, 91 US 489 (1875).

135 *Kelly v. Malott*, 135 F 74 (7th Cir. 1905).

136 *Kastel v. Stieber*, 215 Cal. 37 (1932), at 47.

137 See *Black's Law Dictionary*, supra note 117 and the accompanying text.

138 Howard, supra note 78, at 338, citing *Wedel v. Klein*, 282 NW 606 (Wis Sup Ct 1938).

139 *Venne*, supra note 20, at 234.

140 *Guindon*, supra note 59, at paragraph 60.

141 Ibid., quoting from *Sidhu v. The Queen*, 2004 TCC 174, at paragraph 23.

### Wilful Intent and Culpable Inadvertence in the Proposed Analytical Framework

The consideration of wilful intent and culpable inadvertence within the proposed analytical framework will most likely apply to non-complex tax situations.[142] Courts should generally give subjective factors significant weight in such situations, particularly where they involve less sophisticated taxpayers without the resources, education, or literacy necessary to fully appreciate even basic aspects of their filing position. Nevertheless, the following indicia of gross negligence are proposed:[143]

- the refusal to review the tax return,
- the failure to question scenarios that would unmistakably seem "too good to be true" even to a careless individual, or
- a complete and flagrant disregard for compliance with the law.

### Idea #3: Departure from the Standard of Care

Departing from an objective external standard is another indicium of gross negligence. The Supreme Court of Canada in *R v. Creighton* found that the actus reus for criminal negligence is met where there is a marked departure from the standard of care that a reasonable person would have exercised in all the circumstances.[144] The mens rea is met where the harm is objectively foreseeable.[145] Importantly, the court required a heightened departure from the standard of care to separate criminal negligence from ordinary negligence.

Although the Supreme Court in *Creighton* applied an objective standard, the court's later analysis in *R v. Javanmardi* placed great weight on the *circumstances* in which negligence occurs,[146] to such an extent that subjective factors are now clearly relevant in completing the analysis. In *Javanmardi*, the court considered the accused's training, qualifications, and experience to establish the appropriate standard of care.[147]

142 See, for example, *Lauzon*, supra note 131, and *Torres*, supra note 131. In both cases, the taxpayer claimed fictitious business losses after meeting with a tax-savings promoter. There was no complex tax planning involved.

143 The factors listed here are similar to the Federal Court of Appeal's reasons for allowing subsection 163(2) penalties in *Wynter*, supra note 16.

144 [1993] 3 SCR 3, at 59. As discussed above, supra note 133, caution is necessary when considering criminal law in relation to civil penalties. However, the standard of care is common to both and provides an excellent example of the tension that courts experience in finding a proper standard of care for the circumstances. See *McCulloch v. Murray*, [1942] SCR 141, at 145, for reference to a "very marked departure from the standards by which responsible and competent people . . . habitually govern themselves."

145 *Creighton*, supra note 144, at 58-59.

146 2019 SCC 54, at paragraph 38.

147 Ibid., at paragraph 39.

*Creighton* and *Javanmardi* are both good law in Canada. Nevertheless, these two cases illuminate the tension in criminal law in deciding on an appropriate standard of care and the necessary departure in assigning moral culpability. In particular, there is a tension between objective and subjective standards for a finding of criminal negligence. An objective standard can offer consistency, certainty, stability, and predictability, but can be harsh and rigid. On the other hand, subjective standards add flexibility and consider the unique characteristics of the accused, but they introduce endless variety in establishing the standard of care.

Canadian courts rightly allow subsection 163(2) penalties where a taxpayer's conduct departs markedly from the standard of care expected of a reasonable person. A recurring situation is one where the taxpayer does not read the tax return and find obvious errors.[148] However, courts almost always describe this conduct as wilful blindness, when perhaps the failure also overlaps as a marked departure from the standard of care of a reasonable taxpayer. Since the Supreme Court in *Javanmardi* considered circumstances such as the training, qualifications, and experience of the accused, tax courts can consider the same class of characteristics for taxpayers. The benefit of this approach is that it offers flexibility in those cases where unsophisticated taxpayers fail to review their tax return. For better or worse, many taxpayers rely on a tax return preparer as they rely on a mechanic to fix their vehicle: understanding a tax return can be as overwhelming as understanding what is wrong with a car's engine. It is common for some taxpayers to sign their return without understanding any part of it. By shifting the analysis for this type of conduct away from a broad wilful blindness standard and toward departure from the standard of care, courts may find acceptable reasons why certain taxpayers fail to review their tax return in light of their education, literacy, and ability to understand the return.

Another benefit of emphasizing gross negligence in the analysis is clarity in how courts view recklessness in complex tax-planning situations. As discussed above, recklessness "involves knowledge of a danger or risk and persistence in a course of conduct which creates a risk that the prohibited result will occur."[149] It is a subjective awareness of a risk, which requires less certainty than either knowledge or wilful blindness that "the prohibited result will occur." However, as discussed above, courts currently have a tendency to allow reckless conduct to intrude into their analysis of knowledge and wilful blindness, and in so doing forgo a robust gross negligence analysis. But recklessness alone should not be considered to meet the elements in subsection 163(2); instead, courts should ask whether the reckless conduct is part of a marked departure from the conduct of a reasonable taxpayer in the circumstances.[150]

148 See, for example, *Wynter*, supra note 16; *Lauzon*, supra note 131; and *Torres*, supra note 131.

149 *Sansregret*, supra note 32, at paragraph 22.

150 To establish gross negligence under subsection 163(2), a marked departure from the norm should be the appropriate standard; see *Creighton*, supra note 144. However, the conduct need not reach the heightened level of a marked *and substantial* departure standard that has developed elsewhere in the criminal law; see, for example, *Tutton*, supra note 132, at 1430-31. Further,

### Departure from the Standard of Care in the Proposed Analytical Framework

The analytical framework being proposed would apply in complex and non-complex tax situations regarding the standard of care. For complex tax situations, courts can consider the element of recklessness by comparing the taxpayer's conduct with that of a reasonably prudent taxpayer. It is probably correct to assert that reasonably prudent taxpayers only take filing positions with a reasonable basis. If this is true, a strong indicator of a marked departure from reasonable conduct is whether the taxpayer had no reasonable basis whatsoever for the filing position in the return.[151] A reasonable basis should be a filing position that is more than frivolous, merely arguable, or colourable, but less than certain on a balance of probabilities. A position with the indicia of good faith, such as the taxpayer's "genuine effort to comply,"[152] may be more likely to have a reasonable basis. In addition, the indicia of good faith might be informed by the quality of the taxpayer's books and records, and whether contemporaneous documentation exists for the tax plan, such as the formal opinion letter called for in *Paletta*.[153]

For non-complex tax situations, courts may consider

- whether the taxpayer had a professional or apparent professional prepare the tax return,
- the taxpayer's involvement in preparing the return,
- the taxpayer's history of compliance,
- the taxpayer's prior contact with the CRA,
- the number of income sources, and
- the administrative effort required to comply with the Act.

### The Analytical Framework and Paletta

How does this proposed analytical framework apply to *Paletta*? As discussed earlier in this article, the Federal Court of Appeal found that the taxpayer was wilfully blind owing to his subjective awareness of the risks of his filing position and his disregard of those risks. However, it is difficult to characterize the taxpayer's conduct as deliberately shutting his eyes: he asked three tax lawyers for advice and received a number of documents that indicated that the tax plan was acceptable. This activity cannot be characterized as deliberately shutting one's eyes to avoid learning a fact, nor did Mr. Paletta attempt to find improper protection by not having sufficient

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although the two concepts are not necessarily equivalent, adopting a marked departure standard is consistent with the "high degree of negligence tantamount to intentional acting" described in *Venne*, supra note 20, at 234.

151 See also the US Internal Revenue Code of 1986, as amended, section 1.6662-3, for a similar relationship between negligence and a reasonable basis.

152 *Lauzon*, supra note 131, at paragraph 29.

153 *Paletta*, supra note 2, at paragraph 84.

knowledge.[154] However, the question is whether Mr. Paletta's conduct as a whole was grossly negligent.

In applying the proposed analytical framework for gross negligence, perhaps Mr. Paletta's conduct would meet the threshold under either the risk and consequences clustered idea or the departure from the standard of care clustered idea. First, under the risk and consequences idea, the Federal Court of Appeal would most likely have found that the cost of mitigating the risk would have been low relative to the magnitude of the tax benefit that Mr. Paletta hoped to receive.[155] Further, the court could have found that the plan involved a complex but understandable risk; Mr. Paletta helped to create the plan and likely understood that if the plan failed, he would be liable for the tax that he tried to avoid. The methods of mitigating the risk were likewise understandable since Mr. Paletta only needed a source of income.[156] Finally, his financial acumen should have indicated to him that perhaps the plan was too good to be true. At this stage, the Federal Court of Appeal could have considered whether Mr. Paletta's oral consultation with three separate lawyers and his obtaining third-party written opinions were sufficient to address the risk in his filing position. It is plausible that the Federal Court of Appeal would have reached the same conclusion with respect to the assessment of subsection 163(2) penalties through the risk and consequences clustered idea.

Second, under the departure from the standard of care idea, it would be much less plausible that the Federal Court of Appeal could have found grossly negligent conduct. As stated above, relying on a reasonable basis for one's filing position is not a marked departure from the standard of care of a reasonably prudent taxpayer. It is a position that is more than frivolous, merely arguable, or colourable, but less than certain on a balance of probabilities. The indicium of good faith is a strong indicator for a reasonable basis. Mr. Paletta had some indicia of good faith in that he made a genuine effort to consult with tax lawyers and tried to obtain answers on the acceptability of the tax plan. Additionally, the Tax Court of Canada's acceptance of the tax plan perhaps provides some comfort that there was a reasonable basis for the filing position.

The proposed analytical framework intuitively maps onto the facts of *Paletta*, addresses the concerns that this article raises with respect to an overly broad wilful blindness standard and an underinclusive gross negligence standard, and plausibly reaches the same conclusion as the Federal Court of Appeal. This alignment with the outcome of the case highlights the efficacy and relevance of the proposed framework.

154 To continue the metaphor, Mr. Paletta's eyes could not have been fully shut, but maybe they were not fully open either.

155 *Paletta*, supra note 2, at paragraph 84.

156 See *Friedberg*, supra note 13.

## POLICY RATIONALE FOR MAINTAINING THE DISTINCTION BETWEEN GROSS NEGLIGENCE AND WILFUL BLINDNESS

There is a policy reason for distinguishing between wilful blindness and gross negligence. While both elements of subsection 163(2) apply equally to all taxpayers, the gross negligence element takes on a heightened role for tax practitioners assessing the acceptable risk for complex tax plans and legitimate tax-avoidance transactions.[157] While much has been said about tax avoidance, it is generally true that when Parliament enacts tax law, most taxpayers try to do what is acceptable and avoid what is unacceptable.[158] When the analysis for subsection 163(2) becomes confused, or when mere recklessness can substitute for knowledge, taxpayers and tax practitioners have less certainty in undertaking innovative and complex tax plans for fear of paying a potentially unprincipled penalty. Alternatively, by having a rigorous, logical, and predictable penalty regime, Canada can improve the competitiveness of its tax system through increased certainty and predictability.[159]

Further, where there is clear protection for taxpayers who sufficiently address and mitigate the risks in their tax returns, taxpayers will be motivated to reduce their risks properly. This approach may help to minimize improper tax avoidance.[160] As the

157 For a modern documentary that canvasses the tax-avoidance issue in Canada, see TVO Today Docs, "The Great Canadian Tax Dodge," March 15, 2019 (www.youtube.com/watch?v=0KgFd-TjcRM).

158 Ibid., at minute 40:19.

159 False statement or omission penalties are part of a broader legislative scheme designed to promote voluntary compliance with the Act. Each of these penalties fits with the other enforcement measures in the Act, and using a principled approach to interpret one penalty helps to provide context and guidance as to how other penalties should be interpreted. This is particularly important for taxpayers, advisers, the CRA, and courts navigating the interpretation of new penalties. For example, the recently introduced penalty under section 245 (the general anti-avoidance rule [GAAR]) directly links to subsection 163(2) since it reduces the maximum assessable GAAR penalty; see Canada, Department of Finance, *Explanatory Notes to Legislative Proposals Relating to the Income Tax Act and Regulations (Budget 2023 and Other Proposals)* (Ottawa: Department of Finance, August 4, 2023), at 125 (herein referred to as "the explanatory notes"). Given such legislative interrelatedness, adhering to a principled interpretation for subsection 163(2) penalties can influence future judicial interpretations of new penalties and may aid taxpayer decision making as new penalties are introduced into the legislation.

160 At the time of writing, the government had proposed draft legislation for a modernized GAAR, including a 25 percent penalty for a tax benefit denied by GAAR (explanatory notes, supra note 159, at 125). The government had also passed legislation for mandatory disclosure of reportable transactions, notifiable transactions, and reportable uncertain tax treatments under sections 237.3, 237.4, and 237.5, respectively. Recent amendments also include expanded trust reporting rules under subsections 150(1.1), (1.2), (1.3), and (1.4). Each provision increases the potential civil tax penalties that may apply to taxpayers and their advisers. With the increasing number of penalty provisions, it may be time for the government to recognize the need to develop a fair, consistent, and comprehensive statutory approach to penalty administration. Such a statutory analysis might mirror a previous US approach; see United States, Internal

law stands now, courts can shortcut the analysis by finding wilful blindness through recklessness. This shortcut creates uncertainty because the courts do not provide guidance on adequately addressing risks and what the reasonably prudent taxpayer does in various circumstances. This problem is curable, but courts must shift the focus of their legal analysis.

## CONCLUSION

Over time, Canadian courts have overemphasized the wilful blindness doctrine while simultaneously underemphasizing the role that gross negligence plays in assessing false statements or omissions under subsection 163(2). This is problematic because an overly broad wilful blindness standard risks losing sight of the protective concepts traditionally generated by the two elements of subsection 163(2)—that is, knowledge and gross negligence. Ultimately, this article argues that narrowing the scope of wilful blindness in the analysis and broadening the role of gross negligence through a cluster-of-ideas interpretive approach will allow courts to provide greater clarity for taxpayers in determining whether conduct should attract penalties under subsection 163(2).

Revenue Service, Executive Task Force for the Commissioner's Penalty Study, *Report on Civil Tax Penalties* (Washington, DC: Internal Revenue Service, 1989). A comprehensive analysis of the enforcement regime in the Act and the underlying philosophy of civil tax penalties is beyond the scope of this article.

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# Policy Forum: Editors' Introduction—Ethics and Taxation

The parameters of ethical tax practice have long preoccupied tax scholars and practitioners, and periodically regulators and governments too. The evolution of the general anti-avoidance rule and related case law along with public scrutiny of advisory firms' behaviour as it relates to tax-planning advice has once again piqued interest in the scope of ethics in tax planning and its appropriate regulation. The four articles in this Policy Forum explore various aspects of this topic from the perspectives of practitioners, revenue authorities, and the public.

Lyne Latulippe opens the forum with her article on the need for transparency. She situates her work in the context of public scrutiny of the behaviour of advisory firms and tax planners and the OECD BEPS[1] response to at least some of those publicly expressed concerns. Latulippe then offers a general overview of ethics in taxation, including the framing of ethics within the context of tax compliance. She then focuses on the ethical obligations of tax professionals. This exploration leads her to conclude that transparency is an essential condition for ethical behaviour to thrive. That transparency extends to engagement with the revenue authorities as well as the public.

In the second article, Jonathan Farrar and Tisha King argue that there is a need for retributive justice in the design of tax systems as a mechanism for ensuring public trust. They conceptualize previous research as comprising two strands. One strand studies the effectiveness of "naming-and-shaming" to encourage compliance. The other strand relies on experiments to understand how taxpayers react to knowledge about tax offences. Drawing from some of their own work, including in particular a larger project on this topic undertaken by King, the authors identify an expectations gap between what Canadians believe is appropriate punishment for "tax crime" and the actual punishment that flows from the determination that a tax crime has been committed. On the basis of their research, they recommend that the Canada Revenue Agency increase the frequency of its prosecutions. The authors accept that there will be challenges in implementing the recommendation, including the difficulty of

1 "BEPS" refers to the multiyear project on tax base erosion and profit shifting by multinational enterprises, undertaken by the Organisation for Economic Co-operation and Development (OECD) and the Group of Twenty (G20). The project resulted in detailed recommendations for 15 specific measures that governing authorities could adopt "to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment" (www.oecd.org/tax/beps). To date, more than 140 countries and other jurisdictions have agreed to collaborate on the implementation of such measures through the OECD/G20 Inclusive Framework on BEPS.

defining tax evasion, the policy of prosecuting cases only where there is an expectation that the revenue authority can win, and scarcity of resources.

In the third article, Malcolm Gammie explores the dilemma faced by revenue authorities—focusing on the United Kingdom's tax authority, His Majesty's Revenue & Customs—which are charged with collecting revenue when the nature of the claim is disputed, leading to litigation. Gammie articulates clear standards to govern the ethical behaviour of tax authorities in these circumstances, including respect for the integrity of the tax system and for a taxpayer's right to challenge the assessment of tax. Gammie also argues that the revenue authorities should be consistent in their approach to cases involving the same statutory provisions, arguing that the same interpretive approach should be applied across cases. Part of what makes Gammie's contribution fascinating is his reliance on five specific examples—involving issues that could also arise in Canada—that help to make the application of these principles concrete.

The final article, by Karen Wensley, begins by probing the absence of a higher-order discussion of why we pay taxes and the nature of the ethical obligation to comply. Wensley observes that the lack of a higher-order discussion results in the conception of tax obligations as a "game" between taxpayers and revenue authorities. She argues that we need to reverse the normalization of tax cheating, pointing to a code of ethics for tax practitioners as one tool that might assist. In articulating the case for a code of ethics, Wensley reviews the existing regulatory framework for tax professionals (both legal and accounting), the scope of a possible code, and implementation challenges. The scope of a code of ethics would include issues such as the need to uphold the integrity of the system (reminiscent of Gammie's article, although primarily from the perspective of private practice), responsibility for factual accuracy, appropriateness of advice, confidentiality, conflict of interest, competency, duty to provide ethical training to apprentices, and duty to maintain the ethics of colleagues. To conclude, Wensley explicitly addresses practitioners and others who may doubt that the result would be worth the effort.

Taken together, these four articles emphasize that any discussion of ethics and taxation needs to address the ethical responsibilities and interactions of all the players in the tax system, including taxpayers, their professional advisers, and the revenue authorities.

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# Policy Forum: Transparency—An Essential Condition for Ethical Behaviour in Tax Planning

Lyne Latulippe

**PRÉCIS**

L'éthique joue un grand rôle dans l'évaluation critique de la pratique de la fiscalité, mais les normes éthiques elles-mêmes ont une incidence limitée sur les décisions de planification fiscale; c'est pourquoi la transparence est un outil nécessaire. Traditionnellement, l'analyse coût-avantage et la gestion des risques guidaient la planification fiscale. Toutefois, l'examen public accru des affaires fiscales des entreprises et l'augmentation des exigences en matière de divulgation ont exercé une pression sur les décisions en matière de planification fiscale, et ainsi ajouté une dimension éthique à la gestion des risques. La transparence est assurément essentielle pour limiter la planification fiscale abusive, mais elle peut avoir une plus grande incidence sur l'éthique en permettant de modifier les « significations morales » des activités de planification fiscale pour les personnes qui y participent.

**ABSTRACT**

Ethics play a significant role in a critical assessment of tax practice, but ethical standards on their own have a rather limited influence on tax-planning decisions; therefore, transparency is a necessary tool. Tax planning has traditionally been driven by cost-benefit analysis and by a risk-management perspective. However, closer public scrutiny of corporate tax affairs and increased disclosure requirements have put pressure on tax-planning decisions, thus adding an ethical dimension to the risk-management perspective. Transparency is certainly essential in limiting the aggressiveness of tax planning, but its impact on ethics may be broader in providing an occasion to change the "moral meanings" in relation to tax-planning activities for those involved.

**KEYWORDS:** AGGRESSIVE TAX PLANNING ■ DISCLOSURE ■ ETHICS ■ PROFESSIONAL ■ TAX PLANNING ■ TRANSPARENCY

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## INTRODUCTION

The discussion on ethics in taxation has gained momentum since the public outrage about abusive tax planning[1] revealed in the early 2000s. Initially, it was mainly activist groups demanding that the wealthiest stop their abusive tax planning and pay a "fair share" of tax.[2] More recently, initiatives by businesses and investors have emerged to encourage corporations to go beyond strict respect for the law and lean toward justice, ethics, and social responsibility.

For example, in 2018 The B Team, an organization bringing together business leaders to develop and promote a reformed business environment built on trust, proposed the adoption of "responsible tax principles," endorsed by more than 25 multinationals.[3] These principles include a statement that "[o]ur tax planning is based on reasonable interpretations of applicable law and is aligned with the substance of the economic and commercial activity of our business."[4] Also, the Principles for Responsible Investment organization, with more than 5,000 members (investment managers, asset owners, and service providers), has provided guidelines to "enable investors to move towards practices that align with tax fairness."[5] These initiatives generally lay out transparency requirements for corporations with respect to their tax affairs.

1 It is a challenge to define what constitutes aggressive or abusive tax planning, and as will be discussed in this article, the definitions depend on the perception of acceptable or unacceptable tax planning. Therefore, tax planning will be situated on a continuum, with acceptable tax planning to the far left, unacceptable tax planning to the far right, aggressive tax planning at centre right, and abusive tax planning closer to the "unacceptable" end of the continuum.

2 Richard Eccleston and Ainsley Elbra, eds., *Business, Civil Society and the "New" Politics of Corporate Tax Justice: Paying a Fair Share?* (Cheltenham, UK: Edward Elgar, 2018).

3 Among these multinationals are BHP, Danone, Unilever, and Groupe Rocher. For the complete list, see The B Team, "Responsible Tax," September 5, 2018, under the heading "Endorsing Companies" (https://bteam.org/our-thinking/news/responsible-tax).

4 The B Team, *A New Bar for Responsible Tax: The B Team Responsible Tax Principles* (New York and London: The B Team, 2018), at 5 (https://bteam.org/assets/reports/A-New-Bar-for-Responsible-Tax.pdf).

5 Principles for Responsible Investment, "Tax Fairness" (www.unpri.org/sustainability-issues/environmental-social-and-governance-issues/governance-issues/tax-fairness).

Governments also felt pressured to respond to the phenomenon of abusive tax planning. Among other actions, governments have chosen to establish transparency obligations for taxpayers and their advisers. The vast base erosion and profit shifting (BEPS) project undertaken by the Organisation for Economic Co-operation and Development (OECD), which addresses deficiencies in the international tax system that enable aggressive tax planning, also recommends more transparency.

Thus, the tax practices of corporations and their advisers are now embedded in this new environment, which differs from that of the 1990s when tax planning flourished, facilitated by the opacity of tax affairs. What role does ethics play in this development for corporations and tax advisers? What do these developments in tax practice and the new obligations say about ethics in taxation? How do new transparency standards alter or replace ethical judgment? Are these standards an essential condition to support ethical behaviour in tax planning?

The first part of this article discusses ethics in general and more particularly as they relate to taxation and tax planning by corporations and tax advisers. The second part elaborates on the trend toward more transparency in tax affairs and its impact on tax planning and ethics in taxation. Finally, the conclusion summarizes the findings from these reflections.

## ETHICS

"Ethics" is defined as "the study of what is morally right and wrong, or a set of beliefs about what is morally right and wrong."[6] Where ethics prevail, a person will tend not to adopt a behaviour that is unethical, generally because of the result[7] or because of the underlying values and principles that guide the decision.[8] Therefore, either the overall impact on human well-being or values determine what behaviour is seen as acceptable. Compliance with the law does not guarantee that the behaviour is ethical, in the same way that failure to follow the law does not necessarily mean that the behaviour is unethical.[9]

There may be instances where a person is considering behaviour that is known to be unacceptable, but consequences such as public shame or penalties will constrain that person from carrying out that action. In such a case, if in the absence of

6 *Cambridge Dictionary* (https://dictionary.cambridge.org), under the entry "Ethics."

7 The consequentialist perspective.

8 The deontological perspective.

9 For example, "[i]t is not because an action is legal that it is moral: adultery, lying, [and] slander are acts that can be considered immoral even though they are not prohibited by law. Conversely, it is not because an act is illegal that it is necessarily immoral: Driving without a license [and] consuming drugs are acts prohibited by law, but if they were not, they would not be immoral in themselves [my translation]." Marie-Pierre Allard, « Les normes juridiques, éthiques et sociales relatives à l'évitement fiscal », in Claudia Champagne, Frank Coggins, and Lyne Latulippe, eds., *Éléments de la finance responsable : une perspective multidimensionnelle* (Montréal : Éditions Yvon Blais, 2018), 413-39, at 427 (https://chairedesjardinsfinanceresponsable.recherche.usherbrooke.ca/cahiers/CahierTous001-21.pdf).

individual negative consequences everyone engaged in this behaviour, it appears that there would be no ethical consideration in the decision-making process, either explicitly or implicitly. However, it may remain relevant to talk about ethics because the underlying values and the overall context (rules, the behaviour of others, external pressures, etc.) evolve over time, influencing what is seen as acceptable or not. There also may be instances where the values supporting an action or decision are not clear or broadly accepted, but again changes over time could alter the perception of what is acceptable and what is not.

Corporations are managed by individuals who often take decisions through the lens of fiduciary duty—that is, to maximize shareholders' profits. However, from a corporate social responsibility (CSR) perspective, managers should consider every stakeholder in reaching a decision, allowing ethical concerns to be addressed more explicitly.

It is also relevant to address ethics for professionals, a discussion that includes codes of conduct but is broader than the content of those codes. Professionals may have their own subset of ethical principles, but these are necessarily related to and influenced by broad values held in society.

## Ethics in Taxation and the Perception of Tax-Planning Activities

The basis for reflection on the ethics of tax practice is found in the principles of tax policy applied in democratic countries. In setting the tax rules for the contribution to the common good and the redistribution of wealth, tax policy choices are based on values of justice and fairness. Citizens consent to be taxed and to comply with the tax system because they respect the values shaping the design of the rules, and compliance is seen as an ethical behaviour.[10]

While some theories explain tax compliance, analyzing decisions through the lens of ethics sheds a different light on tax practice. Tax evasion is unethical not only because it is illegal,[11] but also because it negates the moral obligation to contribute to society through the payment of taxes. In the same vein, abusive tax planning could be unethical because it constitutes a breach of the obligation to contribute to society or because it has a negative impact on society as a whole by withholding tax revenues.[12] But how does one determine what is acceptable tax planning? Is compliance with the letter of the law a minimum standard or the only standard?

For nearly 20 years, pressure from stakeholders, the public, and the government has led to a different reflection on the acceptability of aggressive tax planning. It is

10 Michel Bouvier, *Introduction au droit fiscal général et à la théorie de l'impôt*, 12th ed. (Paris : Lextenso-LGDJ, 2014), at 164-65.

11 Although, as Jean-Pierre Vidal argues, in instances where, for example, there is a corrupt and violent dictatorship in place in a country, tax evasion may be an ethical behaviour. Jean-Pierre Vidal, « Pourquoi se préoccuper d'éthique en fiscalité » (2015) 31:2 *Revue de planification fiscale et financière* 194-224.

12 Allard, supra note 9.

difficult to incorporate acceptability criteria into the law. To influence and further control tax planning, governments rely on solutions that fit with the rational actor model,[13] increasing the audit risk and the severity of monetary and non-monetary consequences of abusive planning to change taxpayers' behaviour (such as denial of eligibility for government contracts). Thus, to the extent that the decision to implement tax planning is based on the cost-benefit ratio, the increase in costs could reduce the incentive to resort to tax planning, particularly the riskiest tax-avoidance strategies. In addition to a cost-benefit analysis, the perception of tax-planning acceptability modifies taxpayers' behaviour, but this perception varies and depends on the perspective of the individual concerned. If this individual holds the view that money is better invested and spent through business activities than by government, a business and its advisers could justify themselves, and sometimes even congratulate themselves, for having implemented more aggressive tax planning to save taxes. Another individual could even argue that tax planning serves the common good, since the money saved in taxes will lead to economic benefits for everyone.[14]

This view can be contrasted with the argument that the payment of tax in a fair manner constitutes support for the whole of society and is the ethical standard in taxation. This way of seeing is often associated with the notion of a fair share of tax, although the latter remains a vague concept. Killian, O'Regan, O'Regan, and Lynch present divergent ethical viewpoints when they state:

> If tax is framed as punishment of the most moral citizens [those who are successful], then an ethical frame can be constructed in which tax minimization for wealthy clients can be seen as ethical, for tax advisors. On the other hand, for those whose perspective is not conservative, the payment of a fair share of taxation to support wider society can be seen as the most ethical position.[15]

Corporate tax decisions can be made according to two different views: either the one where the manager has a fiduciary responsibility toward the shareholders to reduce expenses, including taxes, as much as possible; or the one that considers the company as a corporate citizen with the same obligation to contribute to society as is borne by individual taxpayers.[16] From the first perspective, the choice to implement tax

13 Michael G. Allingham and Agnar Sandmo, "Income Tax Evasion: A Theoretical Analysis" (1972) 1:3-4 *Journal of Public Economics* 323-38.

14 This theory has been disproved by David Hope and Julian Limberg, "The Economic Consequences of Major Tax Cuts for the Rich" (2022) 20:2 *Socio-Economic Review* 539-59 (https://doi.org/10.1093/ser/mwab061).

15 Sheila Killian, Philip O'Regan, Veronica O'Regan, and Ruth Lynch, "How the Game Is Played: The Salience of Ethical Values in the Field of Tax Work," in Marion Brivot and Charles H. Cho, eds., *Research Handbook on Accounting and Ethics* (Cheltenham, UK: Edward Elgar, 2023), 116-25, at 117.

16 Rebecca Martel, Lyne Latulippe, and Marie-Thérèse Dugas, « La fiscalité responsable », in Michel Lafleur, ed., *Les défis de la gestion responsable, des cas inspirants* (Anjou : Fides, 2021), at 266.

planning hinges largely on a cost-benefit analysis. This leads to a risk-management approach that takes reputational risk into account.[17] This is where the perception of what constitutes acceptable or unacceptable tax planning, outside the view held by the manager or the manager's organization, may influence the decision.

From the second perspective, ethics can be incorporated into corporate practices through CSR, of which taxation becomes an essential component, requiring that corporations pay taxes in accordance with both legal and moral norms.[18] Both views, however, incorporate elements of reputation and transparency.

In tax matters, respect for the letter of the law is a minimal ethical standard; ethics in tax practice would require going beyond that. When it comes to tax planning and tax avoidance, the letter of the law is generally followed, but it is possible that the meaning or interpretation of the law can be overstretched and result in unethical behaviour. Drawing the line to distinguish between what is acceptable and what is not is an impossible endeavour. Legal requirements, norms,[19] practices, and the perception held by a variety of actors (managers, investors, advisers, stakeholders, the public, and so on) provide some boundaries in determining what constitutes acceptable tax planning.

## Ethics and Tax Professionals

Tax practice has evolved over the last century. Beginning in the 1980s, a market for tax planning emerged with the involvement of tax professionals.[20] Tax services that focused mainly on tax compliance for accountants and tax litigation for tax lawyers in the mid-20th century were reoriented toward tax planning, spurred in part by globalization. However, the norms governing the tax practice of these professionals have not been modified to reflect this fundamental change in the services provided.

For professionals, ethics go beyond professional norms and standards. Professional codes of conduct do not provide detailed norms regarding tax-planning services. Furthermore, not all tax experts are members of a professional order. The professional norms for chartered professional accountants (CPAs) in Quebec can be used as an example. The CPA must act with competence, dignity, and integrity, and avoid

17 Kathleen O'Neill, Doug Powrie, and Greg Wiebe, "The Role of the Tax Executive in a Corporate Social Responsibility Agenda: Managing Tax Risk on the Public Stage," in *Report of Proceedings of the Sixty-Sixth Tax Conference*, 2014 Conference Report (Toronto: Canadian Tax Foundation, 2015), 7:1-17.

18 Grahame R. Dowling, "The Curious Case of Corporate Tax Avoidance: Is It Socially Irresponsible?" (2014) 124:1 *Journal of Business Ethics* 173-84.

19 Norms are informal or formal, such as those provided by organizations. "In particular, enterprises should comply with both the letter and spirit of the tax laws and regulations of the countries in which they operate. Complying with the spirit of the law means discerning and following the intention of the legislature." Organisation for Economic Co-operation and Development, *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct* (Paris: OECD, 2023), at 51.

20 John Braithwaite, *Markets in Vice, Markets in Virtue* (New York: Oxford University Press, 2005).

harming the good reputation of the profession.[21] Obviously, deontological standards require that the professional not be associated with fraud in any way. On the other hand, the standards do not contain anything specific about advice on tax planning. In addition, the Chartered Professional Accountants Act[22] specifies that professional activities aim to optimize performance, profitability, and growth of the client's assets. Thus, although we can consider that professionals have a dual role—that of supporting their clients and the public interest, which can involve ensuring compliance with the law—it seems that professional standards place an emphasis on the responsibility toward the client.

It is noteworthy that the Quebec code of ethics provides that documents prepared by a CPA must be "in compliance with good practices or current scientific knowledge."[23] It is possible that tax-planning services could be covered here, but it is not clear how. Good practices regarding tax planning may evolve, and perhaps nowadays may require going beyond simply respecting the letter of the law.

As discussed above, it would not be relevant to talk about ethics in taxation if the threshold for what constitutes acceptable tax planning were strict legality, such as respecting the letter of the law only. However, this is probably the foundation on which tax professionals have built their practice, which is based on the principle that taxpayers can structure their affairs to minimize their taxes. In the last two decades of the 20th century, professionals and taxpayers put in place a system in which the letter of the law constituted the only relevant limit to creativity in tax planning.[24] This might have been a dominant norm that justified several aggressive plans. The discourse of those involved in this practice, and particularly the professionals, remained firmly anchored in the argument of legality, and this was still the case in the early 2000s.[25]

The legality argument suggests that there are no grey areas and that you either comply with the law or you do not. However, as Picciotto points out, there is "indeterminacy" in laws (including tax laws).[26] Once the legislation is in place, there is always room for interpretation since the legislation remains ambiguous and imperfect. Thus, tax planning requires judgment and interpretation by tax advisers. What frames that judgment and interpretation? Ethics and risk management are probably both involved in the assessment of the soundness and acceptability of tax planning.

There are nuances in cases where certain tax strategies, although legally sustainable, may be deemed overly aggressive and, as a result, may not be endorsed by certain professionals. Thus, the recommendation of the adviser will take into account the

21 Code of ethics of chartered professional accountants, CQLR c. C-48.1, r. 6.

22 CQLR c. C-48.1, section 2, article 4.

23 Code of ethics of chartered professional accountants, supra note 21, section 34.

24 Lyne Latulippe, "Large Accounting Firms and Tax Planning in a 'Fair Tax' Era," in *Business, Civil Society and the "New" Politics of Corporate Tax Justice*, supra note 2, 128-54.

25 Ibid.

26 Sol Picciotto, "Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation" (2015) 24:2 *Social and Legal Studies* 165-84 (https://doi.org/10.1177/0964663915572942).

level of aggressiveness, which will be evaluated according to the risk associated with this planning and not only strict respect for the letter of the law.

In Canada, before the recent introduction of proposed legislative changes, the potential consequences of pursuing an aggressive tax-planning strategy were minimal. The application of the general anti-avoidance rule (GAAR),[27] which could apply to deny the tax benefit, would place taxpayers in the same financial position as if they had not engaged in the planning (with the addition of interest). The low consequences associated with a possible denial of tax planning by the tax administration may have encouraged clients to accept the implementation of risky tax-avoidance strategies.

A subsidiary argument put forth by tax professionals is that in the case of tax strategies that are legally valid but considered ethically unacceptable, the responsibility for addressing this issue lies with the government, which has the power to amend the relevant laws. Civil society may take offence at certain behaviours that are otherwise clearly provided for in the law. It is then up to the legislator to decide whether it is necessary to amend the legislation to align it with public opinion or whether maintaining these rules is otherwise justifiable.

In the same vein, on the basis of numerous interviews with tax accountants, Killian et al. confirm that professionals hold differing views about ethics:

> [T]ax experts and professionals may see ethics primarily as a form of risk management, or a way of protecting their reputation, rather than as something that has value in its own right. Some are uncomfortable with the intrusion of ethics in what is framed as a technical arena and see it as something subjective, which is at odds with their identity as dispassionate professionals. Others look primarily to the law as a source of ethical values, feeling more comfortable with a view of ethics as a codified set of rules than as core underlying principles or character-based traits. . . . These rather technocratic perspectives, however, are seen as coming under some pressure from wider society, and there is an acknowledgment of a tonal shift in how tax is discussed, and of the acceptability of aggressive tax practices.[28]

It is not the purpose of this article to define what constitutes acceptable or unacceptable behaviour in tax practice. Instead, the aim is to explore how tax practice may be circumscribed, acknowledging a vast grey area within which professionals operate, with some being willing to stretch the boundaries.

Is ethics a useful concept for understanding how to navigate this area? In fact, it seems that the use of ethics to inform decision making on an individual basis in tax planning is rather limited for tax advisers. However, there have been attempts to develop a framework for tax-planning activities of tax advisers more globally. For example, CFE Tax Advisers Europe recently proposed an "ethical quality bar"

27 Section 245 of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended. Recent proposals to modify GAAR, incorporating stronger measures to control aggressive tax planning, are discussed in a later section of this article.

28 Killian et al., supra note 15, at 118.

to help practitioners to exercise professional judgment in determining whether tax planning is acceptable.[29] This framework is based on the following key questions to be addressed when providing advice:

> 1. Is there a genuine economic purpose for the tax planning apart from achieving a tax benefit, either now or in the future? 2. Are the arrangements artificial or manipulated in a form-over-substance approach to achieve a tax benefit? 3. Is the tax planning based on interpretations of applicable international and national tax law which are likely to be considered credible by the courts and informed stakeholders? 4. Would the arrangement be implemented if the relevant tax authority had a full overview of every aspect of the planning? 5. Are there any other potential reasons why the tax planning could be perceived by policymakers and the general public as abusive?[30]

Also, in 2023, the International Ethics Standards Board for Accountants published proposed revisions to the International Code of Ethics for Professional Accountants, which aimed to guide "ethical conduct when providing tax planning (TP) and related services (TP services) to clients, or performing TP activities for employing organizations, thereby maintaining the Code's robustness and relevance as a cornerstone of public trust in the global accountancy profession."[31] This project, launched in 2019, originated from the public attention focused on tax planning and new transparency initiatives. The principles-based approach provides, among other things, that a recommended tax arrangement should have a credible basis and should also consider "the reputational, commercial and wider economic consequences that could arise from the way stakeholders might view the arrangement."[32]

It is relevant to note that while a particular tax-planning strategy may be justified, even in terms of ethical standards, the overall impact of tax practice should also be considered from an ethical perspective. The tax-planning industry has a collective impact on society that goes beyond the decisions of a few individuals. Harrington[33] has shown that the practice of wealth managers collectively contributes to the growth in inequality through trust and estate planning for high-earning individuals who seek to shelter their wealth from taxation. These considerations highlight the importance of thinking collectively about ethics, and not relying only on an individual internalization of norms regarding what is acceptable or not in a particular case.

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29 CFE Tax Advisers Europe, *Discussion Paper, Professional Judgment in Tax Planning—An Ethics Quality Bar for All Tax Advisers*, prepared by the CFE Professional Affairs Committee submitted to the EU institutions in June 2021 (Brussels: CFE Tax Advisers Europe, 2021).

30 Ibid., at 3 and 19.

31 International Ethics Standards Board for Accountants, *Proposed Revisions to the Code Addressing Tax Planning and Related Services, Exposure Draft* (New York: International Federation of Accountants, February 2023), at 6.

32 Ibid., at 29, paragraph R380.12.

33 Brooke Harrington, "Trust and Estate Planning: The Emergence of a Profession and Its Contribution to Socioeconomic Inequality" (2012) 27:4 *Sociological Forum* 825-46 (https://doi.org/10.1111/j.1573-7861.2012.01358.x).

## TRANSPARENCY: A VIRTUE OR A TOOL?

Constructive discussion about tax planning and what is acceptable or not is possible only if there is greater transparency in tax affairs. Transparency gives tax administrations access to the information they need for effective enforcement of tax laws, while also allowing some scrutiny by other stakeholders.

Transparency is often associated with good corporate governance, including ESG (environmental, social, and governance) standards. There is growing concern about the place of taxation in ESG standards and sustainable development goals (SDG), and about tax transparency.[34] While some form of transparency can be required by regulation, transparency that is intrinsically associated with good behaviour may justify the disclosure of information without or beyond the legal obligation to disclose.

Adherence to transparency standards is valued by civil society specifically in some areas, such as the environmental and social impacts of behaviour. However, is transparency necessary to support ethical behaviour? Ethical behaviour probably entails acting ethically whether or not others know about such action. Requiring corporations to be transparent allows citizens to know which corporations are acting in a socially responsible way. This creates pressure on other corporations that may feel obliged to adhere to the same socially responsible standards. Thus, it could be assumed that a requirement of transparency has an effect on the corporation disclosing the information, which will adapt its behaviour accordingly, and also sends a message to everyone else as to what is considered to be socially acceptable.

Transparency, particularly toward the public, is not intuitive when it comes to tax information. Thus, pressures for greater transparency will generally be countered by arguments about confidentiality. When required, corporations will comply and provide more tax transparency as a risk-management strategy, which may include the management of reputational risk.

Providing complete and relevant information upon request is certainly the ethical behaviour to adopt. There may also be instances where corporations wish to enhance their image as good corporate citizens and choose to publish tax information that is not strictly required. However, it is difficult to imagine that there is a standard according to which taxpayers should provide information to the tax administration beyond what is expressly required. The content of disclosures, as well as the circumstances in which they are required, must be clearly specified, so that taxpayers understand what they must do and the tax administration is able to manage this information adequately.

34 Bob van der Made, "European Union: The Revival of Public CbCR Amid New Interest in ESG Transparency," *International Tax Review*, March 30, 2020 (www.internationaltaxreview.com/article/2a6a5f25maowmci6gl0xs/european-union-the-revival-of-public-cbcr-amid-new-interest-in-esg-transparency): "So there is an increasing amount of traction in Europe and the US today regarding public CbCR [country-by-country reporting] and it is clear that tax as an ESG–SDG investment topic is receiving exponentially more attention from various constituencies."

Is transparency an essential condition for ethical conduct, or is it a desirable and useful component of ethics? It is evident that opacity may incite unethical behaviour in tax matters, be it evasion or avoidance. Transparency, although associated with ethics and good governance, is subordinate to them. Furthermore, transparency should not replace discussion of and training in ethics. As Piotrowski[35] warns in relation to public administration, the emphasis on transparency obscures the need for organizations to continue ethics education for employees.

Thus, transparency can be seen as a tool to encourage ethical behaviour because it facilitates control by the tax administration or even influences the perception of a corporation by stakeholders, who can then make informed decisions in their relationship with the corporation.

## Tax Transparency Toward the Tax Administration

The disclosure of information constitutes a central element of a self-assessment regime in which there is an asymmetry between the information held by the taxpayer and the information that is accessible by the tax administration. Expectations of tax transparency have increased globally since the early 2000s. Several countries have implemented different regimes for disclosing information related to tax planning.[36] The global trend has been affirmed and maintained with the OECD's BEPS project, particularly the report and recommendations of action 12 (mandatory disclosure rules) and action 13 (country-by-country reporting).[37] The objective is to provide complete and relevant information in a timely manner to tax administrations, to enable them to control and challenge tax planning as and when required.

Canada took a major step toward mandatory disclosure of tax-planning information in 2010, with the adoption of new disclosure rules for tax planning that was accompanied by one of three general markers—contingent fees, contractual protection, or a confidentiality agreement.[38] The new measures aimed to stop the

35 Suzanne J. Piotrowski, "Transparency: A Regime Value Linked with Ethics" (2014) 46:2 *Administration & Society* 181-89.

36 See Gilles N. Larin, Robert Duong, and Lyne Latulippe, *Des réponses efficaces aux planifications fiscales agressives : Leçons à retenir des autres juridictions : Fascicule 4 : Royaume-Uni — Règles de divulgation* [Effective Responses to Aggressive Tax Planning: What Canada Can Learn from Other Jurisdictions: Instalment 4: United Kingdom—Disclosure Rules] (Sherbrooke, QC : Chaire de recherche en fiscalité et en finances publiques, 2009); and Gilles N. Larin, Robert Duong, and Marie Jacques, *Effective Responses to Aggressive Tax Planning: What Canada Can Learn from Other Jurisdictions: Instalment 8: The United States—Disclosure Rules* (Sherbrooke, QC: Chaire de recherche en fiscalité et en finances publiques, 2009).

37 Organisation for Economic Co-operation and Development, *Mandatory Disclosure Rules, Action 12—2015 Final Report* (Paris: OECD, 2015); and Organisation for Economic Co-operation and Development, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report* (Paris: OECD, 2015).

38 See Gilles Larin, "Some Thoughts on Disclosure Rules in Canada: A Peek into the Future" (2013) 61, supplement *Canadian Tax Journal* 209-20.

cat-and-mouse game that was taking place for some aggressive tax planning. It was perceived that the most aggressive tax planning included one or more of these hallmarks.

Recently, Canada proposed to significantly expand these rules, ensuring that any planning at risk of being refused on the basis of GAAR must be disclosed.[39] This obligation also has more teeth with the establishment of both a penalty for the failure to disclose and a significant penalty if GAAR applies to planning that has not been disclosed.

Deterrence is a demonstrated effect of disclosure regimes. The OECD's mandatory disclosure report refers to the fact that taxpayers are likely "to adopt a more cautious approach" when disclosure of tax planning is required.[40] This has the effect of reducing the number of disclosures, as has been observed in the United Kingdom.[41]

According to the OECD, adding a disclosure obligation for intermediaries can contribute even more effectively to reducing the level of aggressiveness of tax planning.[42] The establishment of disclosure obligations for taxpayers and their advisers[43] can alter the discussion about tax risk between the professional and the client. Indeed, previously, the professional could minimize the risk of aggressive planning for the client—for example, by offering the client contractual protection in the event of a challenge by the tax administration. Such protection could facilitate the acceptance of the planning by the client. With the implementation of Canada's new disclosure rules, not only must information regarding planning be transmitted to the tax administration, but a penalty will increase the financial risk for both the taxpayer (client) and the adviser in the absence of disclosure, and for the taxpayer if GAAR applies. When the professional informs the client that the recommended tax planning must be disclosed, this also puts aside any questions about the risk that the tax administration might later become aware of the planning and launch an audit.

Beyond the impact of mandatory disclosure on the behaviour of the taxpayer who must disclose, the information collected can be useful to the government in modifying legislation and developing verification and communication strategies. Thus, the government can act more widely to counter aggressive tax planning.

These disclosure obligations will certainly have the effect of changing behaviour and may possibly alter the perception of what is acceptable and what is not. While

39 Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023, November 30, 2023.

40 OECD, *Mandatory Disclosure Rules*, *Action 12*, supra note 37, at paragraph 48.

41 Ibid., at paragraph 49.

42 Ibid., at paragraph 27.

43 The application of mandatory disclosure rules to lawyers is being challenged in court on the basis of the solicitor-client privilege. Angelica Dino, "Federation of Law Societies Challenges Mandatory Reporting Obligations Under the Income Tax Act," *Canadian Lawyer*, September 15, 2023 (www.canadianlawyermag.com/practice-areas/tax/federation-of-law-societies-challenges-mandatory-reporting-obligations-under-the-income-tax-act/379712).

ethical behaviour should be adopted without being compelled, in this case mandatory disclosure is a way to force ethical behaviour. However, more broadly, it also forces a discussion about tax planning, and it could modify behaviour more generally in the medium to long term.

When all taxpayers know that corporations and their advisers must be more transparent toward the tax administration about tax planning, confidence in the system can be strengthened and universal compliance supported. These effects can be increased by making more tax information publicly available as well.

## Public Transparency for Stakeholders

Following some corporate scandals and the financial crisis of 2007-8, popular discontent put pressure on the transparency of the tax affairs of large corporations accused of not paying tax.[44] Thus, the situation has evolved, and various initiatives have emerged, such as requirements for public country-by-country reporting[45] and transparency standards for extractive industries.[46] Also, accounting standards—originally the US standards and more recently the international financial reporting standards—have been modified to better report tax risks associated with tax planning. A more detailed form of accounting for uncertain tax positions in financial statements was developed for stakeholders, including investors, to provide access to more accurate information regarding tax positions that may be challenged successfully by the tax administration. Noteworthy is the fact that the US accounting rule specifically indicated that the uncertain tax position had to be evaluated as if the tax administration had all the relevant information to assess this position.[47] Accounting standards thus preceded and, in some ways, facilitated the implementation of measures requiring greater transparency toward the tax administration. Governments can now rely on the obligation to account for uncertain tax positions in the financial statements to support the adoption of mandatory disclosure rules concerning these positions, as is the case in Canada.

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44 Lyne Latulippe, « Risque de réputation et transparence fiscale : un pas vers une prise de décision fiscalement responsable? » in *Éléments de la finance responsable*, supra note 9, 441-65.

45 See the European Union directive for public country-by-country reporting: European Union, Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 amending Directive 2013/34/EU as Regards Disclosure of Income Tax Information by Certain Undertakings and Branches, OJ L 429, December 1, 2021. Also, Australia conducted a consultation on a proposal for public country-by-country reporting in 2023: Australian Government, The Treasury, "Public Country-by-Country Reporting" (https://treasury.gov.au/consultation/c2023-383896).

46 Bernard van Gerrevink, Hilde Atsma, and Jenny Wong, "Bringing Tax Transparency into Focus—Extractive Industries," *International Tax Review*, November 2, 2022 (www.internationaltaxreview.com/article/2au219802uweyjq7zmnls/sponsored/bringing-tax-transparency-into-focus-extractive-industries).

47 Financial Accounting Standards Board, *FASB Interpretation* no. 48, "Accounting for Uncertainty in Income Taxes," June 2006.

Transparency can become a management tool through discourse to signal good behaviour. In response to public pressure and the evolution of these transparency standards, tax advisers recommend that their clients develop a narrative around their tax strategy to manage any reputational risk associated with it.[48] This form of transparency can be described as controlled diffusion of information.

Making more tax information public does not necessarily lead to a better understanding of what constitutes unacceptable tax avoidance or lead to a change in behaviour. Indeed, it could lead to even more confusion about what is acceptable and what is not, because the public does not necessarily understand the application of tax law and its object and spirit.[49]

While transparency may not be the corrective for unacceptable tax planning, it is a useful and perhaps essential tool that opens up discussion and supports an increased role for ethics in taxation.

## CONCLUSION

From this reflection about ethics in taxation and what transparency has to do with it, I conclude that ethics (and CSR) play a significant role in a critical assessment of tax practice, but they have a rather limited influence, on their own, on tax-planning decisions; therefore, transparency is a necessary tool. Tax planning has been driven by cost-benefit analysis and by a risk-management perspective. However, closer public scrutiny of corporate tax affairs and increased disclosure requirements have put pressure on tax-planning decisions, adding an ethical dimension to risk management.

Recent developments in the tax-planning industry have had the effect of shining a spotlight on those involved, raising questions and demands for accountability. Businesses and tax advisers should not ignore this exposure or simply dismiss criticism; instead, they should perhaps take the opportunity to reflect on their tax practice with a view to pursuing and strengthening initiatives aimed at the promotion of standards of conduct in tax planning. As various scholars have demonstrated, the normative framework of business institutions is a determinant for instilling the proper civic thinking among individual actors.[50] While there always has been, and probably always will be, somewhat aggressive tax planning, "constructing a sanitary larder might be the best way to prevent other apples and barrels from turning bad."[51] Ideally, standards for tax-planning activities should be developed collectively by all parties involved. This would help to reinforce the continuing cultural shift toward more responsible tax practice.

48 Latulippe, supra note 24.

49 Lynne Oats and Penelope Tuck, "Corporate Tax Avoidance: Is Tax Transparency the Solution?" (2019) 49:5 *Accounting and Business Research* 565-83, at 566.

50 Michael Gonin, Guido Palazzo, and Ulrich Hoffrage, "Neither Bad Apple Nor Bad Barrel: How the Societal Context Impacts Unethical Behavior in Organizations" (2012) 21:1 *Business Ethics, the Environment & Responsibility* 31-46.

51 Ibid., at 39.

Corporations and tax advisers should be mindful of how their tax-planning strategies are perceived beyond specialized circles. At the very least, they should consider the possible impact on their reputation if they persist in questionable planning. Transparency is certainly essential in limiting the aggressiveness of tax planning, but its impact on ethics may be broader, in providing an occasion to change the "moral meanings"[52] in relation to tax-planning activities for those involved.

52 Steven Hitlin and Stephen Vaisey, "The New Sociology of Morality" (2013) 39:1 *Annual Review of Sociology* 51-68.

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# Policy Forum: Using Retributive Justice To Ensure Public Trust in Canada's Tax System

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**PRÉCIS**

La justice rétributive doit être présente pour garantir la confiance du public dans le système fiscal. Autrement dit, les délinquants fiscaux doivent être tenus responsables de leur comportement contraire à l'éthique et punis conformément à la législation fiscale. Dans cet article, les auteurs résument tout d'abord les recherches universitaires récentes sur l'effet dissuasif de la connaissance des sanctions infligées aux autres pour des délits fiscaux. Ils classent ces recherches en deux catégories : la recherche archivistique sur la dénonciation publique et la recherche expérimentale sur l'éthique fiscale. Ils présentent ensuite les résultats d'une enquête menée auprès de contribuables canadiens adultes qui évalue la sévérité perçue des sanctions pour délits fiscaux. Ils comparent les résultats de cette enquête avec les données globales sur les sanctions pour délits fiscaux au Canada et montrent qu'il existe un écart entre ce que les Canadiens croient être une sanction appropriée pour délits fiscaux et les sanctions réelles. Enfin, les auteurs discutent de l'application de la loi et des autres défis que doivent relever les autorités fiscales pour parvenir à une justice rétributive, et ils considèrent d'autres moyens qui permettraient aux autorités fiscales d'obliger les délinquants fiscaux à répondre de leurs crimes. Ils proposent en dernier lieu que l'Agence du revenu du Canada accroisse la perception de son pouvoir en augmentant la fréquence des poursuites engagées pour fraude fiscale. Les récentes propositions de réforme de la règle générale anti-évitement pourraient donner lieu à plus de poursuites.

**ABSTRACT**

To ensure public trust in the tax system, retributive justice must be present. That is, tax offenders must be held accountable for their unethical behaviour and punished in accordance with tax laws. In this article, the authors first summarize recent academic

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research about the deterrent effect of knowledge of others' tax-crime punishments. They classify this research into two categories: archival "naming-and-shaming" research and experimental tax ethics research. Next, they report the results of a survey of adult Canadian taxpayers in which they assess the perceived severity of tax-crime punishments. They compare these survey results with aggregate tax-crime punishment data in Canada and show that there is an expectations gap between what Canadians believe constitutes appropriate punishment for tax crimes and actual punishments. Finally, the authors discuss enforcement and other challenges for tax authorities in bringing about retributive justice, and consider other ways in which tax authorities might make tax offenders accountable for their crimes. Their ultimate suggestion is that the Canada Revenue Agency needs to increase its perceived power by increasing the frequency of actual prosecutions for tax evasion. Recent proposals for reform of the general anti-avoidance rule may lead to more prosecutions.

**KEYWORDS:** JUSTICE ■ ETHICS ■ TAX ■ PENALTIES ■ ENFORCEMENT ■ CANADA REVENUE AGENCY

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## INTRODUCTION

Recent public opinion survey results reveal a decline in public perceptions of trust in the Canada Revenue Agency (CRA). According to the CRA's annual "Departmental Results Framework" report, first published in 2020-21, the CRA's trust metric decreased from 7.9 in 2020-21 to 6.6 in 2022-23, a 16 percent decline.[1] Both metrics are scored out of 10, where higher scores indicate more trust. In its 2023-24 "Departmental Plan," the CRA indicates that its target trust index is a score of 7.0.[2] The dip in public trust is concerning in light of academic research showing the importance of public trust in fostering voluntary compliance and its connections to power, justice,

1 See Canada Revenue Agency, "Departmental Results Report (2022-2023 Edition)" (www.canada.ca/en/revenue-agency/corporate/about-canada-revenue-agency-cra/departmental-performance-reports/2022-23-departmental-results-report.html).

2 Canada Revenue Agency, *Canada Revenue Agency 2023-24 Departmental Plan* (Ottawa: CRA, 2023), at 8 (www.canada.ca/content/dam/cra-arc/corp-info/aboutcra/dept-plan/2022-23-departmental-plan/cra-arc-dp-2023-24-en.pdf). Actual results for 2022-23 are not yet available.

and deterrence of non-compliance.[3] In this article, we explore how the pursuit of retributive justice can ensure public trust in the tax system.

The importance of trust in tax compliance scholarship is evidenced by, arguably, one of the most influential theories of tax compliance in the past few decades: the slippery-slope framework.[4] This framework integrates ideas from psychology and economics to propose two main components of tax compliance: trust in authorities and power of authorities. Trust is the general public's opinion that a tax authority acts with both goodwill and competence for the good of society. Power is the perception that a tax authority is able to detect and punish tax evasion. In this framework, trust and power are viewed as complementary to the holistic functioning of a tax system.

For trust and power to reinforce each other, tax offenders who violate laws must be punished. If tax offenders are detected and punished, the tax authority will be perceived as powerful and trustworthy. Furthermore, a tax authority will be perceived in this way only if tax offenders are punished in proportion to the severity of their wrongdoing—that is, in accordance with the notion of retributive justice.[5] If tax offenders are punished too excessively, there could be public backlash; conversely, if tax offenders are punished too leniently, there will be little, if any, deterrence effect on observers. Thus, calibrating punishment requires care. Nevertheless, by demanding accountability from tax offenders and punishing them appropriately, a tax authority upholds the integrity of the tax system. In this context, retributive justice can be viewed as an ethical parameter to ensure public trust in the tax system.

If the Canadian public perceives that tax offenders are not held accountable by the tax authority and the justice system, that may help to explain the good-but-not-great public trust scores reported above. Relatively recent international tax scandals, such as those revealed by the Paradise Papers and the Panama Papers, along with the KPMG/Isle of Man situation, involved cases of aggressive tax avoidance, if not tax evasion, in which taxpayers were never prosecuted by the Public Prosecution Service of Canada (PPSC).[6] These stories were blazoned all over the media and likely tainted the public's trust in the integrity of the tax system. Indeed, 53 percent of Canadians believe that the CRA puts too little effort into detecting such aggressive offences by high net worth individuals.[7] Furthermore, if past tax offenders or evaders have not

3 For a review, see Sjoerd Goslinga, Lisette Hel-van Dijk, Peter Mascini, and Albert van Steenbergen, eds., *Tax and Trust: Institutions, Interactions and Instruments* (The Hague, the Netherlands: Eleven, 2019).

4 Erich Kirchler, Erik Hoelzl, and Ingrid Wahl, "Enforced Versus Voluntary Tax Compliance: The 'Slippery Slope' Framework" (2008) 29:2 *Journal of Economic Psychology* 210-25.

5 Michael Wenzel, Tyler Okimoto, Norman T. Feather, and Michael J. Platow, "Retributive and Restorative Justice" (2008) 32:5 *Law and Human Behavior* 375-89, at 375 (https://psycnet.apa.org/doi/10.1007/s10979-007-9116-6).

6 The PPSC prosecutes cases under federal statutes that are referred to it by the Royal Canadian Mounted Police, other federal investigative agencies, and provincial and municipal police forces. See Public Prosecution Service of Canada, "About the PPSC" (www.ppsc-sppc.gc.ca/eng/bas/index.html).

been prosecuted, it will be hard for the public to expect a change in the future, especially with the advent of technological advancements such as blockchain and cryptocurrency, which may bring greater potential for tax evasion.[8]

We opine that more tax offenders should be appropriately punished to ensure public trust in the tax system. To support this point, we discuss and summarize two streams of academic research examining how knowledge of others' tax-crime punishments can deter non-compliance with tax laws. Next, we present the results of a survey on a sample of adult Canadians about their perceptions of the severity of existing tax-crime punishments. The survey results provide some insight into the propriety of existing tax laws that punish tax offenders. Finally, we discuss challenges for tax authorities in meting out retributive justice and suggest ways to address these challenges.

## ACADEMIC RESEARCH ON THE DETERRENT EFFECT OF KNOWLEDGE OF OTHERS' TAX-CRIME PUNISHMENTS

One stream of academic research pertains to "naming-and-shaming," which refers to a strategy of publicly disclosing names of tax offenders to the general public. Shaming is a public emotion arising from public exposure and disapproval of a shortcoming or transgression.[9] Naming-and-shaming is a strategy designed to encourage compliance with tax laws so that taxpayers avoid notoriety as a tax offender. Many countries use naming-and-shaming in income tax contexts. In Canada, for example, the CRA publishes the name and other details relating to individuals, corporations, and trusts convicted of tax evasion.[10]

Several academic studies have examined the use and effectiveness of naming-and-shaming by tax authorities.[11] Blank and Levin[12] analyzed all the press releases issued

7 See Luke LeBrun, "Canadians Believe Canada Revenue Agency Goes Too Easy on Wealthy Tax Dodgers, Internal CRA Report Says," *Press Progress*, March 20, 2023 (https://pressprogress.ca/canadians-believe-canada-revenue-agency-goes-too-easy-on-wealthy-tax-dodgers-internal-cra-report-says).

8 See Katherine Baer, Ruud de Mooij, Shafik Hebous, and Michael Keen, "Crypto Poses Significant Tax Problems—And They Could Get Worse," *IMF* blog, July 5, 2023 (www.imf.org/en/Blogs/Articles/2023/07/05/crypto-poses-significant-tax-problems-and-they-could-get-worse).

9 See June Price Tangney, Jeff Stuewig, and Debra J. Mashek, "Moral Emotions and Moral Behavior" (2007) 58 *Annual Review of Psychology* 345-72, at 348.

10 See Canada Revenue Agency, "Enforcement Notifications: Compliance Actions" (www.canada.ca/en/revenue-agency/news/newsroom/criminal-investigations-actions-charges-convictions.html).

11 Research by Makoto Hasegawa, Jeffrey L. Hoopes, Ryo Ishida, and Joel Slemrod, "The Effect of Public Disclosure on Reported Taxable Income: Evidence from Individuals and Corporations in Japan" (2013) 66:3 *National Tax Journal* 571-608 (https://doi.org/10.17310/ntj.2013.3.03), used Japanese data to analyze naming without shaming. Until the 2005 tax

by the US Department of Justice, Tax Evasion, from 2003 through 2009 in which an individual taxpayer was identified by name. They found that disproportionately high volumes of these releases were issued during the weeks prior to the individual US filing deadline of April 15, ostensibly to influence perceptions of tax enforcement activities while individual taxpayers were preparing their annual tax returns.

Perez-Truglia and Troiano[13] conducted a field experiment in which 34,334 delinquent US taxpayers each received a letter requesting payment. Letters contained language about financial penalties, shaming penalties (in which delinquent taxpayers were shown a list of the names and debt amounts of "tax delinquents living close to your household"), or peer comparisons. They found that letters containing information about shaming penalties (that is, letters that made shaming penalties salient) increased the likelihood of payment for tax debts under $2,500. Relatedly, Dwenger and Treber[14] used Slovenian data to investigate whether a naming-and-shaming policy for tax debt led to a reduction in tax-debt delinquency prior to implementation of the policy. They found that corporations significantly reduced their tax debt. To a lesser extent, self-employed individuals also reduced their tax debt. Thus, naming-and-shaming in the context of delinquent tax payments may be effective in some circumstances.

The other stream of academic research related to naming-and-shaming is hypothetical and uses experiments to understand how taxpayers react to knowledge of others' tax offences. Blaufus, Bob, Otto, and Wolf[15] examined experimentally whether the anticipated shame of being exposed as a tax evader caused taxpayers to be more compliant. Their experiment confirmed that the anticipated shame of being named as a tax evader caused increased compliance. However, the positive effect of anticipated naming-and-shaming diminished over time.

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year, Japan had a "notification system" for high-income taxpayers with incomes above a specified threshold, in which the taxpayer's name, address, and taxable income were posted on a bulletin board in each tax office for two weeks. The authors found evidence that individuals and corporations underreported their income so as to avoid appearing on the public list. In a similar vein, Erlend E. Bø, Joel Slemrod, and Thor O. Thoresen, "Taxes on the Internet: Deterrence Effects of Public Disclosure" (2015) 7:1 *American Economic Journal: Economic Policy* 36-62, analyzed Norwegian data before and after 2001 to determine the effect of a new public disclosure rule introduced in 2001, which allowed anyone with Internet access to look up anyone's income and taxes paid. The authors found that business owners reported 3 percent more income as a result of the public disclosure.

12 Joshua D. Blank and Daniel Z. Levin, "When Is Tax Enforcement Publicized?" (2010) 30:1 *Virginia Tax Review* 1-37.

13 Ricardo Perez-Truglia and Ugo Troiano, "Shaming Tax Delinquents" (2018) 167 *Journal of Public Economics* 120-37.

14 Nadja Dwenger and Lukas Treber, "Shaming for Tax Enforcement" (2022) 68:11 *Management Science* 8202-33.

15 Kay Blaufus, Jonathan Bob, Philipp E. Otto, and Nadja Wolf, "The Effect of Tax Privacy on Tax Compliance—An Experimental Investigation" (2017) 26:3 *European Accounting Review* 561-80.

In a 2023 study, we examined experimentally the impact on observers' tax compliance when a tax evader was (or was not) punished and when the tax evader was (or was not) solely to blame for the tax evasion.[16] We found that observers' tax compliance decreased when a tax evader went unpunished, and that observers' tax compliance increased when a tax evader was punished but only if the tax evader was perceived as fully blameworthy. These results suggest that there can be a salutary impact on observers when a tax evader is punished, provided that the tax evader is perceived as culpable for the crime.

In another 2023 study, Okafor[17] showed experimentally that shaming of tax evaders increased observers' tax-compliance intentions because of retributive justice perceptions, especially when a tax authority used persuasive appeals to accompany the language about the shaming. Also, King[18] identified a boundary condition on the positive impact on observers' compliance of appropriately punishing a taxpayer for tax evasion: if the observer anchors on social norms information, the positive impact of an appropriate punishment is diminished. Using the national tax gap—the level of national tax fraud from uncollected taxes—as a proxy for social norms, this finding suggests that observers who learn the size of the tax gap may view it as a gauge of the extent of tax evasion nationwide. Since the tax gap is usually a large number, observers may think that even if someone's tax evasion is detected, a subsequent punishment is unlikely. This finding also has practical implications for tax authorities wishing to disclose that tax evaders have been punished, because the beneficial impact of this disclosure may be mitigated by public knowledge about the magnitude of the tax gap.

Overall, there is limited research about naming-and-shaming, and especially the extent to which the naming-and-shaming of tax evaders has the desired effect on observers who may be contemplating tax evasion. There is some experimental evidence to suggest that naming-and-shaming can be an effective strategy for increasing observers' tax compliance, but that there are some contextual factors that must be considered as well (relating to perceived culpability, persuasion, and tax-gap knowledge).

Existing research about retributive justice and tax compliance assumes that the punishment for tax evasion "fits the crime." However, this assumption should be empirically validated. In the next section, we discuss the results of a survey in which King investigates the extent to which a sample of adult Canadians view existing punishments for tax crimes as appropriate (or too harsh or too lenient).

16 Jonathan Farrar and Tisha King, "To Punish or Not To Punish? The Impact of Tax Fraud Punishment on Observers' Tax Compliance" (2023) 183:1 *Journal of Business Ethics* 289-311.

17 Oliver Nnamdi Okafor, "Shaming of Tax Evaders: Empirical Evidence on Perceptions of Retributive Justice and Tax Compliance Intentions" (2023) 182:2 *Journal of Business Ethics* 377-95.

18 Tisha King, "First Things First: Using Anchoring Bias To Examine the Effect of Penalty Severity and Social Norms on Compliance" (2023) (https://ssrn.com/abstract=4407004); and Tisha King, "Let the Punishment Fit the Crime: How Retributive Fairness Perceptions Influence Observers' Tax Compliance Intentions" (PhD dissertation, Lazaridis School of Business and Economics, 2021) (https://scholars.wlu.ca/etd/2377).

## PUBLIC PERCEPTIONS OF TAX-CRIME PUNISHMENTS: SURVEY RESULTS FROM CANADA[19]

Using a survey of 331 adult Canadians, King explored the participants' perceptions of tax-crime punishments as being too lenient, appropriate (that is, retributively just, or "fitting the crime"), or too harsh. Participants were recruited using an online platform (Prolific). Participants were randomly selected taxpayers between the ages of 25 and 70 years; 39 percent were male; and they had an average of 12 years of work experience.

When participants entered the survey, they read a hypothetical scenario involving a business owner who failed to report all income and, as a result, did not pay $10,500 in taxes. After details of this tax offence, participants learned of an associated punishment. The punishment was varied in multiple ways across the sample to include a fine, jail time, or a combination of both. Participants were instructed that a punishment was in addition to repayment of actual taxes that were owing on the unreported income. Fines and jail time are the punishments for tax offences stipulated in the Income Tax Act[20] (sections 163(2), 238, and 239) and the Criminal Code[21] (section 121(3)). As well, the amount of the fine was varied such that it ranged from $100 to $21,000 (twice the amount of unreported taxes owing), while jail time was either 15 or 48 months.[22] Overall, there were four variations of possible fines, two variations of possible jail time, and four variations of possible jail time and fines. The following table shows all the possible punishments.

**Punishment conditions**

Fine only
- $100
- $5,250
- $10,500
- $21,000

Jail time only
- 15 months
- 48 months

Jail time plus fine
- 15 months + $10,500
- 48 months + $10,500
- 15 months + $21,000
- 48 months + $21,000

19 Much of the information in this section is drawn from a larger project examining the effects of penalty severity and social norms on tax compliance; see King, supra note 18 (2021 and 2023).

20 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act").

21 RSC 1985, c. C-46.

22 These endpoints frame the range of administrative penalties in the Act.

Each participant was randomly assigned one punishment. Participants rated the severity of their assigned punishment on a scale from 1 ("Too lenient") to 11 ("Too harsh"). Next, participants were presented with all the punishment combinations (as shown in the table above) and rated the severity of each punishment.

The key finding from the survey is that a retributively just punishment is perceived to occur when a tax evader is required to pay a fine of 100 percent of the unpaid taxes, with no jail time. As noted above, this fine is in addition to the repayment of unpaid taxes. When presented with the punishment severity information, where the fine was 100 percent of the amount of taxes misreported, participants rated the punishment severity as a mean of 5.97/11 (standard deviation = 1.77), which is almost exactly the midpoint of 6/11. Since the scale was anchored with "Too lenient" and "Too harsh," a punishment severity rating near the midpoint of the scale (6/11) suggests that the specific punishment is appropriate (neither too lenient nor too harsh). Punishment severity ratings persisted when all punishments for evading $10,500 in taxes were presented on the same screen (randomized to reduce the effects or order bias). In this case, participants rated the punishment condition in which the fine was 100 percent of the amount of taxes evaded as 5.45/11 (standard deviation = 2.05), which again is similar to the midpoint of 6/11. Overall, punishment severity ratings for a fine of 100 percent of the amount of taxes misreported converge, whether rated independently or along with all other punishments.

Okafor and Farrar[23] analyzed a 10-year sample (2006 through 2015) of all Canadian enforcement notices publicly released to the media by the CRA. These notices disclosed a total of 9,183 tax offences. Of these, just 18.4 percent (1,687) related to underreporting of income, which was the same offence as in King's survey. Over 50 percent of convictions related to failure to file a tax return, suggesting that the CRA tends to pick the low-hanging fruit when prosecuting taxpayers. In this period, there were only 63 incarcerations for tax evasion involving the underreporting of income. While the incarceration outcome for this type of tax evasion is low, the results of King's survey suggest that most Canadians would not find the lack of incarceration problematic, since an appropriate punishment for tax evasion is perceived to be a fine equal to the amount of taxes evaded, without incarceration.

Moreover, across their sample, Okafor and Farrar reported tax offences totalling more than $231 million of unreported income. The total fine amount was nearly $124 million, which represents an average fine percentage of just over 53 percent.[24] Since the results of King's survey suggest that this percentage should be closer to 100 percent for the general public to perceive that the punishment for tax evasion

23 Oliver Nnamdi Okafor and Jonathan Farrar, "Punishing in the Public Interest: Exploratory Canadian Evidence Pertaining to Convictions and Incarcerations for Tax Offences" (2021) 40:5 *Journal of Accounting and Public Policy* (https://doi.org/10.1016/j.jaccpubpol.2021.106848).

24 Without rounding, the unreported income in the sample was $231,243,868; the total fine amount was $123,876,883; and the fine percentage relative to unreported income was 53.57 percent. Okafor and Farrar, supra note 23, at 5.

is just, the public may perceive the CRA as being relatively docile and ineffective at meting out retributive justice.

## CHALLENGES FOR TAX AUTHORITIES IN BRINGING ABOUT RETRIBUTIVE JUSTICE FOR TAX EVASION

In this final section, we identify and discuss several challenges facing tax authorities in meting out justice for tax evasion.

### Defining Tax Evasion

Punishing a tax evader for tax evasion is contingent on distinguishing between tax evasion (the deliberate violation of tax laws) and aggressive tax avoidance (staying within the letter of the law, but not the spirit of the law). Owing to the many grey areas between tax evasion and aggressive tax avoidance, wealthy taxpayers can engage in abusive transactions with the assistance of professional tax advisers. For instance, tax lawyers can and do argue that their client was not in deliberate violation of tax laws; the laws may have been bent, but not broken. Unless the tax authority can convince a judge that "bending" rules is tantamount to breaking them, it will remain challenging, if not impossible, for the CRA to ultimately convict a taxpayer of the crime of tax evasion for engaging in some form of aggressive tax avoidance.

### Prosecution of Cases

The PPSC (the national authority tasked with prosecuting federal offences) prosecutes tax crimes on behalf of the CRA. During an inquiry following the KPMG/Isle of Man tax scandal, when questioned as to why the CRA had not prosecuted KPMG or the clients advised by KPMG, the CRA's assistant commissioner of the international tax division stated, "[W]e believe there is some legal risk . . . that our tax assessment could be challenged and may not stand up in court."[25] Thus, if the CRA were to prosecute a probable case of tax evasion and lose, the loss would create a negative precedent, and the CRA could ultimately undermine its own authority.

### Scarce Resources

To prosecute a tax crime takes considerable time and resources. The CRA has limited human and financial resources at its disposal and must decide on appropriate ways to allocate those resources within its organization. Devoting human resources for a case of potential tax evasion may not be considered an optimal allocation across the agency because human resources are relatively scarce and may be better deployed on other cases with a better likelihood of securing a conviction (low-hanging fruit). An attempted prosecution for potential tax evasion can also drag on, and the CRA may wish to obtain a relatively quick settlement, without criminal prosecution.

25 "Finance Committee on May 5th, 2016," *Openparliment.ca* (https://openparliament.ca/committees/finance/42-1/18/ted-gallivan-3), per Ted Gallivan.

## THE WAY FORWARD

Short of requesting and receiving a massive injection of funds to train new staff and poach talent from accounting or law firms, there appears to be little that the CRA, in tandem with the PPSC, can do to bring about more convictions for tax evasion. For the CRA to focus more on increasing the detection of underreporting of income, which constitutes less than 20 percent of tax offence convictions, more human resources are required.

Additionally, the CRA could propel technological solutions, such as artificial intelligence (AI) and machine learning, to improve efficiency and advance the detection of tax offences. These technological advancements can potentially identify patterns in complex tax returns, such as those of high income earners, multinational firms, and large partnerships.[26] Thus, capitalizing on technological advancements can strengthen the CRA's efforts in detecting and punishing tax evasion. Use of AI and machine learning must be considered in tandem with ethical issues surrounding the use of AI, such as a need for transparency, human review to ensure accuracy, and the elimination of bias-driven decision patterns.[27]

We believe that introducing legislation to increase the severity of punishments for tax evasion will be of limited effectiveness, since the current punishment parameters include the punishment mechanism perceived to be the most fair (a fine for tax evasion equal to the amount of taxes evaded). A fine equal to the taxes evaded is currently encoded in administrative and criminal statutes in Canada. However, for the public to perceive that the CRA is powerful and trustworthy, judges may need to take greater care to match the fine with the amount of taxes evaded when sentencing a guilty taxpayer. Recent data from a decade of CRA enforcement notices suggest that the average fine is just over 50 percent of the amount of taxes evaded, when this percentage should be 100 percent, according to public opinion survey data reported by King.

Canada's general anti-avoidance rule (GAAR—section 245 of the Act) is the only legislation currently in the Act that can possibly target aggressive tax avoidance.[28] At the time of writing, proposed changes to GAAR are pending, including a new 25 percent penalty on any tax benefit received, extended time periods within which the CRA may apply GAAR, and a new test of economic substance to determine whether

26 See EY Canada, "How Innovation Deepens Insights for Tax Authorities," *EY*, July 3, 2019 (www.ey.com/en_ca/tax/how-innovation-deepens-insights-for-tax-authorities); and James Alm, Joyce Beebe, Michael S. Kirsch, Omri Y. Marian, and Jay A. Soled, "New Technologies and the Evolution of Tax Compliance" (2020) 39:3 *Virginia Tax Review* 287-356.

27 Joyce Beebe, "AI and Taxes—A Work in Progress: Part 2," *Rice University's Baker Institute for Public Policy*, August 24, 2023 (www.bakerinstitute.org/research/ai-and-taxes-work-progress-part-2).

28 Specific anti-avoidance rules could potentially be legislated as well. See Jinyan Li, "The Misuse and Abuse Exception: The Role of Economic Substance," in Brian J. Arnold, ed., *The General Anti-Avoidance Rule: Past, Present, and Future* (Toronto: Canadian Tax Foundation, 2021), 295-326.

transactions are abusive.[29] Reforming GAAR can improve identification of the occurrence of tax evasion versus tax avoidance.[30] If the GAAR reform is successful, it should make it easier for the CRA to successfully prosecute tax evaders.

Moving forward will require continued efforts by the CRA to convict and punish tax offenders, especially in cases of aggressive tax avoidance, in proportion to the severity of their wrongdoing. By holding tax offenders accountable and punishing them in accordance with the law, the CRA upholds the integrity of the tax system. In this way, pursuing retributive justice can act as an ethical parameter in ensuring public trust in the tax system.

29 Bill C-59, An Act To Implement Certain Provisions of the Fall Economic Statement Tabled in Parliament on November 21, 2023 and Certain Provisions of the Budget Tabled in Parliament on March 28, 2023, November 30, 2023.

30 See David G. Duff, "General Anti-Avoidance Rules Revisited: Reflections on Tim Edgar's 'Building a Better GAAR'" (2020) 68:2 *Canadian Tax Journal* 579-611.

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# Policy Forum: Some Reflections on Ethical Considerations in Tax Litigation

Malcolm Gammie*

**PRÉCIS**

Les discussions sur l'éthique en matière de fiscalité portent généralement sur l'évitement fiscal. Mais quels sont les principes éthiques qui s'appliquent ou devraient s'appliquer aux litiges fiscaux? Les deux parties doivent respecter les règles de conduite ordinaires exigées par le tribunal. Sont-elles pour autant libres de formuler n'importe quel argument pour défendre leur cause? Les contribuables feront appel d'une cotisation fiscale que la loi leur réclame avec laquelle ils sont en désaccord. Ils voudront sûrement présenter tous les arguments qui s'offrent à eux. En tant que responsable de l'administration générale du système fiscal et plaideur récurrent devant les tribunaux, l'administration fiscale doit avoir à l'esprit des considérations plus globales. La cohérence de l'approche et le respect de l'intégrité du système fiscal et du droit du contribuable à démontrer que l'impôt n'est pas légalement exigible doivent faire partie des principes éthiques adoptés par le fisc dans le cadre des litiges fiscaux.

**ABSTRACT**

Discussion of ethics in taxation usually concerns tax avoidance. But what ethical principles are or should be involved in the conduct of tax litigation? Both parties must observe the ordinary rules of conduct required of them by the court. Are they free, however, to advance any argument to make their case? Taxpayers will be appealing a tax assessment contrary to their view of the tax that the law requires of them. They are bound to make any argument that is open to them. A revenue authority should have broader considerations in mind, as the body responsible for the overall administration of the tax system and as a repeat litigant in court. Consistency of approach and respect for the integrity of the tax system and for a taxpayer's right to demonstrate that tax is not legally due should be among the ethical principles that the revenue authority adopts in conducting tax litigation.

**KEYWORDS:** ETHICS ■ APPEALS ■ TAX LITIGATION ■ HIS MAJESTY'S REVENUE & CUSTOMS ■ STANDARDS ■ CONSISTENCY

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## INTRODUCTION

Consideration of ethical principles—the moral principles that govern an individual's behaviour or their conduct of an activity—in the tax field usually focuses on issues of tax avoidance; in particular, on transactions or arrangements or some other course of action designed to eliminate or reduce tax liabilities, usually with that intent solely in mind and often in some "artificial" way, even if ultimately designed to achieve some commercial or family purpose. Tax avoidance (in whatever form) is frequently said to be "unethical" or "immoral," a view that reflects to some extent the statement that "[t]axes are what we pay for civilized society."[1]

Civilized societies, however, generally seek to follow the rule of law and to ensure that tax obligations are imposed on their citizens by the act of a duly-elected legislative assembly and are not randomly collected by those acting on behalf of the state. It is with that in mind that Judge Learned Hand expressed the view that "nobody owes any public duty to pay more than the law demands. Taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."[2]

Everyone will have their own view as to what they think is the "fair" amount of tax that they should pay or, more particularly, what is the fair amount of tax that someone else who appears to be in more fortunate financial circumstances should be paying. Accompanying such thinking is likely to be a view as to whether and to what extent it is appropriate for a person to take steps designed to limit or reduce their contribution to the civilized society in which they live.

One person's view of the tax that another person should pay does not provide the basis for collecting tax in a civilized society. But what is the position when Parliament enacts laws that place in the hands of the state's revenue authority the ability to

1 *Compania General de Tabacos de Filipinas v. CIR*, 275 US 87 (1927), at 100, per Justice Oliver Wendell Holmes.

2 *CIR v. Newman*, 159 F 2d (2d Cir. 1947), at 851.

collect the tax that the revenue authority thinks that a person should pay? What (if any) are the ethical principles or standards that should govern the revenue authority's actions in determining the tax that it thinks should be paid when that is disputed?[3] As I will suggest, the standards that should be expected of a revenue authority in litigation include consistency of approach, respect for the integrity of the tax system, and respect for a taxpayer's right to demonstrate whether the tax is correctly claimed.

## COUNTERING TAX AVOIDANCE

Tax legislation in the United Kingdom has traditionally been drafted to provide detailed rules. Principle-based drafting of tax provisions has not generally been favoured because it leaves a great deal of discretion to His Majesty's Revenue & Customs (HMRC) or, on appeal, to the courts to fill in the detail, and leaves taxpayers uncertain as to their tax obligations.

Nowadays, however, the UK Parliament rarely enacts tax legislation without the addition of anti-avoidance language. Such anti-avoidance provisions are described as "targeted" but the statutory language is "targeted" only in the sense that it is attached to and directed at specific provisions of the particular tax act, rather than being of general application across the act as a whole. Otherwise, the statutory language is usually drafted in general terms, referring to arrangements entered into where the taxpayer has as their main purpose, or as one of their main purposes, the avoidance of the tax to which the provision is attached, or otherwise the purpose of obtaining some unintended tax advantage from the provisions in question.[4] In addition, in the Finance Act 2013,[5] the United Kingdom enacted a general anti-abuse rule, of application across the specified tax acts as a whole.

It is beyond the bounds of this short article to outline all the measures—legislative and administrative, including "soft"-law measures—that the United Kingdom has adopted with the aim of negating whatever HMRC regards as tax avoidance in whatever form.[6] Inevitably, these measures leave considerable discretion in HMRC's

3 The principles that a revenue authority should adopt in administering the tax system and in dealing with taxpayers generally are a separate and far larger topic that falls beyond the bounds of this short article. Here, I am solely concerned with the situation that arises when the tax that the revenue authority claims is disputed, leading to litigation.

4 See Malcolm Gammie, "Tackling Tax Avoidance: The Use and Growth of Statutory 'Avoidance' Language," in Glen Loutzenhiser and Rita de la Feria, *Dynamics of Taxation: Essays in Honour of Judith Freedman* (Oxford, UK: Hart, 2020), chapter 7.

5 2013, c. 29.

6 The administrative measures include provisions requiring the disclosure of tax-avoidance schemes (Finance Act 2004, 2004, c. 12, part 7); legislation aimed at penalizing promoters of tax-avoidance schemes (Finance Act 2014, 2014, c. 26, part 5), including a current proposal to impose criminal sanctions on a person who fails to comply with a notice from HMRC to stop promoting a tax-avoidance scheme; penalties for enablers of defeated tax-avoidance schemes (which can include those who gave legal advice on the scheme) (Finance (No. 2) Act 2017, 2017, c. 32, schedule 16); follower notices under the Finance Act 2014, part 4, under which a penalty can attach to a person who pursues an unsuccessful appeal on an issue that has been

hands as to the manner of their operation. Leaving aside such measures, however, the modern judicial approach to statutory construction, as applied to all legislation, including tax, aims to identify the legislative purpose and interpret the legislative language accordingly. The purpose of most tax legislation is to levy tax in some way or other, and "purposive construction" is proving a powerful weapon in judicial hands, when the courts are called upon to decide between an interpretation of the legislation advanced by HMRC to justify its claim for tax and an interpretation advanced by a taxpayer that will inevitably produce some lesser tax liability.

A taxpayer has a right of appeal against the state's claim for tax. Only the most determined, however, may choose to exercise that right if the cards appear to be stacked against them, given the uncertain ambit of the legislation and the scope that it gives to the revenue authority to support its claim for taxation. Unbridled tax avoidance is liable to undermine the integrity of a tax system, but the same may be equally true if taxpayers have no effective means of challenging a revenue authority's claim for taxation. What, then, are the ethical considerations that should inform a revenue authority's actions when a taxpayer chooses to exercise their appeal right? In my practice, I have represented both HMRC and taxpayers in appeals to the UK tribunals and courts. A number of examples drawn from recent cases serve to illustrate the type of issues that I have in mind.

## SOME EXAMPLES

### Example 1: Trigg—Purposive Construction

In 2016, I represented a taxpayer in his claim for exemption in respect of a gain made on the sale of certain sterling-denominated securities.[7] No tax avoidance was involved; the only question was whether the legislation, purposively construed, exempted a sterling-denominated security that contained a clause addressing the possibility that the United Kingdom (as a member, at the time, of the European Union) might decide to abandon sterling and adopt instead the euro as its currency. The euro was a foreign currency, but the relevant clause could operate only once the euro had ceased to be a foreign currency. HMRC said that the exemption was not available on the basis that the security contained a provision the effect of which would convert the security into a foreign-currency security. HMRC's argument to that effect came straight from the playbook that I had heard before, when representing HMRC, from taxpayers arguing for a literal interpretation of legislation to support their tax avoidance arrangements.

subject to a previous judicial decision; penalties for a person against whom HMRC successfully applies the general anti-avoidance rule. Soft-law measures include the Code of Practice on Taxation for Banks under which the government expects banks to comply with the spirit, as well as the letter, of tax law, discerning and following the intentions of Parliament.

7 *Trigg v. HMRC*, [2018] EWCA Civ. 17.

### Example 2: Tinkler—Judicial Review or Estoppel as a Remedy?

In 2021, I represented HMRC in the Supreme Court in a case in which the taxpayer said that HMRC had failed to give a valid notice opening an inquiry into his tax return for a particular year.[8] As a result of HMRC's failure, the taxpayer said that it was not open to HMRC to amend his return to counteract certain tax arrangements into which he had entered in that year. HMRC accepted that the notice had not been validly given, but contended that the taxpayer had nevertheless engaged in the conduct of HMRC's inquiry and was therefore estopped from contesting its validity. The taxpayer responded that HMRC could not "remedy" its failure on that basis, particularly because in other circumstances a taxpayer would have no equivalent estoppel remedy against HMRC. HMRC's response was that the equivalent remedy against HMRC was for a taxpayer to seek judicial review of HMRC's action.

In a subsequent case,[9] however, in which I was representing taxpayers who were seeking permission to bring judicial review proceedings against HMRC, it was said on behalf of HMRC that permission should be denied because the taxpayer had the alternative remedy of arguing that HMRC could be estopped from pursuing a particular course of action in the tax tribunal.

### Example 3: BlueCrest Capital—Taxation Based on Procedural Grounds or the Law?

In 2018, HMRC sought a "decision in principle" from the First-Tier Tax Tribunal, a longstanding formulation under which the tribunal is asked to decide the issue raised before it but to leave the parties to agree on the correct amount of tax charged in light of the tribunal's decision. The case in question concerned whether certain payments were capital payments or income. Subsequently, HMRC said that the tribunal's decision (to the effect that the payments were income, not capital) was not a decision in principle but was a final decision, so that there was nothing further to be agreed between the parties.[10]

As a result, HMRC said that the taxpayers (some of whom were non-residents) were not entitled to claim the benefit of a double taxation treaty in calculating how much of the income in question was actually liable to UK tax. In a previous case, in which I had represented HMRC, where the First-Tier Tax Tribunal had given a decision in principle, HMRC had raised a new issue in reaching agreement on the amount

8 *Tinkler v. HMRC*, [2021] UKSC 39. If HMRC wishes to inquire into a taxpayer's self-assessment, it must give notice of the inquiry to the taxpayer within certain time limits. Otherwise, the self-assessment will become final and can be reopened only in specified circumstances. HMRC had sent the notice to the wrong address, so that it was not validly given. By the time this was realized, HMRC was out of time to correct the error.

9 The decision is unreported because the case only concerned whether permission should be given to bring judicial review proceedings.

10 *BlueCrest Capital Management LP & Others v. HMRC; Dodd & Others v. HMRC*, [2022] UKUT 200 (TCC).

of taxable income, which had the result of largely denying the taxpayer the benefit of the tribunal's initial decision in principle.[11]

### Example 4: BCM Cayman LP—A Decision Limited to Its Facts or of Wider Application?

In another case, HMRC argued that a Cayman company that had borrowed to acquire a 19 percent interest in a UK trading partnership was not entitled to relief for the interest paid on the loan, and that the interest (if available for relief) should be relieved only as a non-trade expense and not (as claimed) as a trade expense.[12] The company in question was the general partner of a Cayman limited partnership, and its acquisition arose from the desire by an existing partner to retire from the UK partnership. The significant value of the existing partner's interest put it beyond the means of any new partner to finance its acquisition. Accordingly, the Cayman limited partnership was used as a special-purpose vehicle to "warehouse" the 19 percent interest, pending its allocation over time to new UK partners. HMRC did not challenge the price paid for the 19 percent interest, and its argument that the loan financing the Cayman partnership's acquisition was excessive on transfer-pricing grounds was rejected.

Multi-tiered partnership structures are commonly adopted in the United Kingdom, on the basis that they are "transparent" for tax purposes, and interest paid on a loan to acquire an interest in a trading partnership is ordinarily relieved as a trade expense. On the face of it, therefore, in challenging an arrangement that it regarded as involving tax avoidance, HMRC was effectively challenging the longstanding transparent nature of a multi-tiered partnership structure and the basis on which interest on a loan taken to finance the acquisition of a partnership interest in a trade is ordinarily relieved.

### Example 5: London Luton Hotel—The Relevance of Subsequent Legislative Amendment

In the final example, HMRC contended that a specific property investment incentive, in the form of 100 percent relief for the expenditure incurred in converting disused property into productive business premises, was limited to the physical conversion costs incurred, and did not extend to the entire price that the taxpayer had paid to a developer to convert a disused flight training centre at Luton Airport into a hotel.[13] The incentive in question had been introduced by a Labour government in 2005; however, in 2013 (after the development in question had been completed), the then Conservative/Liberal government said that the relief was being claimed in circumstances that went wider than intended. Following a public consultation, the legislation was amended in 2014 with a view to limiting the incentive. The amended legislation was

11 *Ingenious Games LLP & Others v. HMRC*, [2021] EWCA Civ. 1180.

12 *BCM Cayman LP & Anor v. HMRC*, [2023] EWCA Civ. 1179.

13 *London Luton Hotel BPRA Property Fund LLP v. HMRC*, [2023] EWCA Civ. 362.

not retrospective in operation, but HMRC nevertheless continued to argue (in the event, successfully) that the incentive did not extend to the full amount of the expenditure incurred by the taxpayer to secure the conversion of the property at Luton Airport.

## Some Principles for Consideration

Of necessity, I have summarized the five examples briefly to illustrate the particular points that I wish to draw out for consideration. In none of the examples was HMRC acting unlawfully. But nor is a person who sets out to avoid (rather than to evade) tax acting unlawfully. However, that does not prevent a taxpayer's action in avoiding tax from being criticized as unethical. Do similar considerations apply in assessing a revenue authority's actions in responding to an appeal designed to determine the taxpayer's legal obligation to pay tax? Each example raises a different issue as to how a revenue authority should approach such an appeal, and how a court should respond.

As regards the latter, in 1993, Lord Oliver noted that judges on the whole know very little about tax as a coherent subject. As he observed, "[t]hey are called upon from time to time to examine under a microscope isolated points arising under particular sections of taxing statutes but few, if any, of them have any comprehensive knowledge or understanding of revenue law."[14] His particular point was that few judges have ever gained an understanding of tax law by *practising* in that field. In the United Kingdom at the time, the first stage of a direct tax appeal was heard by either the General Commissioners or the Special Commissioners of Income Tax.[15] The former were a lay tribunal (advised by a legally qualified clerk), and the latter comprised a smaller number of legally qualified individuals, most of whom had practised in the tax field at some stage of their career. Following the 2009 tax appeals reform, the tax chambers of the first-tier and upper tribunals are staffed by legally qualified judges, some (but not all) of whom will have practised revenue law before their appointment.[16] The situation in the higher courts remains largely as Lord Oliver described.

In most appeals, taxpayers are free to argue their case as they think fit. They may be constrained by previous authority, but they are free to distinguish their case, or to argue that an earlier decision was wrong. They are unlikely to be constrained by their previous arguments because the likelihood is that they will be litigating the

14 Lord Oliver of Aylmerton, "Judicial Approaches to Revenue Law," in Malcolm Gammie, ed., *Striking the Balance: Tax Administration, Enforcement and Compliance in the 1990s*, IFS Sixth Residential Conference, 16-17 April 1993, Conference Report (London, UK: Institute for Fiscal Studies, 1993), 173-86, at 173.

15 Indirect tax appeals were heard by the VAT & Duties Tribunal, the judges of which were legally qualified and would have practised in that field at some stage in their careers. I was appointed a special commissioner and a judge in the VAT & Duties Tribunal in 2002.

16 Given my existing judicial position at the time, I automatically became an Upper Tribunal judge. It remains possible for a judge in the First-Tier Tax Tribunal to sit with a lay tribunal member. Upper Tribunal appeals are usually heard by two judges, one of whom may be a Chancery court judge with no particular experience in the tax field.

issues for the first and only time. A revenue authority, on the other hand, is a "repeat litigant." To my mind, this demands a degree of consistency in the arguments that are put on its behalf.

Accepting a degree of consistency, however, is the revenue authority free to advance *any* argument in support of the claim for taxation, or are there limits? Tax appeals that concern the interpretation of "open" or "uncertain" language are generally capable of two, if not more, meanings. In this respect, a revenue authority appears before the court as the party that will have been closely engaged in the formulation and enactment of the legislation in question and its subsequent administration, and can therefore appear to have a superior knowledge of the purpose that the legislation is designed to achieve. Does that give the revenue authority carte blanche in terms of the arguments that it can advance to justify its interpretation, especially if the court is constituted of judges that have no comprehensive knowledge or understanding of revenue law or of the points in issue?

Finally, can a revenue authority properly rely on procedural grounds to deny a taxpayer the opportunity to put forward an argument that may demonstrate that the tax claimed by the revenue authority is not due as a matter of law? The burden of proof to demonstrate that tax is not due as claimed ordinarily rests on the taxpayer, and one might expect, therefore, that the taxpayer should not be denied the opportunity to explain why the tax is not due. The revenue authority (in contrast to the taxpayer) will rarely be prejudiced if, as a result, the taxpayer can demonstrate that the tax demanded is not due as the revenue authority claims.

## AN ANALYSIS OF THE EXAMPLES

What standards should then apply in the examples that I have chosen? In *Trigg*, it was open to HMRC to argue that a literal interpretation of the statutory language represented the legislative purpose: essentially, literal and purposive construction coincided. That said, my previous experience in successfully arguing for HMRC against that conclusion (which arguments I put for Mr. Trigg) raises the question whether purposive construction operates even-handedly. In other words, to my mind, it tends to suggest that, if it serves the revenue authority's purpose, HMRC can more easily argue in favour of a strict interpretation of the legislation than can a taxpayer. Ultimately, *Trigg* was decided in the taxpayer's favour having regard to the terms of the securities, but the issue concerning the application of purposive construction remains an open question.[17]

In *Tinkler*, the Supreme Court decided that the taxpayer was estopped from relying on HMRC's failure to open a valid inquiry into his tax affairs for the year, given that he had actively engaged in that inquiry and it was no longer open to HMRC to remedy matters. However, the court did not have to resolve as part of its decision whether the equivalent remedy for a taxpayer against HMRC was judicial review.

17 See Malcolm Gammie, "Trigg v HMRC: Reflections on Purposive Construction" [2018] no. 5 *British Tax Review* 521-55.

On the other hand, I had put HMRC's case to the Supreme Court on the basis that the taxpayer's remedy was judicial review and not estoppel. I would not have felt it appropriate to suggest the opposite to a lower tribunal in a subsequent case. HMRC was, however, represented in that other case by different counsel, who was under no such constraint.

This mirrors another case,[18] in which HMRC sought to issue follower notices[19] on the basis that the scheme adopted by the taxpayer had been successfully challenged in an earlier case.[20] I had represented HMRC in that earlier case and was aware that the issue in respect of which HMRC was seeking to impose the follower notices had not arisen for the court's decision in that case. Accordingly, in my view, the earlier case did not provide the basis for a follower notice. HMRC, however, instructed different counsel to test the follower notice issue, albeit in the event unsuccessfully.

*BlueCrest* presents a different issue: having asked the First-Tier Tax Tribunal to give a decision in principle, was it appropriate for HMRC to then change tack and say that the tribunal's decision was in fact a final decision? Furthermore, was it appropriate for HMRC to adopt a procedural tactic to deny the taxpayers the opportunity to argue that the payments, which the tribunal had concluded were income (contrary to the taxpayers' arguments), were not in fact taxable as a matter of law?

As matters transpired, the Upper Tribunal on further appeal decided that the lower tribunal's decision was final and concluded that procedural considerations trumped the taxpayers' right to advance further arguments as to why, if the payments were income, they were not in fact subject to tax.[21] The conclusion in this case has been described by a learned commentator as "very strange" and "counter-intuitive,"[22] and as potentially involving a breach of international law by denying the taxpayers their entitlement to rely on a double taxation convention entered into by the United Kingdom.[23]

HMRC nevertheless secured judicial approval for its action, but was its action an ethical course to adopt? How, by comparison, might HMRC have reacted had the taxpayer in the *Ingenious* litigation, having succeeded in part in the First-Tier Tax

18 *R (ota of Locke) v. HMRC*, [2019] EWCA Civ. 1909.

19 A follower notice imposes a penalty if a person pursues an unsuccessful appeal on an issue that has been subject to a previous judicial decision; see supra note 6.

20 *Eclipse Film Partners No 35 LLP v. HMRC*, [2015] EWCA Civ. 95.

21 *BlueCrest*, supra note 10, at 178. The tribunal considered that HMRC would be prejudiced by the delay in time and costs involved in dealing with the issues raised, and that there was a strong policy in favour of finality of litigation. However, this is by no means absolute: in both *Ingenious* and *Tinkler*, litigation that started in 2013 was referred back to the First-Tier Tax Tribunal in 2022 for further consideration.

22 Not least because HMRC's counsel accepted that the First-Tier Tax Tribunal had not been asked to deal with issues of calculation, but a final decision would suggest that the tribunal must have dealt with those issues.

23 John Avery Jones, "HMRC v BlueCrest Capital Management LP: A Serious Procedural Problem" [2023] no. 3 *British Tax Review* 262-68.

Tribunal, sought to block HMRC's new argument that in the event denied the taxpayer of the majority of its success at the first hearing?[24] *BlueCrest* and *Ingenious* can be distinguished, but it begs the question as to whether, from any standpoint, it is a distinction without a difference.

*BCM Cayman LP* raises questions as to the scope of the arguments presented by HMRC and of the decision that the court reached as a result. As I have noted, tiered partnership arrangements are widely adopted, and their transparent nature has a long pedigree.[25] In addition, relief for interest on money borrowed to acquire an interest in a partnership trade, where the taxpayer is taxed on their share of the profits, is (in my experience) always given as an expense of the trade by deduction against the partner's share. So were HMRC's arguments to the contrary in *BCM Cayman LP* designed to call into question the longstanding understanding of the law as a general matter, irrespective of their wider implications, or were they designed solely to counter an arrangement to which HMRC objected? And how, then, in the future, does HMRC intend to apply the decision that it has secured in its favour as a result?

Finally, the Court of Appeal's decision in *London Luton Hotel*, which disagreed with the decision of the Upper Tribunal, at least suggests that Parliament had no need to amend the legislation in 2014, and may even have done so to broaden the expenditure that qualified for the incentive rather than, as appeared to be the intention at the time, to narrow the qualifying expenditure. The UK courts rarely take note of later amendments in considering the meaning of earlier tax legislation.[26] But to what extent ought a revenue authority to do so in advancing its arguments as to the interpretation of that earlier legislation?

## CONCLUSION

As with most debates on ethical considerations in the tax field, everyone must reach their own view of the issues that arise in the examples considered here. Few would challenge the idea that it is ultimately for Parliament to decide what to tax. If, however, in doing so, Parliament chooses to confer increased discretion on the revenue authority to decide where the line should be drawn between taxation, exemption, or relief, it is obviously important that the revenue authority should be seen to approach the determination of the tax that is lawfully charged in an ethical manner.

24 See *Ingenious Games LLP and Others v. HMRC*, [2016] UKFTT 521 (TC); and *Ingenious Games LLP and Others v. HMRC*, [2017] UKFTT 429 (TC).

25 See Malcolm Gammie, "The Origins of Fiscal Transparency in UK Income Tax," in John Tiley, ed., *Studies in the History of Tax Law*, vol. 4 (Oxford, UK: Hart, 2010), 33-66; and Michael McGowan, *Classifying Entities and the Meaning of 'Tax Transparency': The UK Perspective* (Alphen aan den Rijn, the Netherlands: Kluwer Law International, 2023).

26 The United Kingdom does not have the equivalent of section 45(2) of Canada's Interpretation Act, RSC 1985, c. I-21. The question is whether a later amendment casts light on an earlier ambiguity; see *Cape Brandy Syndicate v. IRC*, [1921] 2 KB 403, at 414, per Lord Sterndale MR: "I think it is clearly established in *Attorney-General v Clarkson* that subsequent legislation on the same subject may be looked to in order to see what is the proper construction to be put upon an earlier Act where that earlier Act is ambiguous."

To my mind, this at least involves ensuring that there is an element of consistency in approach, with due consideration of the overall structure of the taxation regime in question, as illustrated by examples 4 and 5. The aim should be to reach the correct result, and not just to put any argument of which a court might be persuaded on the basis that it is advanced by the revenue authority. In particular, it cannot be right to contend for a particular interpretation of the legislation against a taxpayer of which the revenue authority disapproves but to adopt a different approach in other cases. Legislation cannot mean one thing when avoidance is alleged and another when it is not. That can only follow from the adoption of specific anti-avoidance legislation to that effect.

What is obviously to be avoided is an approach, as Lord Normand put it in 1949, that effectively overstretches the language of the statute in order to subject to taxation people of whom the courts or the revenue authority disapprove.[27] Most importantly of all, in my view, an approach that seeks to inhibit or deny a taxpayer the opportunity to demonstrate that the tax claimed is not due as a matter of law seems difficult to defend by any standard.

27 *Lord Vestey's Executors v. IRC* (1949), 31 TC 1 (HL), at 90.

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# Policy Forum: Ethics and Tax Practice—We Need To Talk

Karen Wensley*

**PRÉCIS**

Cet article soutient que le comportement éthique des fiscalistes contribue grandement au bon fonctionnement du régime d'autocotisation et à la perception qu'il est équitable. À l'inverse, le comportement contraire à l'éthique de certains fiscalistes peut nuire à cette perception et à cette efficacité. L'article examine les moyens par lesquels l'éthique des fiscalistes peut être érodée et les facteurs de cette érosion. Il propose un code de déontologie pour les fiscalistes canadiens et examine ce qu'un tel code devrait inclure, comment il pourrait être mis en œuvre ainsi que les avantages et les inconvénients de l'adoption d'un tel code.

**ABSTRACT**

This article argues that the ethical behaviour of tax practitioners is a key contributor to the effective functioning and perceived fairness of a self-assessment tax system. Conversely, the unethical behaviour of some tax practitioners can erode that perception and effectiveness. The article looks at the ways in which the ethics of tax practitioners can be eroded and the drivers of this erosion. It proposes a code of ethics for Canadian tax practitioners, and discusses what such a code should include, how it might be implemented and the pros and cons of adopting such a code.

**KEYWORDS:** ETHICS ■ FAIRNESS ■ PROFESSIONAL STANDARDS ■ RESPONSIBILITIES

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## INTRODUCTION

A system of taxation might appear to be a good illustration of ethical principles in action. Individuals (in a democracy) are agreeing to voluntarily contribute personal resources to benefit society as a whole. Utilitarians, who look for the greatest good overall, can measure societal goods such as education, safety, and infrastructure. Not only would it be less efficient to purchase these things individually, but there is also an overall benefit to the economy from a safe and educated society. Deontologists, who care about the rights of others and the duties owed to them, might cite universal health care or welfare benefits. Regardless, paying taxes can be viewed as a form of ethical behaviour.

On the other hand, of course, paying taxes is an onerous obligation. Even in a democracy, we do not feel that we have agreed to pay them. We believe that we are paying too much relative to others. We criticize the services that we receive as being poor, inefficient, and not worth what we are paying. We complain that the tax burden is unsustainable and a drag on the economy.

There is very little discussion among tax practitioners and in the general public of why we pay taxes and why we have an ethical obligation to comply. Instead, the focus is on the issues of enforcement and compliance with tax law (what can I get away with?), and interpreting the tax law to one's own benefit (paying the least amount of tax allowed by law). If ethical conduct is a consideration, it generally arises in the form of blaming others—"bad" people or corporations that do not pay their fair share. How did this come about?

Paying (or not paying) tax has become viewed as a game rather than an obligation. Winning the game is equivalent to paying the least amount of tax. Research tells us that a substantial minority of us will cheat in games, whether the game is a test, a video game, or a psychology experiment.[1] The likelihood of cheating is reduced when cheaters feel that they will be shamed if their cheating is exposed.[2] The tax game is played by individual taxpayers and also by tax practitioners who may be rewarded for their creative tax solutions. The game is played by both sides—government (the Canada Revenue Agency [CRA] and the Department of Finance) versus taxpayers.

Tax non-compliance has become normalized. Even though research has shown that fear of exposure reduces cheating only if it is accompanied by social norms that

1 The International Center for Academic Integrity recently updated studies in Donald L. McCabe, Kenneth D. Butterfield, and Linda K. Treviño, *Cheating in College: Why Students Do It and What Educators Can Do About It* (Baltimore: Johns Hopkins University Press, 2012). The authors found that 29.3 percent of university students admitted that they had cheated on an exam. Nelson Granados reported in *Forbes* on a study by the cybersecurity firm Irdeto that 37 percent of gamers admitted to cheating when playing online. See Nelson Granados, "Report: Cheating Is Becoming a Big Problem in Online Gaming," *Forbes*, April 30, 2018 (www.forbes.com/sites/nelsongranados/2018/04/30/report-cheating-is-becoming-a-big-problem-in-online-gaming/).

2 For an excellent overview of the motivations for and deterrents to cheating, see Ferric C. Fang and Arturo Casadevall, "Why We Cheat" (May 2013) 24:2 *Scientific American Mind* 30-37.

shame the cheater, many kinds of tax non-compliance (such as not declaring goods at customs or avoiding sales tax by paying in cash) are openly admitted or even bragged about. The recent assertion by the Internal Revenue Service that Microsoft owes $29 billion in tax[3] does not appear to have hurt the company's reputation, although companies have been hurt in other countries (for example, in the United Kingdom)[4] for paying no tax in that jurisdiction. While these corporate strategies are likely to have fallen short of tax evasion, the distinction is lost on the general taxpaying public.

The normalization of non-compliance reinforces the belief that others are paying too little tax and we are paying too much. Those at the lower economic levels of society believe that the rich and large corporations, aided and abetted by clever (and possibly unscrupulous) tax practitioners, are not paying their fair share. The rich believe that they shoulder too high a tax burden and blame tax evaders in the underground economy and/or government waste. Employees suspect that the self-employed are hiding income. Corporations blame Canada for not matching lower tax rates available in other jurisdictions.

When someone feels that they are paying more than their fair share of taxes, it is easy to justify cheating. The psychology of ethics tells us that since we all believe that we are ethical people, it must be someone else's fault if we cheat; we blame the unfairness of the tax system, or the duty to the client or shareholder, or the compensation system at professional firms. Attributing blame to others inoculates us against uncomfortable feelings of shame. The fired PWC Australia partners who have been excoriated in the media for a blatant violation of confidentiality[5] are doubtless feeling victimized, and not ashamed. This is not because they are bad people, but because their brains are reacting against the cognitive dissonance of admitting to being unethical. Practitioners at other firms may be feeling superior, assuring themselves that they would never do such a thing, rather than engaging in self-reflection about whether they might in fact have done something equally unethical.

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3 See "Microsoft Owes $29B in Unpaid Taxes, IRS Claims," *CBC News*, October 13, 2023 (www.cbc.ca/news/business/microsoft-irs-tax-1.6994965).

4 For example, BBC News reported in June 2013 that Starbucks "announced . . . it would pay more corporation tax after a public outcry and an investigation by MPs." See "Starbucks Pays UK Corporation Tax for First Time Since 2009," *BBC News*, June 23, 2013 (www.bbc.com/news/uk-politics-23019514). This followed 15 years during which Starbucks paid no corporate tax in the United Kingdom.

5 This article refers several times to the PwC Australia violation of confidentiality. A former tax partner of PwC Australia is alleged to have provided to current PwC Australia tax partners confidential information that he obtained in consultations with the Australian government regarding upcoming changes to tax rules relating to international companies. The current tax partners in turn were alleged to have used the information to approach a select group of clients about implementing tax-planning ideas before the advent of the new rules. (Stephen Foley, "PwC Australia's Culture Attacked in Tax Leak Scandal Report," *Financial Times*, September 27, 2023.) The example is chosen because of the public availability of information and the recency of the situation. However, it is unlikely that this type of conduct is unique to that firm.

Given the pressures to act unethically, the players on the government side of the tax game have reacted by creating more rules. This has resulted in an exponential growth in tax law and regulations, and in compliance requirements. On the tax practitioners' side, rewards for creative tax ideas have grown, constrained to a degree by firms' quality-control processes that more or less successfully discourage their practitioners from selling schemes that are clearly outside what is allowed by law. But firms' quality-control processes tend to be narrowly focused on documented application of tax law and do not cover situations such as the PWC Australia matter, which deals with the misuse of confidential information. Alternatively, practitioners avoid facing uncomfortable facts by writing opinions that place responsibility for accuracy solely on the client.

The solution to these escalating ethical problems is not simple. Reversing the normalization of tax cheating needs a multi-faceted approach. Recent media coverage has painted tax practitioners as unscrupulous and willing to do anything to earn big fees from clients. However unsupported this criticism may be in most cases, tax practitioners do influence the perceived fairness of the tax system, and unethical practitioners can harm the reputation of their colleagues. It is therefore logical that we should ask what role tax practitioners can play in setting an example, by practising tax ethically and by influencing others to do the same. This article considers the need for and benefits of a code of ethics for tax practitioners that sets out what ethical tax practice means.

## A CODE OF ETHICS FOR TAX PRACTITIONERS?

Tax practitioners in Canada may be chartered professional accountants (CPAs) or lawyers, or may have other or no professional designations. That makes it difficult to create a detailed code of ethics that would apply universally. In any case, those with professional designations must already abide by the rules of their profession. However, CPA institutes and law societies write rules for their group as a whole and not for tax practitioners in particular. For the reasons discussed above, there are issues unique to the practice of tax that would make the creation of such a code of ethics beneficial.

Practitioners who work in professional firms are generally also expected to comply with the firm's code of ethics and standards of conduct. These include quality-control procedures, client-acceptance rules, conflict-of-interest rules, and others. But codes and standards vary from firm to firm, and may not capture all of the ethical issues that may arise. One could ask whether the violation of confidentiality that the former partner of PWC Australia was alleged to have committed was envisaged by the firm's code of ethics.

It is also worth considering whether the mindset of tax practitioners might make them less ethically astute when it comes to tax practice. The day job of a tax practitioner is to find clever ways in which the tax law can be interpreted or applied in order to minimize a client's tax burden. This enhances the practitioner's skill in making fine distinctions, and in persuading others (clients, tax authorities, the judiciary) of interpretations that may not make sense to the general public. This skill can also be used (or abused) to rationalize behaviour such as withholding information from the CRA

or ignoring uncomfortable facts. Research appears to support these observations; for example, Doyle, Hughes, and Summers[6] found that tax practitioners are less ethical than the general population when it comes to ethical dilemmas relating to tax matters. They suggest that one cannot simply trust the professional judgment of tax practitioners in ethical matters.

By way of illustration, imagine the justifications that a PWC Australia partner might have used to become comfortable with taking tax-planning ideas to the firm's most lucrative clients in the face of possible changes to Australian tax law. (Consider this to be fiction in the same way that the TV series "Succession" was fiction.)

- The former partner who got confidential information from the government is no longer a PWC partner, so I am not responsible for his behaviour.
- I only told my clients that there were "potential" changes to the tax law, so confidentiality was not really broken.
- I was not close to the source and I didn't know, and didn't ask, how the information about potential changes to the law was obtained.
- Probably other firms are doing the same thing.
- The duty to my clients to save tax superseded all other obligations.
- Other partners seemed OK with the approach, so who am I to question it?
- I am under huge pressure to meet my revenue targets, and there is no other way to do that. The firm is implicitly encouraging this behaviour.
- This is a unique opportunity; it's "just this once."
- This is a big win for me and for the firm, and winning is what it's all about.

These rationalizations are powerful, and merely having a code of ethics for tax practitioners will not stop them. But the code can be a basis for discussion, self-reflection, training, monitoring, and mentoring.

## SCOPE OF A CODE OF ETHICS

In recent years, professional codes of ethics have increasingly included a larger societal obligation in addition to specific obligations to the client or patient. For example, the American Medical Association in 2001 added the principle that "[a] physician shall recognize a responsibility to participate in activities contributing to the improvement of the community and the betterment of public health."[7] The code of ethics of the Chartered Financial Analysts Institute includes a responsibility to maintain the integrity of financial markets.[8] This obligation is broader than a simple prohibition on insider trading because it underlines the idea that individuals who make their living

6 Elaine Doyle, Jane Frecknall Hughes, and Barbara Summers, "An Empirical Analysis of the Ethical Reasoning of Tax Practitioners" (2013) 114:2 *Journal of Business Ethics* 325-39.

7 American Medical Association, "AMA Principles of Medical Ethics" (https://code-medical-ethics.ama-assn.org/principles), at principle VII.

8 Code of Ethics and Standards of Professional Conduct (www.cfainstitute.org).

trading on financial markets have a duty and self-interest to ensure that those markets can be trusted. The Law Society of Ontario's rules of conduct include the duty to maintain "[p]ublic confidence in the administration of justice."[9] The Institute of Chartered Accountants of Scotland has put forward the principle that

> CAs are a force for good in the organisations in which they work. They can also influence those around them, and thereby help shape the culture and values of their organisation. The cumulative effect of their influence can help reinforce the importance of ethics at the core of business practices and of a more responsible and holistic approach to business. In this way, CAs are a key component of building public trust in business, to the benefit of our broader society.[10]

Despite these lofty goals, there is still confusion about what it means to uphold ethical standards. For example, in 2022, EY surveyed corporate directors, senior management, and other employees. Ninety-seven percent of those surveyed said that integrity was important, but "only a third (33%) of respondents believe that an important characteristic of integrity is behaving with ethical standards," while half (50 percent) cited compliance with laws, regulations, and codes of conduct.[11] If one extrapolates these statistics to tax practitioners in Canada, the challenge is to go beyond compliance and talk about ethical standards.

Aspiring to be a "force for good" has become fashionable. A quick Google search of the phrase turns up everything from the Dalai Lama to corporate mission statements, preambles to professional codes of ethics, and university statements of purpose. Can tax practitioners be a "force for good"? Should they?

Even if one finds the idea of tax practitioners leading the charge as forces for good implausible, the concept of enlightened self-interest still justifies a wider ethical perspective on the practice of tax. Media coverage of the PWC Australia situation and various aggressive tax-planning schemes, especially those involving tax havens, has negatively affected the reputation of tax professionals. While some might consider this good advertising ("I am the person who can save you the most tax!"), in the longer term surely clients want tax advice that works, avoids penalties, and keeps them out of the media. The escalating game of tax practice discussed above has other implications, including a decreasing level of trust between tax practitioners and tax authorities. Canada has benefited from consultation between the two sides, and discontinuing such discussions can only lead to more onerous, impractical, or counterproductive changes to the law.

If one accepts the proposition that an increased focus on ethics in tax practice is good for practitioners, taxpayers, and society in general, a tax practitioner code of

9 Law Society of Ontario, "Rules of Professional Conduct" (https://lso.ca/about-lso/legislation-rules/rules-of-professional-conduct/chapter-2), at section 2.1-1.

10 The Institute of Chartered Accountants of Scotland, *The Power of One, Ethics*, 2d ed. (Edinburgh: ICAS, 2015), at 3.

11 EY, *Tunnel Vision or the Bigger Picture? Global Integrity Report 2022* (EY, 2022), at 7.

ethics is a logical place to start. While tax practitioners in North America do not strictly meet the definition of "professionals," in that they have no governing body of their own that can enforce rules of tax practice, they meet other parts of the definition, such as being entrusted with providing specialist advice relied on by the public. A tax practitioner code of ethics should build on the codes of ethics of other professions while taking into account issues unique to tax practice.[12]

Most importantly, the work and consultation that would be required to create a code of ethics for tax practitioners would draw significant attention to the ethical issues, which should include the following:

- *The integrity of the tax system.* In a self-assessment system, building trust that everyone is paying their fair share of taxes is critical. Adherence to the law is clearly part of this principle, but tax practitioners should also be asking themselves whether their actions are undermining that trust. From an enlightened self-interest perspective, tax practitioners should consider that if trust in the self-assessment tax system continues to erode, tax authorities will be incentivized to enact more sweeping (and therefore more expensive) powers of compliance and enforcement, and less nuanced tax provisions (such as digital taxes). The rest of the code of ethics should elaborate on what undermining that integrity might entail. How might the practitioner more objectively assess whether an interpretation of the law is going too far? How does being truthful with the CRA align with the practitioner's duty to a client? Do practitioners have an obligation to set an example with respect to their own tax compliance? (For example, how should one respond to a contractor who offers a cash price with no sales tax or an invoiced price including the tax?)
- *Responsibility for factual accuracy.* Whether a tax plan works depends on the facts of the situation as well as the applicable law. But tax practitioners often place the responsibility for the accuracy of those facts on the client, even when the facts have been "suggested" by the practitioner, or seem implausible, or where there is an uncomfortable indication that they may be fabricated. A code of ethics should include the responsibility for tax practitioners to be satisfied that the facts presented are correct, and not just to assume that they are. What does this mean in practice?
- *Appropriateness of advice.* While it is probably appropriate to assume that the tax departments of large multinational corporations have the expertise to assess

12 Other jurisdictions do have tax practitioner bodies, such as the Chartered Institute of Taxation (CIT) in the United Kingdom. While according to its website, the CIT's "primary purpose is to promote education in taxation," it does publish rules of Professional Conduct in Relation to Taxation, which members must follow. See United Kingdom, Chartered Institute of Taxation, "About Us" (www.tax.org.uk/about-us). In addition to establishing general principles, the CIT deals with matters specifically relevant to tax practice, such as tax planning and dealing with errors. The standards were developed jointly with a number of other organizations, including the Institute of Chartered Accountants in England and Wales.

the appropriateness of a tax plan or position to their circumstances, smaller companies or individuals may be relying on a tax practitioner to make that judgment for them. Therefore, a code of ethics should require that the client understands the risks and that those risks are aligned with the client's appetite for risk. In addition, the tax practitioner should be required to take into account the capacity of the client to implement a tax plan, the lack of which may make advice inappropriate. This must mean more than just having the client sign a statement that they understand the advice that they are getting.

- *Confidentiality.* Before the PWC Australia situation, confidentiality requirements would likely have focused on client information. But clearly there is a larger issue. As long as tax authorities find it useful to consult with tax practitioners or former tax practitioners, the prohibition on using insider knowledge gained from such consultations should be part of the code of ethics. Even when there is no formal consultative role, a close working relationship between senior government officials and tax practitioners may give rise to issues of exploitation of the knowledge gained or of preferential access to officials.
- *Conflict of interest.* All professional codes of ethics have prohibitions on acting on conflicts of interest, which is by nature the antithesis of ethical behaviour. Tax practice is rife with such conflicts, not only where the practitioner's own gain is opposed to the best interest of the client, but also where the practitioner acts for clients with potentially opposing interests. Setting out and discussing examples of conflicts of interest would be beneficial.
- *Competence.* All professional codes of ethics contain requirements that the practitioner maintain the knowledge to practise competently, and refrain from providing advice in areas in which the practitioner is not competent. This includes a requirement to consult others where appropriate, and responsibility for the work done by individuals supervised by the practitioner. It would also include properly documenting the work.
- *Duty to provide ethics training and mentoring of apprentices.* Professions are built on an apprenticeship model whereby more experienced practitioners have a duty to train those newer to the field, but a code of ethics should explicitly include the responsibility for the ethical behaviour and training of newer members. This must be more than an online course and accompanying quiz, and must include mentoring as well as training.
- *Duty to maintain the ethical conduct of colleagues.* The PWC Australia matter was apparently widely known to a number of partners. Some of them must have had private or internally discussed misgivings. A code of ethics should include the responsibility for the actions of colleagues where there are reasonable grounds to believe that unethical conduct is taking place. This starts with confronting colleagues who are guilty of unethical behaviour, but extends to reporting such behaviour as appropriate. This is perhaps the most difficult principle to apply in practice, since the social norm of not reporting on the unethical actions of others is very strong.

## IMPLEMENTATION OF A CODE OF ETHICS

Because tax practice itself is not a regulated profession (although, in Canada, CPAs and lawyers are regulated), there is no governing body to initiate and operationalize a code of ethics for Canadian tax practitioners. The federal Department of Finance could impose a code of ethics to which practitioners would have to adhere in order to represent clients in communicating with the CRA, but this would be rife with compliance problems and would add layers of cost and infrastructure. A good start would be for the parties to voluntarily cooperate in creating a code of ethics for tax practitioners in Canada.

This would require that CPA and legal firms, large and small, volunteer to help draft the code, perhaps with organizational support provided by the Canadian Tax Foundation. Even the process of trying to draft, and then comment on and revise, the code would raise awareness of the importance of the issues. The danger would be that the resulting code would be watered down to something innocuous that everyone could agree to, but even a statement of principles would be a start. Those writing the code of ethics would need to include practitioners with experience in how ethical dilemmas arise and what can go wrong; academics with knowledge of ethical thought and of how other professions or jurisdictions have dealt with such codes; and other individuals with the knowledge to understand how the terms of the code might intersect with provisions in the Income Tax Act[13] dealing with issues such as misrepresentation.

With no formal body to enforce compliance, firms and individual practitioners would be encouraged to voluntarily sign up to the code. Such participation would require that the code be incorporated into the firm's or the individual's rules of practice, which would presumably already have sanctions for non-compliance. Participating practitioners could receive certification indicating their pledge to abide by the code. Consideration should be given to the question of when in the process the inclusion of CRA and other tax officials, and of tax practitioners in industry, should be contemplated.

Merely having a code of ethics would make little difference unless it was a living document. As a start, the code of ethics should be included in training such as the in-depth tax program of CPA Canada (the chartered professional accountants institute) and in tax conferences such as those of the Canadian Tax Foundation. Specialist groups, such as indirect tax or expatriate tax practitioners, would discuss its application to common issues in their practice. But ethics cannot be a stand-alone topic of conversation. Case studies used in training to teach technical topics can incorporate an ethical issue (such as unclear facts or a conflict of interest). Papers presented at conferences, especially those dealing with compliance, interaction with the CRA, duty to clients, etc., should be encouraged to consider the wider ethical implications and not just what is required by law or existing professional codes of conduct.

13 RSC 1985, c. 1 (5th Supp.), as amended.

Professional codes of ethics in all fields continue to evolve in response to changes in society and to specific events such as financial scandals. A tax practitioner code of ethics would have to be an evolving document. The work to keep it current would also serve to keep the topic under discussion.

## COUNTERING ARGUMENTS AGAINST A CODE OF ETHICS

There are, no doubt, many tax practitioners who will argue that the effort to create a code of ethics for tax practitioners in Canada is a waste of time, for reasons that are often persuasive. These may include the following:

- The nature of tax practice is adversarial, and tax practitioners have no obligation to the integrity of the tax system beyond what is required by law.
- Codes of ethics are too generic to be of practical use.
- Practitioners will continue to act out of self-interest (earning money by saving tax for clients) regardless of anything in a code of ethics.
- Most tax practitioners are already ethical in their practice, and writing a code of ethics suggests the opposite.
- PWC Australia is an aberration that cannot occur in Canada.
- CPA and law society rules of professional conduct already deal with the ethical issues of tax practice.
- An interprofessional code of ethics will have no enforcement mechanism, and therefore no impact.

There are thousands of articles and books written on the benefits, or lack thereof, of codes of ethics. A full review of the findings is beyond the scope of this article. But, in general, the consensus is that employees of organizations with a code of ethics tend to feel more supported in making ethical decisions, and that organizations that have adopted a code of ethics tend to act more ethically than those that have not. This may be circular reasoning: more ethical organizations are likely to prioritize having a code of ethics. Of course, we should not naïvely believe that simply having a code of ethics for tax practitioners will make all tax practitioners behave more ethically. But it has been noted that the process of developing a code of ethics plays a role "in gaining consensus on professional values and ethical norms,"[14] and a code of ethics is a "first tangible commitment to being ethical."[15] Tax practitioners in Canada would benefit from a discussion of how to build that consensus.

14 Mark S. Frankel, "Professional Codes: Why, How, and with What Impact?" (1989) 8:2-3 *Journal of Business Ethics* 109-15, at 109.

15 Greg Wood and Malcolm Rimmer, "Codes of Ethics: What Are They Really and What Should They Be?" (2003) 16:2 *International Journal of Value-Based Management* 181-95, at 181.

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# Douglas J. Sherbaniuk Distinguished Writing Award

JEFFREY SHAFER AND CHRIS SHERIDAN

Jeffrey Shafer and Chris Sheridan are the 2023 recipients of the Canadian Tax Foundation's Douglas J. Sherbaniuk Distinguished Writing Award. Their paper, "Treaty Shopping: Current Developments," was published in the 2022 Conference Report (Toronto: Canadian Tax Foundation, 2023), 29:1-39. The paper was selected by a committee of experienced tax professionals as the best writing published by the Foundation in 2022-23. The award, which is conferred annually, is named for the Foundation's late director emeritus.

Jeffrey Shafer practises in all areas of Canadian domestic and cross-border income tax law, with a particular focus on mergers and acquisitions, international transfer pricing, private equity investment, domestic and international corporate and trust reorganizations, and the taxation of various investment vehicles. His practice also includes acting for taxpayers at all levels in the tax appeals process.

Chris Sheridan has been practising in the area of corporate tax planning for 10 years. He primarily advises clients on the tax aspects of mergers and acquisitions, corporate reorganizations, and cross-border transactions. He also has experience with tax dispute resolution and tax litigation.

# Prix d'excellence en rédaction Douglas J. Sherbaniuk

**JEFFREY SHAFER ET CHRIS SHERIDAN**

Jeffrey Shafer et Chris Sheridan sont les récipiendaires 2023 du Prix d'excellence en rédaction Douglas J. Sherbaniuk de la Fondation canadienne de fiscalité. Leur papier intitulé « Treaty Shopping: Current Developments » a été publié dans le 2022 Conference Report (Toronto: Canadian Tax Foundation, 2023), 29:1-39. Le papier a été retenu par un comité composé de professionnels en fiscalité à titre de meilleur article publié par la Fondation en 2022-23. Ce prix, décerné annuellement, est nommé à la mémoire du défunt directeur emeritus de la Fondation.

Jeffrey Shafer exerce dans tous les domaines du droit canadien de l'impôt sur le revenu national et transfrontalier, et notamment sur les fusions et acquisitions, les prix de transfert en matière internationale, les placements en capital-investissement, les réorganisations de sociétés et de fiducies nationales et internationales et l'imposition de diverses structures de placement. Dans sa pratique, il représente également des contribuables à tous les niveaux dans le processus d'appel en matière d'impôt.

Chris Sheridan pratique dans le domaine de la planification fiscale des entreprises depuis 10 ans. Il conseille principalement des clients sur les aspects fiscaux des fusions et acquisitions, des réorganisations d'entreprises et des transactions transfrontalières. Il a également de l'expérience dans le règlement de différends fiscaux et dans les litiges fiscaux.

# Canadian Tax Foundation Regional Student-Paper Awards

Each year, the Canadian Tax Foundation awards up to four regional student-paper prizes. Depending on the merit of the papers received, one prize may be awarded for each of four regions of the country: Atlantic Canada (the Canadian Tax Foundation-McInnes Cooper Award); Quebec (the Canadian Tax Foundation-Osler Hoskin Harcourt Award); Ontario (the Canadian Tax Foundation-Fasken Martineau DuMoulin Award); and western Canada (the Canadian Tax Foundation-Bert Wolfe Nitikman Foundation Award). Papers must be written as a requirement of a tax-related course, including directed research courses, and can address any aspect of the Canadian tax system, including comparative analyses, tax policy, tax compliance, tax planning, and tax system design. Papers may be written in either English or French and must be recommended for award consideration by the professor or instructor of the course.

Papers will be reviewed by three independent reviewers, and abstracts (of 400 words or less) of the award-winning papers will be published in the *Canadian Tax Journal*. The authors of the winning papers will also receive a cash prize from the firms or institutions sponsoring the awards and a one-year membership in the Foundation, entitling them to receive complimentary copies of many of the currently issued Foundation publications, including the *Canadian Tax Journal*, *Canadian Tax Focus*, *Tax for the Owner-Manager*, *Perspectives on Tax Law & Policy*, *International Tax Highlights*, and the annual tax conference report, along with one year of complimentary access to TaxFind, the Foundation's online research database. As members of the Foundation, winners can also take advantage of generous discounts on other publications as well as discounted registration fees for Foundation conferences and courses.

Submissions to the student-paper competition should be addressed to the Canadian Tax Foundation, Student-Paper Competition, 145 Wellington Street West, Suite 1400, Toronto, ON M5J 1H8, or e-mailed to CTF_Awards@ctf.ca. Entries must be accompanied by a letter of recommendation from the professor or instructor of the tax course for which the paper was written and must include the student's name and e-mail address if known. The submission deadline for the 2023-24 academic year is June 30, 2024.

# THE CANADIAN TAX FOUNDATION-OSLER HOSKIN HARCOURT AWARD FOR QUEBEC

## Étienne C. Laplante (2022-23 recipient)

The Canadian Tax Foundation is pleased to announce that Étienne C. Laplante is the winner of the Canadian Tax Foundation-Osler Hoskin Harcourt Award for the best Quebec paper of 2022-23 dealing with an aspect of Canadian taxation.

Mr. Laplante's paper, "Le 'deux-vingt' en 2022 : enjeux fiscaux et commerciaux d'actualité en matière de rémunération des gestionnaires de fonds d'investissement," was written for the Master in Taxation program at the University of Sherbrooke.

**ABSTRACT**

Despite the success and popularity of private equity funds in Canada and the relative homogeneity of their legal structures and business practices, several ambiguities remain in the application of Canada's tax law to their legal structure.

While most investment funds are organized according to a widespread model, the contractual nature of the governing documents of private equity funds provides investors and managers with a great deal of freedom in establishing their business arrangements, resulting in a wide variety of subtleties and variations in this model from fund to fund.

The purpose of this essay is to draw the attention of investment fund practitioners to certain ambiguities in the application of tax laws to various common practices in the remuneration of fund managers and to highlight the main avenues to be considered for monitoring and clarification when establishing an investment fund.

To this end, the first chapter of this essay outlines the typical legal and business structure of private equity funds, including the current two-tier model of fund manager compensation—commonly referred to as "two-twenty"—consisting of management fees and carried interest. Certain variations applicable to this compensation structure and model will also be detailed.

The second chapter addresses tax and business issues related to management fees. In particular, the application of sales taxes to management fees, the deductibility of management fees in the calculation of the fund's income, and the various commercial arrangements for the payment of management fees are examined.

The third chapter focuses on tax and business issues related to carried interest, including the impact of deferred interest on sales taxes applicable to management fees and the use of a special limited partner whose sole function is to receive the deferred interest.

## THE CANADIAN TAX FOUNDATION-BERT WOLFE NITIKMAN FOUNDATION AWARD FOR THE WESTERN PROVINCES

### Matthew London (2022-23 recipient)

The Canadian Tax Foundation is pleased to announce that Matthew London is the winner of the Canadian Tax Foundation-Bert Wolfe Nitikman Award for the best western provinces student paper of 2022-23 dealing with an aspect of Canadian taxation.

Matthew London's paper "Incentivizing Giving Through the Removal of Capital Gains Tax from the Donation of Private Company Shares" was written for the JD program at Robson Hall Faculty of Law, University of Manitoba. Upon receipt of his JD in 2024, Matthew will be commencing a clerkship at the Tax Court of Canada.

**ABSTRACT**

Corporations utilize charitable donations as part of their overall Corporate Social Responsibility (CSR) decisions. From the outside, philanthropic efforts by corporations may seem honourable and an innocent act. However, corporations in Canada have used charity as a methodology to change policy and garner political influence to better help their own strategic outlook. This can create a dynamic where governmental entities, lobby groups, and other elected representatives are at risk of interference, persuasion, or influence by corporations who may offer philanthropic funding to those with political and policy influence. It is well documented that corporations do donate to various causes, often receiving tax benefits for doing so, but there is also the question of how they decide where they should indeed donate. If corporations decide to donate to specific entities where they will be able to influence decisions and policies in adjacent areas, then corporations are essentially buying influence while disguising it as philanthropy. Corporations who are hiding political and strategic advocacy behind donations are utilizing a taxpayer subsidy to express their voice. Should Canada aim to mitigate inference in the form of philanthropic efforts? Is it morally wrong for decision makers to accept charitable contributions from those seeking policy changes from them? In what ways do corporations use philanthropy to impose their strategic wishes on the policies that directly affect them? What patterns do corporations follow in making charitable donations, and do these shift with changing executive leadership positions within the company?

# Prix régionaux du meilleur article par un étudiant de la Fondation canadienne de fiscalité

Chaque année, la Fondation canadienne de fiscalité (FCF) décerne jusqu'à quatre prix régionaux pour des articles rédigés par des étudiants. Selon la qualité des articles qui ont été soumis, un prix peut être décerné pour chacune des quatre régions du pays : le Canada atlantique (le Prix FCF-McInnes Cooper); le Québec (le Prix FCF-Osler Hoskin Harcourt); l'Ontario (le Prix FCF-Fasken Martineau DuMoulin); et l'ouest canadien (le Prix FCF-Bert Wolfe Nitikman Foundation). Les articles doivent avoir été rédigés dans le cadre d'un cours lié à la fiscalité, y compris les cours de travaux dirigés, et ils peuvent porter sur tout aspect du régime fiscal canadien, notamment les analyses comparatives, la politique fiscale, l'observation des règles fiscales, la planification fiscale et la conception du régime fiscal. Les articles peuvent être rédigés en anglais ou en français et une lettre de recommandation du professeur ou du chargé d'enseignement du cours doit être au dossier.

Les articles sont évalués par trois examinateurs indépendants, et des précis (de 400 mots ou moins) des articles primés seront publiés dans la *Revue fiscale canadienne*. Les auteurs des articles primés recevront aussi une récompense en argent des organismes ou des sociétés qui commanditent le prix ainsi qu'une adhésion d'une année à la FCF, leur donnant le droit de recevoir des exemplaires gratuits d'un grand nombre d'ouvrages publiés par la FCF, dont *Revue fiscale canadienne*, *Focus sur la fiscalité canadienne*, *Actualités fiscales pour les propriétaires exploitants*, *Perspectives en fiscalité et en politique fiscale*, *International Tax Highlights* ainsi que le Rapport de la conférence annuelle en fiscalité, avec un accès d'un an à TaxFind en ligne, l'outil de recherche électronique de données de la FCF. À titre de membre de la FCF, les lauréats bénéficient également de réductions appréciables sur le prix d'autres publications ainsi que sur les frais d'inscription aux conférences et aux cours offerts par la FCF.

Les dossiers de participation au concours du meilleur article rédigé par un étudiant doivent être transmis par la poste à la FCF, Concours du meilleur article rédigé par un étudiant, 145 Wellington Street West, Suite 1400, Toronto, ON M5J 1H8, ou par courriel à CTF_Awards@ctf.ca. Les dossiers doivent être accompagnés d'une lettre de recommandation du professeur ou du chargé d'enseignement du cours en fiscalité dans le cadre duquel l'article a été rédigé ainsi que du nom de l'étudiant et de son adresse courriel si connue. La date d'échéance de présentation des dossiers pour l'année universitaire 2023-24 est le 30 juin 2024.

## PRIX DE LA FONDATION CANADIENNE DE FISCALITÉ-OSLER HOSKIN HARCOURT POUR LE QUÉBEC

### Étienne C. Laplante (récipiendaire 2022-23)

La FCF a le plaisir d'annoncer qu'Étienne C. Laplante est le lauréat du Prix Fondation canadienne de fiscalité-Osler Hoskin Harcourt pour le meilleur article de 2022-23 de la province de Québec qui traite d'un aspect de la fiscalité canadienne.

L'article de M. Laplante intitulé « Le 'deux-vingt' en 2022 : enjeux fiscaux et commerciaux d'actualité en matière de rémunération des gestionnaires de fonds d'investissement » a été rédigé dans le cadre du programme de maîtrise en fiscalité de l'Université de Sherbrooke.

#### PRÉCIS

En dépit du succès et de la popularité des fonds de capital-investissement au Canada et de la relative homogénéité de leurs structures juridiques et pratiques commerciales, plusieurs ambiguïtés subsistent dans l'application de la législation fiscale du Canada à leur structure juridique.

Bien que la plupart des fonds d'investissement soient organisés selon un modèle répandu, la nature contractuelle des documents constitutifs des fonds de capital-investissement procure aux investisseurs et aux gestionnaires une grande liberté dans l'établissement de leur entente commerciale, résultant en une grande diversité de subtilités et variations de ce modèle d'un fonds à l'autre.

Le présent essai vise à attirer l'attention des praticiens œuvrant auprès des fonds d'investissement sur certaines ambiguïtés dans l'application des lois fiscales à diverses pratiques courantes en matière de rémunération des gestionnaires de fonds et à mettre en lumière les principales avenues de veille et de clarification à prendre en considération dans l'établissement d'un fonds d'investissement.

À cette fin, le premier chapitre du présent essai expose la structure juridique et commerciale habituelle des fonds de capital-investissement, incluant le modèle courant de rémunération à deux volets des gestionnaires de fonds — communément appelée « deux-vingt » — composée de frais de gestion et d'un intérêt différé (*carried interest*). Certaines variations applicables à cette structure et à ce modèle de rémunération sont également détaillées.

Le deuxième chapitre traite d'enjeux fiscaux et commerciaux relatifs aux frais de gestion. Plus particulièrement, l'application des taxes à la consommation aux frais de gestion, la déductibilité des frais de gestion dans le calcul du revenu du fonds et les différents arrangements commerciaux de paiement des frais de gestion seront étudiés.

Le troisième chapitre porte sur des enjeux fiscaux et commerciaux relatifs à l'intérêt différé (*carried interest*), dont l'incidence de l'intérêt différé sur les taxes à la consommation applicables aux frais de gestion ainsi que l'utilisation d'un commanditaire spécial n'ayant pour seul fonction que la réception de l'intérêt différé.

# PRIX DE LA FONDATION CANADIENNE DE FISCALITÉ – BERT WOLFE NITIKMAN FOUNDATION POUR L'OUEST CANADIEN

## Matthew London (Récipiendaire 2022-23)

La FCF a le plaisir d'annoncer que Matthew London est le lauréat du Prix Fondation canadienne de fiscalité-Bert Wolfe Nitikman Foundation pour le meilleur article de 2022-23 rédigé par un étudiant de l'Ouest canadien qui traite d'un aspect de la fiscalité canadienne.

L'article de M. London intitulé « Incentivizing Giving Through the Removal of Capital Gains Tax from the Donation of Private Company Shares » a été rédigé pour le programme JD de la Faculté de droit Robson Hall, Université du Manitoba. Dès l'obtention de son JD en 2024, Matthew entreprendra un stage à la Cour canadienne de l'impôt.

### PRÉCIS

Dans le cadre de leur prise de décisions générales en matière de responsabilité sociale des entreprises (RSE), les sociétés utilisent les dons de bienfaisance. De l'extérieur, les efforts philanthropiques des entreprises peuvent sembler honorables et constituer un acte innocent. Cependant, les sociétés au Canada ont utilisé les dons de bienfaisance comme moyen de changer les programmes et obtenir une influence politique afin de favoriser leurs propres visions stratégiques. Cela peut créer une dynamique où les entités gouvernementales, les groupes de pression et d'autres représentants élus sont à risque d'ingérence, de persuasion ou d'influence de la part de sociétés qui peuvent offrir un financement philanthropique à ceux qui exercent une influence en matière de programmes et de politique. C'est bien documenté que les sociétés font des dons à diverses causes, recevant souvent des avantages fiscaux pour le faire, mais il y a aussi la question de savoir comment elles décident à qui elles devraient effectivement faire un don. Si les entreprises décident de faire des dons à des entités précises où elles seront en mesure d'influencer les décisions et les politiques dans des domaines connexes, cela revient sensiblement à l'achat d'influence déguisé en philanthropie. Les entreprises qui cachent, derrière les dons, des revendications politique et stratégique utilisent une subvention des contribuables pour exprimer leur voix. Est-ce que le Canada devrait essayer d'atténuer l'inférence sous la forme d'actions philanthropiques? Est-il moralement répréhensible pour les décideurs d'accepter des dons de bienfaisance de la part de ceux qui cherchent à obtenir des changements de politiques? De quelles façons les entreprises utilisent-elles la philanthropie pour imposer leurs souhaits stratégiques aux politiques qui les touchent directement? Quelles tendances sont suivies par les entreprises pour faire des dons de bienfaisance, et est-ce qu'elles changent lorsqu'il y a des remaniements de postes de direction au sein de l'entreprise?

# Best Newsletter Article by a Young Practitioner Award

For a ninth year, the Canadian Tax Foundation has presented the Best Newsletter Article by a Young Practitioner Award. Newsletter articles, in addition to being a valuable service to the profession in their own right, are often a stepping stone to lengthier pieces of writing, such as articles in the *Canadian Tax Journal* and papers for Foundation conferences. For a young practitioner (YP), early success in publishing newsletter articles may lead to a tax career in which writing is a regular and ongoing part of the individual's contribution to the profession.

The Foundation defines a YP as an individual who has 10 years or less of experience working in the taxation field after becoming fully qualified (for example, after receiving their professional designation). This year's award is given for the best newsletter article that (1) was written solely by one or more authors who was a YP at the time of publication, and (2) appeared in any of the four newsletters published by the Foundation in 2022: *Canadian Tax Focus*, *Tax for the Owner-Manager*, *Perspectives on Tax Law and Policy*, and *International Tax Highlights*. This year, most of the 57 articles eligible for the award appeared in *Canadian Tax Focus*, which generally publishes only articles of which the author (or one of the co-authors) is a YP. Seven eligible articles appeared in *Tax for the Owner-Manager*, and two articles appeared in *International Tax Highlights*.

A total of 10 of the articles eligible for the award were reviewed by a four-member committee whose members have been extensively involved with the Foundation through its publications and YP steering committees. The criteria applied by the committee were essentially the same as the criteria for the Foundation's Douglas J. Sherbaniuk Distinguished Writing Award. The members of the committee were

- Valérie Duchesneau, Ontario Ministry of Finance, Toronto;
- Shaira Nanji, Osler Hoskin & Harcourt LLP, Calgary;
- Anjali Navkar, Torys LLP, Toronto; and
- Katharine Skulski, Department of Finance Canada, Ottawa.

The committee gave the awards to six authors in respect of the following four articles:

- Dean Blachford (Blachford Tax Law, Ottawa: Dean@BlachfordTaxLaw.com) and Conor Leggott (Quintal Professional Corporation, Ottawa: conor @quintalpc.com), "A Proposed Four-Part Test for Evaluating ITC Eligibility" (2022) 22:2 *Tax for the Owner-Manager* 9-10.

- Will House (KPMG Law LLP, Vancouver: whouse@kpmg.ca) and James Painter (Anthem Properties Group Ltd., Vancouver: jpainter@anthemproperties.com), "Granting an Option To Acquire an Interest in a Partnership" (2022) 12:3 *Canadian Tax Focus* 8-9.
- William Musani (McLeod Law LLP, Calgary: wmusani@mcleod-law.com), "Crypto Tax: Did You Pay Your GST/HST?" (2022) 22:4 *Tax for the Owner-Manager* 8-9.
- Henry Shew (Our Family Office Inc., Toronto: henry@ourfamilyoffice.ca), "Incorrectly Executing the 50 Percent Solution on a Subsection 164(6) Redemption" (2022) 22:2 *Tax for the Owner-Manager* 12-14.

YPs (and anyone else) interested in writing for the Foundation's newsletters are invited to contact the newsletter editors: Alan Macnaughton (amacnaughton@uwaterloo.ca) for *Canadian Tax Focus*, Joan Jung (jejung@millerthomson.com) for *Tax for the Owner-Manager*, Jeffrey Trossman (jeffrey.trossman@blakes.com) for *Perspectives on Tax Law and Policy*, and Angelo Nikolakakis (angelo.nikolakakis@ca.ey.com) for *International Tax Highlights*. In Quebec, prospective contributors to the newsletters are invited to contact Éric Hamelin (eric.hamelin@usherbrooke.ca) of the Université de Sherbrooke, French content editor of *Canadian Tax Focus*, or Carl Deslongchamps (cdeslongchamps@ctf.ca) of the Quebec office.

Individuals interested in participating in any of the events and activities of the Foundation's YP chapters across Canada are invited to contact either the chair of their local chapter's steering committee or Robyn Corrigan (rcorrigan@ctf.ca) of the national office. For the Montreal and Quebec City chapters, they are invited to contact Carl Deslongchamps (cdeslongchamps@ctf.ca) of the Quebec office.

There are YP chapters in Calgary, Edmonton, Halifax, Kelowna, Kitchener-Waterloo, London, Mississauga, Montreal, Ottawa, Quebec City, Saskatoon, Toronto, Vancouver, and Winnipeg.

# Prix pour le meilleur article de bulletin par un jeune fiscaliste

Pour une neuvième année, la Fondation canadienne de fiscalité a remis le Prix pour le meilleur article de bulletin rédigé par un jeune fiscaliste. Les articles de bulletin, en plus d'apporter un service précieux à la profession en tant que telle, sont souvent un tremplin vers des écrits plus longs, comme des articles publiés dans la *Revue fiscale canadienne* et des articles présentés lors des conférences de la Fondation. Obtenir du succès pour la rédaction d'articles de bulletin tôt dans sa carrière en tant que jeune fiscaliste (JF) peut mener à un parcours en fiscalité où la rédaction constituera une part intégrante et continue de la contribution de cette personne à la profession.

La Fondation définit un JF comme une personne ayant 10 ans ou moins d'expérience de travail dans le domaine de la fiscalité, et ce, après l'obtention de ses qualifications (par exemple, après avoir reçu son titre professionnel). Cette année, ce prix est décerné pour le meilleur article de bulletin qui (1) a été rédigé exclusivement par un ou plusieurs auteurs qui étaient de JF au moment de la publication, et (2) a été publié dans l'un des quatre bulletins de la Fondation en 2022 : *Canadian Tax Focus*, *Actualités fiscales pour les propriétaires exploitants*, *Perspectives en fiscalité et en politique fiscale* et *Faits saillants de la fiscalité internationale*. La plupart des 57 articles admissibles cette année au prix ont paru dans *Canadian Tax Focus*, bulletin qui publie généralement des articles dont l'auteur (ou un des coauteurs) est un JF. Sept des articles admissibles ont été publiés dans *Actualités fiscales pour les propriétaires exploitants*, et deux articles ont paru dans *Faits saillants de la fiscalité internationale*.

Parmi les articles admissibles au prix, 10 ont été examinés par un comité constitué de quatre membres ayant été très impliqués dans les publications de la Fondation et dans ses comités directeurs pour JF. Les critères appliqués par le comité étaient essentiellement les mêmes que ceux pour le Prix d'excellence en rédaction Douglas J. Sherbaniuk de la Fondation. Les membres du comité étaient :

- Valérie Duchesneau, ministère des Finances de l'Ontario, Toronto;
- Shaira Nanji, Osler Hoskin & Harcourt S.E.N.C.R.L./s.r.l., Calgary;
- Anjali Navkar, Torys S.E.N.C.R.L., Toronto; et
- Katharine Skulski, ministère des Finances du Canada, Ottawa.

Le comité a décerné les prix à six auteurs pour les quatre articles suivants :

- Dean Blachford (Blachford Tax Law, Ottawa : Dean@BlachfordTaxLaw.com) et Conor Leggott (Quintal Professional Corporation, Ottawa : conor@quintalpc.com), « A Proposed Four-Part Test for Evaluating ITC Eligibility » (2022) 22:2 *Actualités fiscales pour les propriétaires exploitants* 9-10.
- Will House (KPMG Law s.r.l./S.E.N.C.R.L., Vancouver : whouse@kpmg.ca) et James Painter (Anthem Properties Group Ltd., Vancouver : jpainter@anthemproperties.com), « Granting an Option To Acquire an Interest in a Partnership » (2022) 12:3 *Canadian Tax Focus* 8-9.
- William Musani (McLeod Law LLP, Calgary : wmusani@mcleod-law.com), « Crypto Tax: Did You Pay Your GST/HST? » (2022) 22:4 *Actualités fiscales pour les propriétaires exploitants* 8-9.
- Henry Shew (Our Family Office Inc., Toronto : henry@ourfamilyoffice.ca), « Incorrectly Executing the 50 Percent Solution on a Subsection 164(6) Redemption » (2022) 22:2 *Actualités fiscales pour les propriétaires exploitants* 12-14.

Les JF (et toute autre personne) intéressés à rédiger des articles pour les bulletins de la Fondation sont invités à communiquer avec les rédacteurs en chef des bulletins : Alan Macnaughton (amacnaughton@uwaterloo.ca) pour *Canadian Tax Focus*, Joan Jung (jejung@millerthomson.com) pour *Actualités fiscales pour les propriétaires exploitants*, Jeffrey Trossman (jeffrey.trossman@blakes.com) pour *Perspectives en fiscalité et en politique fiscale* et Angelo Nikolakakis (angelo.nikolakakis@ca.ey.com) pour *Faits saillants de la fiscalité internationale*. Au Québec, les contributeurs potentiels aux bulletins sont invités à communiquer avec Éric Hamelin (eric.hamelin@usherbrooke.ca) de l'Université de Sherbrooke, rédacteur en chef du contenu français de *Canadian Tax Focus*, ou Carl Deslongchamps (cdeslongchamps@ctf.ca) au bureau du Québec.

Les personnes intéressées à participer aux événements et activités de l'une des divisions des JF de la Fondation au Canada sont invitées à communiquer avec le président ou la présidente du comité directeur de la division locale ou avec Robyn Corrigan (rcorrigan@ctf.ca) au bureau national. Pour les divisions de Montréal et de Québec, elles sont invitées à communiquer avec Carl Deslongchamps (cdeslongchamps@ctf.ca) au bureau du Québec.

Il y a des divisions de JF à Calgary, Edmonton, Halifax, Kelowna, Kitchener-Waterloo, London, Mississauga, Montréal, Ottawa, Québec, Saskatoon, Toronto, Vancouver et Winnipeg.

# Canadian Tax Foundation Lifetime Contribution Award

As of 2016, the Canadian Tax Foundation honours each year individuals who, through their volunteer efforts and body of work, have made substantial and outstanding contributions to the Foundation during their careers. The Lifetime Contribution Award is the most prestigious award conferred by the Foundation. The selection committee takes into account the individual's contributions to Foundation publications and conferences, service on the board of governors and other committees, and participation in other organizations and activities that further the Foundation's purposes.

The 2023 recipients were Bruce Ball and Penelope Woolford.

For further information about the nomination and selection process for this award, see the Foundation website.

# Prix de la Fondation canadienne de fiscalité pour une contribution exceptionnelle

Depuis 2016, la Fondation canadienne de fiscalité rend hommage chaque année à des personnes qui, par leur travail bénévole et leurs réalisations, ont contribué de façon importante et exceptionnelle à la Fondation au cours de leur carrière. Le Prix pour une contribution exceptionnelle est le prix le plus prestigieux décerné par la Fondation. Le comité de sélection prend en compte la contribution de la personne aux publications et aux conférences de la Fondation, son travail au sein du conseil des gouverneurs et d'autres comités, ainsi que sa participation à d'autres organisations et activités qui contribuent à la réalisation des objectifs de la Fondation.

Les lauréats de 2023 étaient Bruce Ball et Penelope Woolford.

Pour obtenir de plus amples renseignements sur le processus de nomination et de sélection pour ce prix, consultez le site Web de la Fondation.

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# Finances of the Nation

David Lin*

## SURVEY OF PROVINCIAL AND TERRITORIAL BUDGETS, 2023-24

*For almost 60 years, the Canadian Tax Foundation published an annual monograph,* Finances of the Nation, *and its predecessor,* The National Finances. *In a change of format, the 2014* Canadian Tax Journal *introduced a new "Finances of the Nation" feature, which presents annual surveys of provincial and territorial budgets and topical articles on taxation and public expenditures in Canada. This article surveys the 2023-24 provincial and territorial budgets.*

*The underlying data for the* Finances of the Nation *monographs and for the articles in this journal will be published online in the near future.*

**KEYWORDS:** BUDGETS ■ PROVINCIAL TAXES ■ TERRITORIAL ■ GOVERNMENT FINANCE ■ GOVERNMENT EXPENDITURES ■ PROGRAM BUDGETING

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## INTRODUCTION

This article has two distinct parts. First, it sets out tables and charts that show aggregate figures related to projected 2023-24 budget revenues and expenditures for the various provinces and territories, as well as tables that show corporate income tax rates, personal income tax brackets and rates, and other matters. Second, the article summarizes the projected budget revenues and expenditures in tabular form and also summarizes the tax changes in narrative form, for each province and territory.

## SUMMARY INFORMATION

The strong and fast economic recovery that provinces and territories saw in 2022 continued into 2023. Similar to 2022, almost every province or territory presented a significant revision of its forecasted deficit for the 2022-23 fiscal year when it tabled its budget for the 2023-24 fiscal year. British Columbia, Alberta, and Ontario all saw significant upward revisions when tabling their budgets for the 2023-24 fiscal year. High tax revenues continue to help reduce forecasted deficits, with many provinces and territories providing a medium-term outlook that navigates their budgets out of a deficit position.

The provinces and territories delivered their 2023-24 fiscal year budgets between February and May 2023. With inflation well over the Bank of Canada's targeted rate throughout 2022 and 2023, a common theme in all of the budgets delivered by the provinces and territories in 2023 was affordability for their residents. While this article focuses on tax changes, the provinces and territories delivered a wide variety of measures to improve affordability that were not limited to reducing the tax burden of their residents, including initiatives to increase the amount of affordable housing.

All of the territories—Yukon, the Northwest Territories, and Nunavut—delivered their budgets early in 2023. Yukon and the Northwest Territories forecasted budgetary surpluses for the 2023-24 fiscal year, of $48 million and $178 million, respectively. Nunavut forecasted a small budgetary deficit of $8 million, owing to ambitious spending plans. Nunavut is trying to make progress toward its *Katujjiluta* mandate, which includes the goal of providing at least 1,000 new housing units by the end of the government's mandate.[1]

British Columbia's 2023 budget, tabled on February 28, 2023, shows a projected budgetary deficit of $4.2 billion for the 2023-24 fiscal year. This is largely due to the government's investment in the future of the province—specifically, the investment of

> $8.7 billion more in operating funding across the fiscal plan to support new priority measures. This includes funding to help with rising costs, build more affordable homes, strengthen health care and mental health care, and fight climate change, while training people for good-paying jobs in a cleaner economy.[2]

Alberta's 2023 budget, tabled on February 28, 2023, shows a projected budgetary surplus of $2.4 billion for the 2023-24 fiscal year. The province's 2022-23 fiscal year budget had a significant revision upward to a budgetary surplus of $10.4 billion because "[o]il and natural gas prices were unexpectedly high in 2022-23 mainly due to Russia's invasion of Ukraine in February of 2022. Alberta government revenue reached a new record of $76 billion as a result."[3] Alberta's economic outlook forecasts continued budgetary surpluses through to the 2025-26 fiscal year; however, the province's revenue is volatile owing to Alberta's reliance on non-renewable resource revenue and related corporate income tax revenue. Accordingly, as the budget notes, Alberta has developed these forecasts "based on a moderate decline in energy prices, with improving global economic growth, but a great deal of uncertainty remains."[4]

Saskatchewan's 2023 budget, tabled on March 22, 2023, shows a projected budgetary surplus of $1 billion for the 2023-24 fiscal year. The budget notes that

1 Nunavut, Department of Finance, 2023 Budget, Budget Address, February 23, 2023, at 11.

2 British Columbia, Ministry of Finance, 2023 Budget, Budget Plan, February 28, 2023, at 1.

3 Alberta, Treasury Board and Ministry of Finance, 2023 Budget, Budget Plan, February 28, 2023, at 11.

4 Ibid., at 12.

> [t]he momentum for ongoing growth in 2023 builds from an exceptional economic performance in 2022, which was primarily driven by high commodity prices, a strong labour market, increased investment, and a rebound in crop production from the drought of 2021 (the worst experienced in the province in nearly two decades).[5]

With strong economic growth in the 2022-23 fiscal year, the medium-term financial outlook included in the budget now forecasts budgetary surpluses through to the 2026-27 fiscal year.

Manitoba's 2023 budget, tabled on March 7, 2023, shows a projected budgetary deficit of $363 million for the 2023-24 fiscal year. Manitoba has balanced budget legislation contained in the Fiscal Responsibility and Taxpayer Protection Act[6] (FRTPA), which requires the government not to incur a deficit greater than a baseline amount and penalizes ministers by reducing their salaries if the deficit is not reduced by at least $100 million per year. Manitoba's 2020 budget indicated that amendments to the FRTPA would be forthcoming. Bill 48, the Fiscal Responsibility and Taxpayer Protection Amendment Act, received royal assent on May 20, 2021.[7] It changes the FRTPA to reset the baseline amount for 2020-21 to the deficit reported, allows the government to exclude COVID-19 pandemic expenditures in determining the deficit for the 2021-22 fiscal year for the purposes of the FRTPA, and provides a timeline of eight years for the government to eliminate the budgetary deficit. The 2023 budget still forecasts budgetary deficits for the province through to the 2026-27 fiscal year, but indicates that the province is "on track to balance the budget by 2028/29."[8]

Ontario's 2023 budget, tabled on March 23, 2023, shows a projected budgetary deficit of $1.3 billion for the 2023-24 fiscal year. The budget also shows a significant revision of the forecasted deficit for the 2022-23 fiscal year, from $19.9 billion, as originally forecasted, to $2.2 billion. Ontario states that the reason for this adjustment is the 2023 budget projects revenues in the 2022-23 fiscal year to be

> $20.6 billion higher than forecast in the *2022 Budget*. This increase is largely driven by higher taxation revenue as a result of higher tax assessments for 2021 and prior years, based on information received from the Canada Revenue Agency (CRA) since the release of the *2022 Budget*.[9]

In 2020, amendments were made to the Fiscal Sustainability, Transparency and Accountability Act, 2019[10] that paused the requirement to include a recovery plan to return to a balanced budget in the 2020-21 fiscal year. The province's 2023 budget forecasts a return to a budgetary surplus in the 2024-25 fiscal year.

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5 Saskatchewan, Ministry of Finance, 2023 Budget, March 22, 2023, at 30.

6 CCSM c. F84.

7 SM 2021, c. 42.

8 Manitoba, Department of Finance, 2023 Budget, Budget Plan, March 7, 2023, at 25.

9 Ontario, Ministry of Finance, 2023 Budget, March 23, 2023, at 129 (emphasis in original).

10 SO 2019, c. 7, schedule 30.

Quebec's 2023 budget, tabled on March 21, 2023, projects a budgetary deficit of $1.6 billion, excluding any deposits of dedicated revenues in the Generations Fund, a fund dedicated exclusively to repaying the province's debt. Quebec's Balanced Budget Act[11] (BBA) requires that the government balance the budget within five years subsequent to a budgetary deficit arising as a result of a disaster or significant deterioration of economic conditions. The 2021 budget indicated that "the government wishes to suspend the effects of the *Balanced Budget Act* as of 2021-2022 in order to gradually reduce the deficit without hindering services to Quebecers or a sustainable recovery of economic growth,"[12] and amended the BBA to eliminate the obligation to table a budget that restores fiscal balance and to implement measures to reduce the budget overruns. The 2023 budget notes that "the Minister of Finance is lifting the suspension of these effects as of the end of fiscal 2022-2023."[13] Accordingly, the 2023 budget includes a plan to restore the province to a balanced budget by the 2027-28 fiscal year. The 2023 budget also indicates that the government wishes to modernize the BBA to "improve fiscal flexibility in determining the fiscal balance" and "abolish the stabilization reserve," with details to be provided at a later date.[14]

Most of the Atlantic provinces continue to report budgetary deficits in their budgets for the 2023-24 fiscal year. New Brunswick continues to be the exception, with its 2023 budget, tabled on March 21, 2023, forecasting a budgetary surplus of $41 million for the 2023-24 fiscal year and continued budgetary surpluses through to the 2025-26 fiscal year. Nova Scotia's 2023 budget, tabled on March 23, 2023, projects a budgetary deficit of $279 million in the 2023-24 fiscal year, with continued budgetary deficits through to the 2026-27 fiscal year. The 2023 budget states that

> [t]he Government of Nova Scotia continues to place emphasis on achieving a sustainable fiscal position. The four-year fiscal plan reflects that the deficits being incurred to fix healthcare and address other priorities are manageable and within Nova Scotia's growing economic capacity.[15]

Prince Edward Island's 2023 budget, tabled on May 25, 2023, projects a budgetary deficit of $98 million for the 2023-24 fiscal year and continued budgetary deficits through to the 2025-26 fiscal year, with no indication of how the province plans to return to a balanced budget. Newfoundland and Labrador's 2023 budget, delivered on March 23, 2023, projects a budgetary deficit of $160 million for the 2023-24 fiscal year, but forecasts a return to a balanced budget for the 2024-25 fiscal year onward.

11 CQLR c. E-12.00001.

12 Québec, Finances Québec, 2021-2022 Budget, Budget Plan, March 25, 2021, at H.23.

13 Québec, Finances Québec, 2023-2024 Budget, Budget Plan, March 21, 2023, at H.28.

14 Ibid.

15 Nova Scotia, Department of Finance and Treasury Board, 2023 Budget, March 23, 2023, at 2.

Overall, the provinces and territories continued to deliver status-quo budgets for the 2023-24 fiscal year, with significant investments and budget measures to try to improve affordability for their residents.

Table 1 aggregates the projected budget revenue and expenditure items in each province and territory for the 2023-24 fiscal year. The figures reflect the budget summaries presented in the second part of this article. The different jurisdictions' budget projections are not strictly comparable, owing in part to accounting differences across the provinces and territories.[16] The placement of the various jurisdictions' figures in a single table remains useful as a way of illustrating trends and distinctions that can stimulate discussion. The provinces and territories are listed in descending order based on each jurisdiction's original budget projection of its expected tax revenue.

Figure 1 presents similar information and includes surpluses and deficits at the right of the figure. Each projected revenue source amount is shown as a percentage of total revenues, and the projected surplus or deficit is shown as a percentage of total expenditures. Figure 2 shows projected tax revenues by source as a percentage of total revenues. Figure 3 shows projected expenditures by spending category as a percentage of total expenditures, and health-care expenditures per capita.

The provinces and territories have the primary responsibility for education, health, and social services expenditures. Across all jurisdictions, health-care expenditures for the 2023-24 fiscal year averaged 38.8 percent of total expenditures, as shown in table 2. For example, for the 2023-24 fiscal year, Ontario projected health-care and long-term-care expenditures of $81,009 million or 39.58 percent of total expenditures ($204,680 million, as shown in table 16). In contrast, in the territories, projected spending on health care in 2023-24 accounted for 17.95 percent of total expenditures for Nunavut, 27.65 percent for the Northwest Territories, and 29.78 percent for Yukon. However, on a per capita basis, the results for the territories vis-à-vis Ontario appeared to reverse. These trends are reflected in table 3, which sets out the health-care expenditures (as projected in the 2017-18 to 2023-24 budgets) as a percentage of total expenditures and per capita in Ontario and the territories.

Table 4 sets out the health-care expenditure projections for all the provinces and territories for 2023-24 as a percentage of total expenditures and per capita. Again, these amounts may not be strictly comparable, given accounting differences in the way COVID-19-related health expenditures are reported. Some provinces and territories have carved out COVID-19-related health expenditures into separate line items that may not be reflected in the health-care expenditures reported in this table. Furthermore, demographic factors, including the age distribution of the population,

16 For a discussion of accounting differences between Canadian jurisdictions, see Colin Busby and William B.P. Robson, *Credibility on the (Bottom) Line: The Fiscal Accountability of Canada's Senior Governments, 2013*, C.D. Howe Institute Commentary no. 404 (Toronto: C.D. Howe Institute, 2014). For a reconciliation of changes in the Alberta budget, see Ronald Kneebone and Margarita Wilkins, "Recent Changes to Provincial Government Budget Reporting in Alberta" (2018) 11:1 *SPP Communiqué* [University of Calgary School of Public Policy] 1-8 (https://doi.org/10.11575/sppp.v11i0.43275).

**TABLE 1 Provincial and Territorial Revenues and Expenditures, Budget Projections, Fiscal Year 2023-24**

| Province/territory | Tax revenue | Federal transfers | Other sources of revenue[a] | Total revenues | Total expenditures | Adjustments[b] | Surplus/ (deficit) |
|---|---|---|---|---|---|---|---|
| | | | *millions of dollars* | | | | |
| Ontario | 144,222 | 34,844 | 25,301 | 204,367 | (204,680) | (1,000) | (1,313) |
| Quebec[c] | 92,736 | 29,742 | 25,253 | 147,731 | (147,856) | (1,500) | (1,625) |
| British Columbia | 45,324 | 13,593 | 18,773 | 77,690 | (81,206) | (700) | (4,216) |
| Alberta | 24,992 | 12,552 | 33,109 | 70,653 | (66,782) | (1,500) | 2,371 |
| Manitoba | 10,304 | 7,299 | 4,111 | 21,714 | (21,877) | (200) | (363) |
| Saskatchewan | 9,634 | 3,555 | 6,489 | 19,678 | (18,660) | | 1,018 |
| Nova Scotia | 7,584 | 4,814 | 1,771 | 14,169 | (14,820) | 372 | (279) |
| New Brunswick | 5,749 | 4,602 | 1,842 | 12,193 | (12,152) | | 41 |
| Newfoundland and Labrador | 4,405 | 2,229 | 3,055 | 9,689 | (9,849) | | (160) |
| Prince Edward Island | 1,446 | 1,215 | 334 | 2,995 | (3,093) | | (98) |
| Northwest Territories | 343 | 1,993 | 149 | 2,485 | (2,206) | (101) | 178 |
| Yukon | 171 | 1,327 | 373 | 1,871 | (1,773) | (50) | 48 |
| Nunavut | 165 | 2,527 | 146 | 2,838 | (2,796) | (50) | (8) |

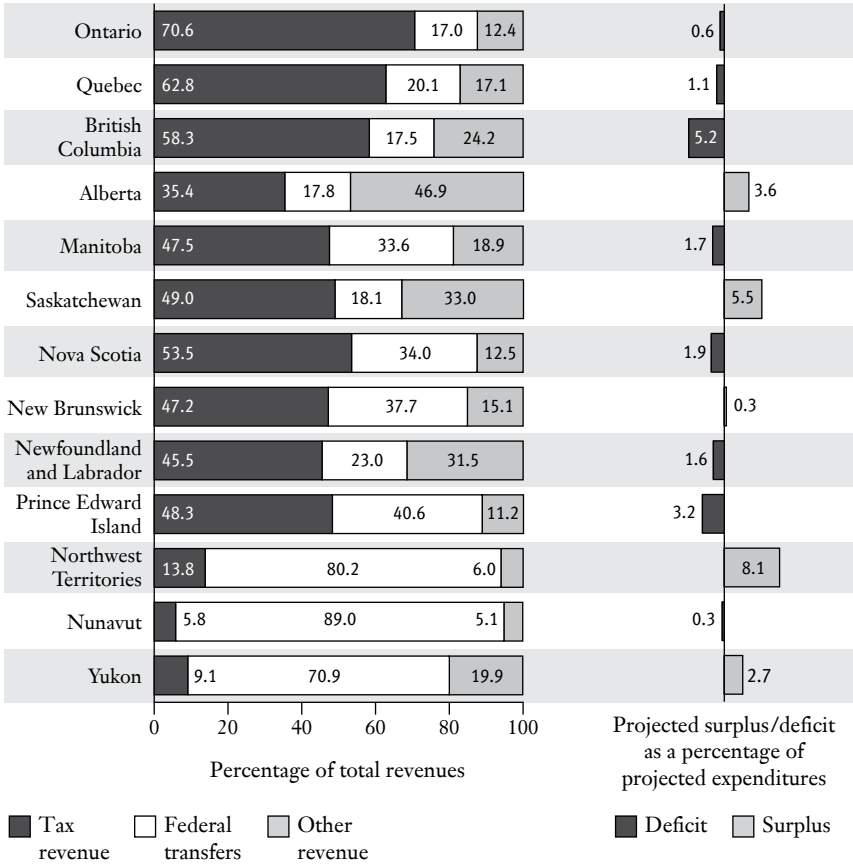
a Other sources of revenue may include, but are not limited to, resource royalties; premiums, fees, and licences; commercial Crown corporation transfers; and investment income.

b Adjustments included consolidation numbers (in some cases) and transfers to and from reserve funds.

c Taxfilers in Quebec qualify for the Quebec abatement, which reduces their federal income tax by 16.5 percentage points. Of this amount, 13.5 percentage points relate to opting-out arrangements for certain federal-provincial programs, such as hospital care and social welfare, where Quebec increased its personal income taxes by an equivalent amount. Quebec receives the value through increased provincial tax revenue, while other provinces receive the corresponding amounts in cash. The remaining 3.0 percentage points relate to the youth allowances recovery, which the federal government recovers each year from Quebec. None of the amounts presented in this table and elsewhere in this article are adjusted for the Quebec abatement.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

**FIGURE 1 Projected Provincial and Territorial Revenues by Source, as a Percentage of Total Revenues, and Projected Surplus/Deficit as a Percentage of Projected Expenditures, Fiscal Year 2023-24**



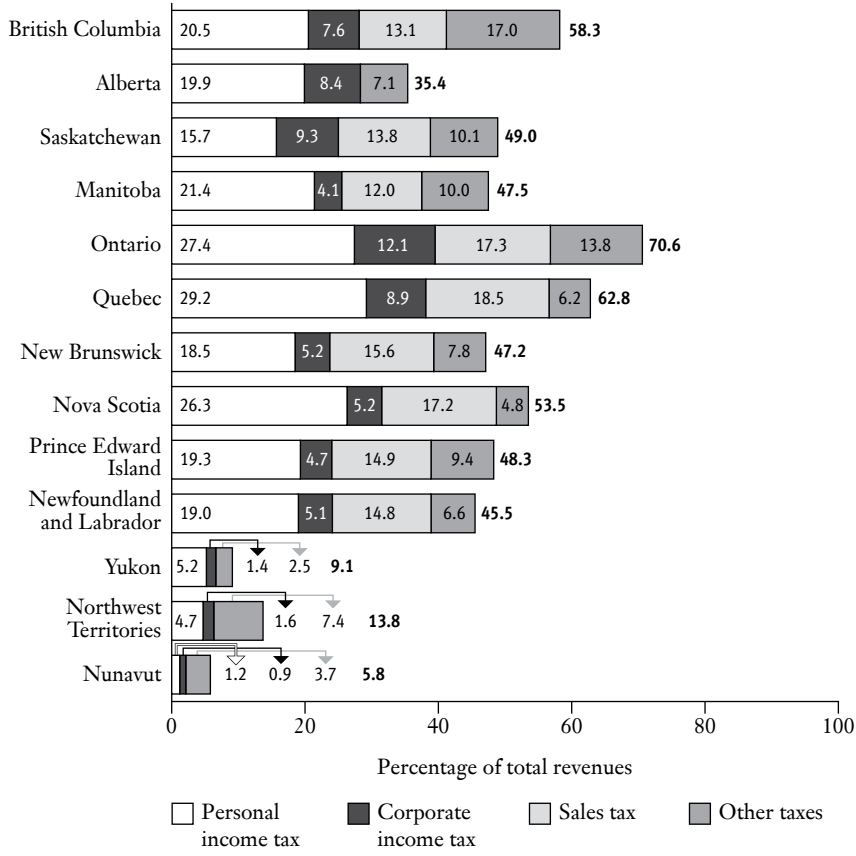

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24 and the data summary in table 1.

will vary between provinces and territories, and will likely affect their health-care expenditures. An article in this feature in 2020 examined the sustainability of Canada's public debt and provincial debt given the economic shock from COVID-19 and the potential effect of aging on provincial health expenditures.[17]

Table 5 shows the provincial and territorial surpluses and deficits since the (revised) budget projections for 2018-19 and also includes figures set out in the most recently

17 Trevor Tombe, "Provincial Debt Sustainability in Canada: Demographics, Federal Transfers, and COVID-19," Finances of the Nation feature (2020) 68:4 *Canadian Tax Journal* 1083-1122.

**FIGURE 2 Projected Provincial and Territorial Tax Revenues by Source as a Percentage of Total Revenues, Fiscal Year 2023-24**

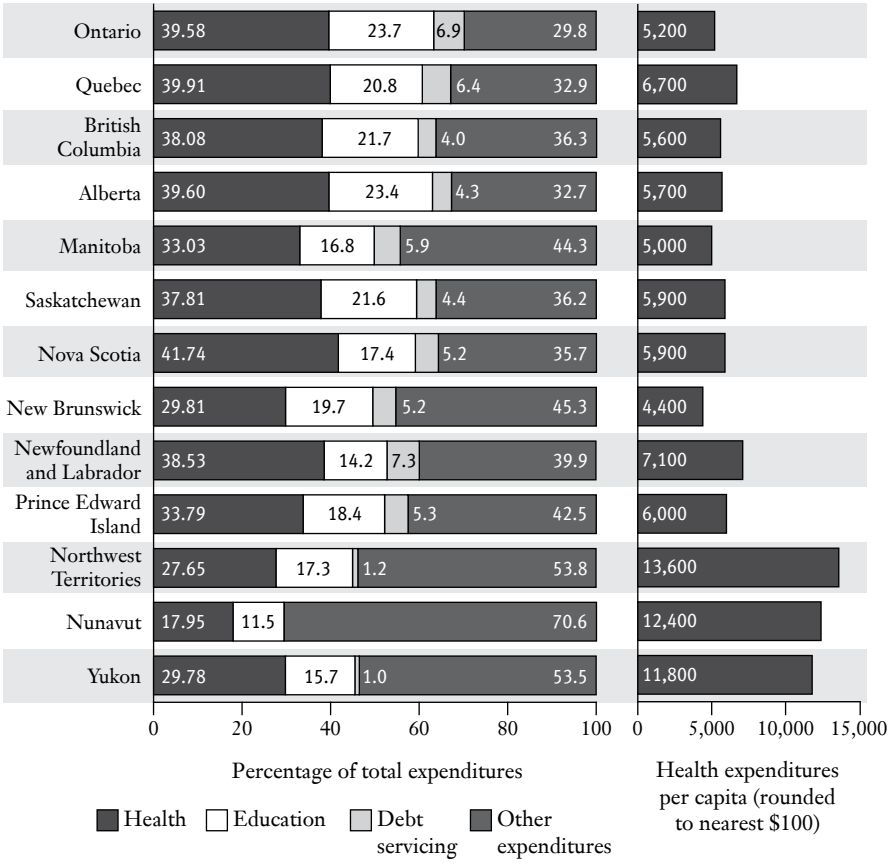



Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

issued 2023-24 budgets for planned or targeted budgetary surpluses or deficits for the ensuing two, three, or four fiscal years. The short-term and medium-term outlooks in the 2023-24 budgets indicate that many provinces and territories expect to remain in a balanced budget position in future years or see a path to return to a balanced budget soon.

On the basis of budget projections in the tables set out in the second part of this article, projected aggregate income tax revenue in the 2023-24 budgets of all provinces and territories was $145.5 billion from personal income tax and $54.5 billion from corporate income tax, for total revenue of $200.0 billion from income tax. Projected aggregate sales tax revenue was $84.4 billion, for a total of $138.9 billion from sources other than personal income tax (that is, corporate income tax and sales

**FIGURE 3 Projected Provincial and Territorial Expenditures by Spending Category as a Percentage of Total Expenditures, Fiscal Year 2023-24**




Source: Based on provincial and territorial budget documents cited in the source notes for tables 4 and 12-24.

tax). Thus, as has been the case since 2014, in 2023-24 the provinces and territories expect to collect more tax revenue from personal income tax than from corporate income tax and sales tax combined. There continues to be significant growth of personal income tax and corporate income tax revenues forecasted for 2023-24. Surprisingly, the 2023 federal fall economic statement projects only modest growth in personal income tax revenue and a decline in corporate income tax revenue for the 2023-24 fiscal year, with $218.0 billion of revenue forecasted from personal income tax, $79.8 billion from corporate income tax, and $13.4 billion from non-resident income tax, for a total of $311.2 billion from income tax, plus $52.1 billion from

**TABLE 2 Provincial and Territorial Health-Care Expenditures, Budget Projections, Fiscal Years 2020-21 to 2023-24**

| Province/territory | Health-care expenditures | | | | Percentage of total expenditures | | | |
|---|---|---|---|---|---|---|---|---|
| | 2020-21[a] | 2021-22 | 2022-23 | 2023-24 | 2020-21[a] | 2021-22 | 2022-23 | 2023-24 |
| | *millions of dollars* | | | | *percent* | | | |
| Ontario | 64,646 | 69,781 | 75,165 | 81,009 | 34.56 | 37.49 | 37.84 | 39.58 |
| Quebec | 52,459 | 52,358 | 55,842 | 59,015 | 41.28 | 40.35 | 40.18 | 39.91 |
| British Columbia | 24,595 | 26,106 | 27,685 | 30,927 | 35.10 | 40.55 | 38.99 | 38.08 |
| Alberta | 20,616 | 21,418 | 22,018 | 26,446 | 33.94 | 37.36 | 37.08 | 39.60 |
| Manitoba | 7,460 | 6,624 | 6,741 | 7,226 | 38.43 | 34.08 | 34.98 | 33.03 |
| Saskatchewan | 6,248 | 6,535 | 6,824 | 7,056 | 38.62 | 38.24 | 38.73 | 37.81 |
| Nova Scotia | 5,285 | 5,333 | 5,471 | 6,186 | 42.88 | 42.76 | 41.16 | 41.74 |
| New Brunswick | 2,946 | 3,097 | 3,266 | 3,623 | 28.64 | 29.15 | 28.87 | 29.81 |
| Newfoundland and Labrador | 3,352 | 3,420 | 3,592 | 3,795 | 37.38 | 36.60 | 38.13 | 38.53 |
| Prince Edward Island | 808 | 846 | 911 | 1,045 | 33.44 | 33.81 | 34.22 | 33.79 |
| Northwest Territories | 522 | 597 | 595 | 610 | 27.53 | 29.66 | 28.94 | 27.65 |
| Yukon | 461 | 490 | 510 | 528 | 30.29 | 29.38 | 29.11 | 29.78 |
| Nunavut | 496 | 496 | 472 | 502 | 21.31 | 21.32 | 18.81 | 17.95 |

Note: Owing to accounting differences between provinces and territories, direct comparison of the above numbers is not strictly appropriate. This is especially true for the 2020-21 through 2022-23 fiscal years because of potential variations in the reporting of COVID-19 expenditures, which would affect the health-care expenditures reported.

a Owing to COVID-19, amounts presented were from the province's or territory's budget or fiscal update, whichever was released later in the year.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

**TABLE 3 Health-Care Expenditures in Ontario and the Territories as a Percentage of Total Expenditures and per Capita, 2017-18 to 2023-24**

| | Health-care expenditures as a percentage of total expenditures | | | | Health-care expenditures per capita | |
|---|---|---|---|---|---|---|
| Fiscal year | Ontario | Nunavut | Northwest Territories | Yukon | Ontario | Territorial (Nunavut, Northwest Territories, Yukon) range |
| | *percent* | | | | *dollars* | |
| 2017-18 . . . . . | 38.12 | 18.03 | 25.00 | 35.18 | 3,800 | 9,500-12,100 |
| 2018-19 . . . . . | 38.13 | 18.81 | 26.97 | 32.21 | 4,300 | 10,400-11,200 |
| 2019-20 . . . . . | 38.97 | 21.54 | 27.52 | 30.88 | 4,400 | 10,900-12,000 |
| 2020-21 . . . . . | 34.56 | 21.31 | 27.53 | 30.29 | 4,400 | 11,000-12,600 |
| 2021-22 . . . . . | 37.49 | 21.32 | 29.66 | 29.38 | 4,700 | 11,400-13,100 |
| 2022-23 . . . . . | 37.84 | 18.81 | 28.94 | 29.11 | 5,000 | 11,600-13,000 |
| 2023-24 . . . . . | 39.58 | 17.95 | 27.65 | 29.78 | 5,200 | 11,800-13,600 |

Sources: Numbers for 2017-18 through 2018-19 are from Vivien Morgan, "Survey of Provincial and Territorial Budgets, 2017-18," Finances of the Nation feature (2018) 66:1 *Canadian Tax Journal* 37-109, at 47; and "Survey of Provincial and Territorial Budgets, 2018-19," Finances of the Nation feature (2019) 67:1 *Canadian Tax Journal* 81-160, at 91. Numbers for 2019-20 through 2022-23 are from David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," Finances of the Nation feature (2020) 68:1 *Canadian Tax Journal* 185-250, at 196; "Survey of Provincial and Territorial Budgets, 2020-21," Finances of the Nation feature (2021) 69:1 *Canadian Tax Journal* 145-215, at 156; "Survey of Provincial and Territorial Budgets, 2021-22," Finances of the Nation feature (2022) 70:1 *Canadian Tax Journal* 125-85, at 136; and "Survey of Provincial and Territorial Budgets, 2022-23," Finances of the Nation feature (2023) 71:1 *Canadian Tax Journal* 217-72, at 228. Numbers for 2023-24 are from this article. Population data are from Statistics Canada table 17-10-0009-01 (formerly CANSIM table 051-0005), "Population Estimates, Quarterly," averaged for the 2023 calendar year (www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000901). Because the budget numbers were estimated and the population data can vary, the per capita numbers are rounded to the nearest hundred dollars.

sales tax[18]—for a total of $145.3 billion from sources other than personal income tax (corporate income tax, non-resident income tax, and sales tax). The 2023 federal fall economic statement notes that the increase in personal income tax revenues is "due to increased labour income from higher levels of employment and rising wages"[19] and the decrease in corporate income tax revenues is "due to the projected slowdown in economic growth, lower year-to-date corporate income tax receipts and lower corporate profits in 2023-24, particularly in the non-financial sector."[20] See table 6 for a tabular presentation of the revenue projections set out above, compared to

18 Canada, Department of Finance, Fall Economic Statement 2023, November 21, 2023, at 78, table A1.5.

19 Ibid., at 79.

20 Ibid.

**TABLE 4 Health-Care Expenditures as a Percentage of Total Expenditures and per Capita, Budget Projections, 2023-24**

| Province/territory | Health-care expenditures | Population | Health-care expenditures as a percentage of total expenditures | Health-care expenditures per capita |
|---|---|---|---|---|
| | *millions of dollars* | *'000s* | *%* | *dollars* |
| British Columbia | 30,927 | 5,499.5 | 38.08 | 5,600 |
| Alberta | 26,446 | 4,673.8 | 39.60 | 5,700 |
| Saskatchewan | 7,056 | 1,205.9 | 37.81 | 5,900 |
| Manitoba | 7,226 | 1,449.2 | 33.03 | 5,000 |
| Ontario | 81,009 | 15,561.3 | 39.58 | 5,200 |
| Quebec | 59,015 | 8,851.1 | 39.91 | 6,700 |
| New Brunswick | 3,623 | 831.2 | 29.81 | 4,400 |
| Nova Scotia | 6,186 | 1,053.3 | 41.74 | 5,900 |
| Prince Edward Island | 1,045 | 172.8 | 33.79 | 6,000 |
| Newfoundland and Labrador | 3,795 | 537.6 | 38.53 | 7,100 |
| Northwest Territories | 610 | 44.7 | 27.65 | 13,600 |
| Yukon | 528 | 44.8 | 29.78 | 11,800 |
| Nunavut | 502 | 40.6 | 17.95 | 12,400 |

Note: Owing to accounting differences between provinces and territories, direct comparison of the above numbers is not strictly appropriate. Because the budget numbers were estimated and the population data can vary, the per capita numbers are rounded to the nearest hundred dollars.

Sources: Table 2; and population data from Statistics Canada table 17-10-0009-01 (formerly CANSIM table 051-0005), "Population Estimates, Quarterly," averaged for the 2023 calendar year (www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000901).

projections for fiscal years 2017-18 to 2023-24. Table 6A shows the projected tax revenues for each province and territory as detailed in the 2023-24 budgets, including total and per capita amounts.

Table 7 shows the statutory corporate income tax rates in the provinces and territories for 2023.

From a personal income tax perspective, most jurisdictions have established a higher tax rate bracket for high income earners over the past decade: British Columbia (for 2014, 2015, and from 2018 onward), Ontario (from 2012), Quebec (from 2013), Nova Scotia (from 2010), and Alberta, New Brunswick, Newfoundland and Labrador, and Yukon (all from 2015). Manitoba and Prince Edward Island have not established a higher tax rate bracket for high income earners, given that in both provinces the highest marginal tax rate applies at relatively lower levels of income. However, Prince Edward Island and Ontario impose a surtax on high income earners.

Personal income tax amounts are indexed for inflation in most provinces and all three territories. Only two provinces do not index personal income tax amounts for inflation: Nova Scotia and Prince Edward Island. However, Prince Edward Island's

**TABLE 5 Revised, Projected, and Planned Provincial and Territorial Surpluses and Deficits, 2018-19 and Onward**

| Province/territory | 2018-19 budget [revised] | 2019-20 budget [revised] | 2020-21 budget[a] [revised] | 2021-22 budget [revised] | 2022-23 budget [revised] | 2023-24 budget | 2024-25 plan | 2025-26 plan | 2026-27 plan | 2027-28 plan |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | *millions of dollars* | | | | | |
| British Columbia | 219<br>[374] | 274<br>[1,354] | (13,643)<br>[(8,144)] | (9,698)<br>[(483)] | (5,461)<br>[3,592] | (4,216) | (3,754) | (3,043) | | |
| Alberta | (8,802)<br>[(6,711)] | (8,704)<br>[12,152] | (21,239)<br>[(20,192)] | (18,221)<br>[(3,207)] | 511<br>[10,390] | 2,371 | 2,037 | 1,369 | | |
| Saskatchewan | (365)<br>[(380)] | 34<br>[(319)] | (2,130)<br>[(1,865)] | (2,611)<br>[(2,185)] | (463)<br>[1,147] | 1,018 | 208 | 134 | 101 | |
| Manitoba | (521)<br>[(470)] | (360)<br>[(325)] | (2,048)<br>[(2,080)] | (1,597)<br>[(1,393)] | (548)<br>[(378)] | (363) | (294) | (197) | (53) | |
| Ontario | (14,544)<br>[(7,435)] | (9,024)<br>[(8,672)] | (38,468)<br>[(38,468)] | (33,108)<br>[(13,496)] | (19,850)<br>[(2,170)] | (1,313) | 200 | 4,400 | | |
| Quebec | 904<br>[5,606] | 2,504<br>[2,638] | (338)<br>[(3,226)] | (9,170)<br>[(3,897)] | (3,005)<br>[(1,670)] | (1,625) | (597) | 544 | 1,731 | 2,842 |
| New Brunswick | (189)<br>[5] | 23<br>[98] | (299)<br>[(13)] | (245)<br>[488] | 35<br>[863] | 41 | 27 | 39 | | |
| Nova Scotia | 29<br>[28] | 34<br>[41] | (779)<br>[(706)] | (585)<br>[108] | (506)<br>[(259)] | (279) | (464) | (611) | (499) | |
| Prince Edward Island | 2<br>[14] | 2<br>[(4)] | (173)<br>[(120)] | (112)<br>[(27)] | (93)<br>[(66)] | (98) | (58) | (32) | | |

(Table 5 is concluded on the next page.)

**TABLE 5 Concluded**

| Province/territory | 2018-19 budget [revised] | 2019-20 budget [revised] | 2020-21 budget[a] [revised] | 2021-22 budget [revised] | 2022-23 budget [revised] | 2023-24 budget | 2024-25 plan | 2025-26 plan | 2026-27 plan | 2027-28 plan |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | *millions of dollars* | | | | | |
| Newfoundland and Labrador | (683)<br>[(521)] | 1,924<br>[1,114] | (1,838)<br>[(1,644)] | (825)<br>[(400)] | (351)<br>[784] | (160) | 297 | 286 | 71 | 25 |
| Northwest Territories | 23<br>[40] | 60<br>[(70)] | 203<br>[(31)] | 69<br>[28] | 131<br>[3] | 178 | 228 | 155 | 124 | |
| Yukon | (5)<br>[(7)] | (6)<br>[(19)] | 4<br>[(7)] | (7)<br>[25] | 39<br>[44] | 48 | 59 | 45 | | |
| Nunavut | (54)<br>[(105)] | (34)<br>[(56)] | (30)<br>[(21)] | (14)<br>[16] | 40<br>[68] | (8) | 113 | 227 | | |

a Because of COVID-19, the budgeted amounts presented are from the province's or territory's budget or fiscal update, whichever was released later in the year.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

**TABLE 6 Comparison of Projected Revenues from Personal and Corporate Income Tax, Sales Tax, and Non-Resident Tax—Federal, Provincial, and Territorial Jurisdictions, 2017-18 to 2023-24**

| | Federal | | | | | | Provincial and territorial | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | PIT | CIT | Non-resident tax | Sales tax | Income tax | Non-PIT | PIT | CIT | Sales tax | Income tax | Non-PIT |
| Fiscal year | (1) | (2) | (3) | (4) | (1+2+3) | (2+3+4) | (5) | (6) | (7) | (5+6) | (6+7) |
| | | | | | | *millions of dollars* | | | | | |
| 2017-18 | 152.1 | 43.6 | 6.9 | 35.1 | 202.6 | 85.6 | 99.3 | 31.0 | 57.7 | 130.3 | 88.7 |
| 2018-19 | 161.4 | 47.3 | 8.3 | 37.7 | 217.0 | 93.3 | 99.9 | 34.2 | 64.6 | 134.0 | 98.8 |
| 2019-20 | 170.4 | 46.3 | 9.7 | 40.8 | 226.4 | 96.8 | 105.8 | 35.8 | 67.1 | 141.5 | 102.8 |
| 2020-21 | 162.1 | 39.2 | 9.9 | 29.4 | 211.2 | 78.5 | 107.2 | 26.0 | 60.4 | 133.2 | 86.4 |
| 2021-22 | 185.6 | 57.3 | 10.6 | 42.0 | 253.5 | 109.9 | 108.4 | 30.4 | 68.4 | 138.8 | 98.8 |
| 2022-23 | 209.4 | 91.0 | 13.8 | 47.2 | 314.2 | 152.0 | 126.7 | 43.6 | 78.5 | 170.3 | 122.1 |
| 2023-24 | 218.0 | 79.8 | 13.4 | 52.1 | 311.2 | 145.3 | 145.5 | 54.5 | 84.4 | 200.0 | 138.9 |

CIT = corporate income tax; PIT = personal income tax.

Sources: Numbers for 2017-18 through 2018-19 are from Vivien Morgan, "Survey of Provincial and Territorial Budgets, 2017-18," Finances of the Nation feature (2018) 66:1 *Canadian Tax Journal* 37-109; and "Survey of Provincial and Territorial Budgets, 2018-19," Finances of the Nation feature (2019) 67:1 *Canadian Tax Journal* 81-160, at 96. Numbers for 2019-20 through 2022-23 are from David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," Finances of the Nation feature (2020) 68:1 *Canadian Tax Journal* 185-250, at 200; "Survey of Provincial and Territorial Budgets, 2020-21," Finances of the Nation feature (2021) 69:1 *Canadian Tax Journal* 145-215, at 161; "Survey of Provincial and Territorial Budgets, 2021-22," Finances of the Nation feature (2022) 70:1 *Canadian Tax Journal* 125-85, at 141; and "Survey of Provincial and Territorial Budgets, 2022-23," Finances of the Nation feature (2023) 71:1 *Canadian Tax Journal* 217-72, at 232. Numbers for 2023-24 are from this article and from Canada, Department of Finance, Fall Economic Statement, November 21, 2023, at 78, table A1.5.

**TABLE 6A Projected Tax Revenues for Provinces and Territories, by Category and per Capita, 2023-24**

| Province/territory | PIT | CIT | Sales tax | Other | Total | Per capita |
|---|---|---|---|---|---|---|
| | | | *millions of dollars* | | | *dollars* |
| British Columbia | 15,953 | 5,938 | 10,187 | 13,246 | 45,324 | 8,200 |
| Alberta | 14,069 | 5,911 | na | 5,012 | 24,992 | 5,300 |
| Saskatchewan | 3,092 | 1,825 | 2,720 | 1,997 | 9,634 | 8,000 |
| Manitoba | 4,646 | 886 | 2,602 | 2,170 | 10,304 | 7,100 |
| Ontario | 55,982 | 24,668 | 35,350 | 28,222 | 144,222 | 9,300 |
| Quebec | 43,126 | 13,192 | 27,290 | 9,128 | 92,736 | 10,500 |
| New Brunswick | 2,261 | 636 | 1,902 | 950 | 5,749 | 6,900 |
| Nova Scotia | 3,731 | 740 | 2,438 | 675 | 7,584 | 7,200 |
| Prince Edward Island | 578 | 142 | 445 | 281 | 1,446 | 8,400 |
| Newfoundland and Labrador | 1,843 | 496 | 1,431 | 635 | 4,405 | 8,200 |
| Northwest Territories | 118 | 40 | na | 185 | 343 | 7,700 |
| Yukon | 98 | 27 | na | 46 | 171 | 3,800 |
| Nunavut | 34 | 25 | na | 106 | 165 | 4,100 |
| Total and per capita average | 145,531 | 54,526 | 84,365 | 62,653 | 347,075 | 8,700 |

CIT = corporate income tax; PIT = personal income tax.

Sources: Based on provincial and territorial budget documents cited in the source notes for tables 12-24, and on population data from Statistics Canada table 17-10-0009-01 (formerly CANSIM table 051-0005), "Population Estimates, Quarterly" averaged for the 2023 calendar year (www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000901).

2023 budget notes that the government "will implement income tax reform measures. Beginning in 2024, the current three brackets and rates, plus the surtax that acts like a fourth bracket, will be replaced with a five-bracket system."[21]

Surtaxes are sometimes applied in addition to regular provincial or territorial personal income tax. All federal, provincial, and territorial marginal personal income tax rates on ordinary income and interest, as well as surtaxes, are shown in graphic form in figure 4 as a function of taxable income. Table 8 sets out the provincial and territorial personal income tax brackets and rates for 2023.

Table 9 shows the sales tax rates in each jurisdiction for 2023. British Columbia, Saskatchewan, and Manitoba imposed a separate provincial sales tax (PST). Ontario and the Atlantic provinces—Newfoundland and Labrador, Nova Scotia, New Brunswick, and Prince Edward Island—are harmonized sales tax (HST) participating provinces that harmonize sales taxes with the federal goods and services tax (GST). Quebec has its own Quebec sales tax (QST), which applies in a manner similar to the GST. Alberta and the three territories do not impose sales taxes. There were no changes to provincial or territorial sales tax rates in 2023.

21 Prince Edward Island, Department of Finance, 2023 Budget, Budget Address, May 25, 2023, at 9.

**TABLE 7 Provincial and Territorial Corporate Income Tax Rates, 2023**

| Province/territory | General rate | M & P rate | Small business rate | Small business limit[a] |
|---|---|---|---|---|
| | | *percent* | | *dollars* |
| British Columbia | 12.0 | 12.0 | 2.0 | 500,000 |
| Alberta | 8.0 | 8.0 | 2.0 | 500,000 |
| Saskatchewan[b] | 12.0 | 10.0 | 0.5 | 600,000 |
| Manitoba | 12.0 | 12.0 | 0.0 | 500,000 |
| Ontario | 11.5 | 10.0[c] | 3.2 | 500,000 |
| Quebec | 11.5 | 11.5 | 3.2 | 500,000 |
| New Brunswick | 14.0 | 14.0 | 2.5 | 500,000 |
| Nova Scotia | 14.0 | 14.0 | 2.5 | 500,000 |
| Prince Edward Island | 16.0 | 16.0 | 1.0 | 500,000 |
| Newfoundland and Labrador | 15.0 | 15.0 | 3.0 | 500,000 |
| Northwest Territories | 11.5 | 11.5 | 2.0 | 500,000 |
| Yukon | 12.0 | 2.5 | 0.0 | 500,000 |
| Nunavut | 12.0 | 12.0 | 3.0 | 500,000 |

M & P = manufacturing and processing.

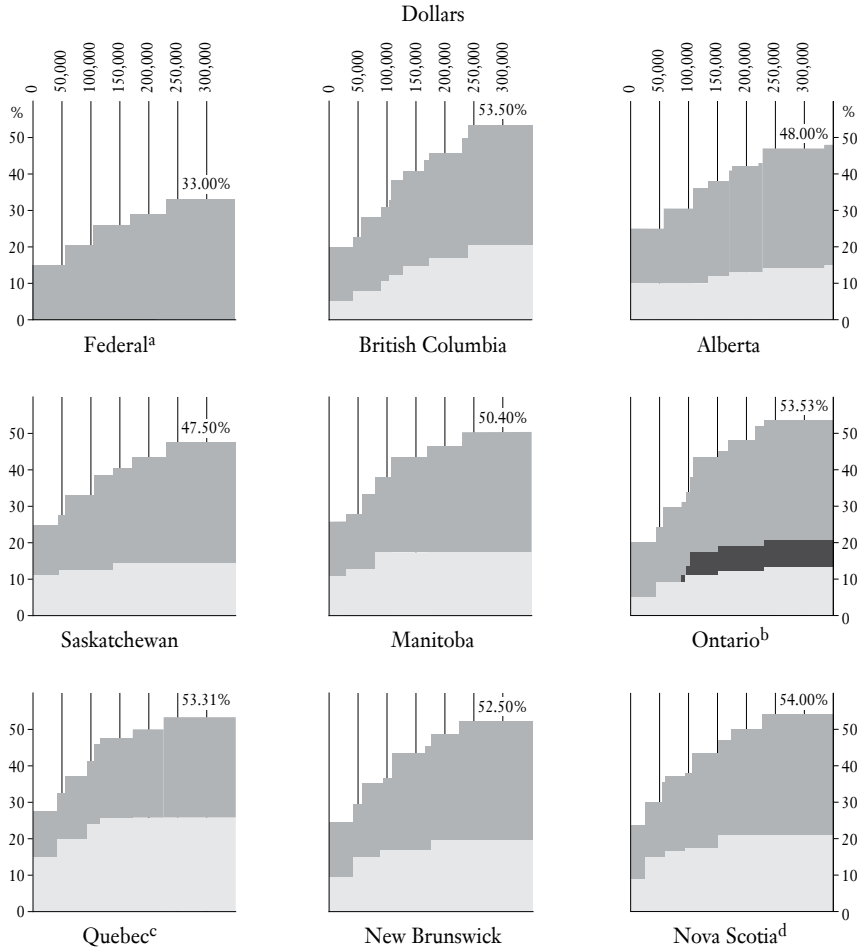
a The small business limit is reduced by the greater of $0.10 ($0.12 in Saskatchewan) for every $1 of taxable capital employed in Canada in the preceding year by the Canadian-controlled private corporation (CCPC) on an associated basis in excess of $10 million and $5 ($6 in Saskatchewan) for every $1 of passive investment income earned by the CCPC on an associated basis in excess of $50,000 (except in Ontario and New Brunswick). This business limit is shared by all associated CCPCs.

b Saskatchewan's small business rate was reduced to 0 percent effective October 1, 2020. However, the small business rate was scheduled to increase to 1 percent effective July 1, 2022, and 2 percent (the small business rate in effect prior to the reduction in 2020) effective July 1, 2023. In August 2022, the Saskatchewan four-point affordability plan extended the small business rate reduction and delayed restoration of the rate to 2 percent until July 1, 2024. On July 1, 2023, the small business corporate tax rate increased from 0 to 1 percent because of the delayed restoration of the small business rate.

c In Ontario, the M & P rate applies to income from manufacturing, processing, farming, mining, logging, and fishing operations carried on in Canada and allocated to the province.

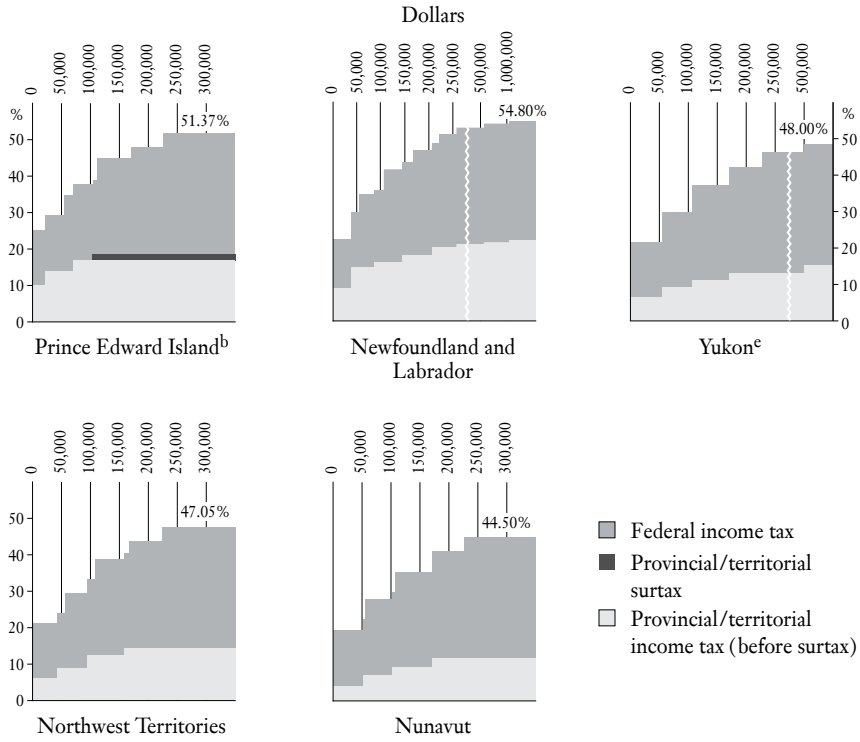
Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

**FIGURE 4 Personal Income Tax Marginal Rates Applicable to Taxable Income, 2023**




(Figure 4 is concluded on the next page.)

**FIGURE 4 Concluded**




a The federal basic personal amount is reduced when a taxpayer's net income is $165,430 or more. The federal rates presented do not reflect this clawback of the basic personal amount.

b Surtax calculations assume that the only credit claimed by the taxpayer is the basic personal amount.

c Federal income tax has been reduced by 16.5 percentage points to reflect the provincial abatement.

d Nova Scotia's basic personal amount is increased by up to $3,000 if taxable income is under $75,000. The provincial rates do not reflect the tax savings from an increased basic personal amount.

e Yukon's basic personal amount is reduced when a taxpayer's net income is $165,430 or more. The territorial tax rates presented do not reflect this clawback of the basic personal amount.

Source: Data compiled by the author.

**TABLE 8 Provincial and Territorial Personal Income Tax Brackets and Rates, 2023**

| Province/territory | Tax bracket | Rate | Surtax (percentage of regular tax) and top combined rate[a] |
|---|---|---|---|
| | *dollars* | *percent* | |
| British Columbia | 0 to 45,654 | 5.06 | |
| | over 45,654 to 91,310 | 7.70 | |
| | over 91,310 to 104,835 | 10.50 | |
| | over 104,835 to 127,299 | 12.29 | |
| | over 127,299 to 172,602 | 14.70 | |
| | over 172,602 to 240,716 | 16.80 | |
| | over 240,716 | 20.50 | Top combined rate of 53.50% |
| Alberta | 0 to 142,292 | 10.00 | |
| | over 142,292 to 170,751 | 12.00 | |
| | over 170,751 to 227,668 | 13.00 | |
| | over 227,668 to 341,502 | 14.00 | |
| | over 341,502 | 15.00 | Top combined rate of 48.00% |
| Saskatchewan | 0 to 49,720 | 10.50 | |
| | over 49,720 to 142,058 | 12.50 | |
| | over 142,058 | 14.50 | Top combined rate of 47.50% |
| Manitoba | 0 to 36,842 | 10.80 | |
| | over 36,842 to 79,625 | 12.75 | |
| | over 79,625 | 17.40 | Top combined rate of 50.40% |
| Ontario | 0 to 49,231 | 5.05 | Surtax equal to 20% of basic provincial tax greater than $5,315 |
| | over 49,231 to 98,463 | 9.15 | Additional surtax equal to 36% of basic provincial tax greater than $6,802 |
| | over 98,463 to 150,000 | 11.16 | |
| | over 150,000 to 220,000 | 12.16 | |
| | over 220,000 | 13.16 | Top combined rate of 53.53% |
| Quebec[b] | 0 to 49,275 | 14.00 | |
| | over 49,275 to 98,540 | 19.00 | |
| | over 98,540 to 119,910 | 24.00 | |
| | over 119,910 | 25.75 | Top combined rate of 53.31% |
| New Brunswick[c] | 0 to 47,715 | 9.40 | |
| | over 47,715 to 95,431 | 14.00 | |
| | over 95,431 to 176,756 | 16.00 | |
| | over 176,756 | 19.50 | Top combined rate of 52.50% |
| Nova Scotia[d] | 0 to 29,590 | 8.79 | |
| | over 29,590 to 59,180 | 14.95 | |
| | over 59,180 to 93,000 | 16.67 | |
| | over 93,000 to 150,000 | 17.50 | |
| | over 150,000 | 21.00 | Top combined rate of 54.00% |

(Table 8 is concluded on the next page.)

**TABLE 8 Concluded**

| Province/territory | Tax bracket | Rate | Surtax (percentage of regular tax) and top combined rate[a] |
|---|---|---|---|
| | *dollars* | *percent* | |
| Prince Edward Island[e] | 0 to 31,984 | 9.80 | Surtax equal to 10% of basic provincial tax in excess of $12,500 |
| | over 31,984 to 63,969 | 13.80 | |
| | over 63,969 | 16.70 | Top combined rate of 51.37% |
| Newfoundland and Labrador | 0 to 41,457 | 8.70 | |
| | over 41,457 to 82,913 | 14.50 | |
| | over 82,913 to 148,027 | 15.80 | |
| | over 148,027 to 207,239 | 17.80 | |
| | over 207,239 to 264,750 | 19.80 | |
| | over 264,750 to 529,500 | 20.80 | |
| | over 529,500 to 1,059,000 | 21.30 | |
| | over 1,059,000 | 21.80 | Top combined rate of 54.80% |
| Northwest Territories | 0 to 48,326 | 5.90 | |
| | over 48,326 to 96,655 | 8.60 | |
| | over 96,655 to 157,139 | 12.20 | |
| | over 157,139 | 14.05 | Top combined rate of 47.05% |
| Yukon | 0 to 53,359 | 6.40 | |
| | over 53,359 to 106,717 | 9.00 | |
| | over 106,717 to 165,430 | 10.90 | |
| | over 165,430 to 500,000 | 12.80 | |
| | over 500,000 | 15.00 | Top combined rate of 48.00% |
| Nunavut | 0 to 50,877 | 4.00 | |
| | over 50,877 to 101,754 | 7.00 | |
| | over 101,754 to 165,429 | 9.00 | |
| | over 165,429 | 11.50 | Top combined rate of 44.50% |

a The top federal rate, used to arrive at the top combined rate, is 33 percent.
b Quebec's 2023 budget reduced the tax rate for the first individual tax bracket from 15 percent to 14 percent and the tax rate for the second individual tax bracket from 20 percent to 19 percent.
c On November 1, 2022, New Brunswick announced a decrease in the personal income tax rates that would apply for the 2023 and subsequent taxation years: the second tax bracket rate was reduced from 14.82 percent to 14.00 percent; the third tax bracket rate was reduced from 16.52 percent to 16.00 percent; the fourth tax bracket was eliminated and merged with the third bracket, at the new reduced rate of 16.00 percent; and the highest tax bracket rate was reduced from 20.30 percent to 19.50 percent.
d Personal tax brackets are not indexed for inflation.
e Personal tax brackets are not indexed for inflation. Prince Edward Island's 2023 budget announced personal income tax bracket reform, including the elimination of the surtax, to come into effect for the 2024 taxation year.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

**TABLE 9 Provincial and Territorial Sales Tax Rates, Percent, 2023**

| Province/territory | GST or federal portion of HST | Provincial portion of HST | PST and QST | Combined[a] |
|---|---|---|---|---|
| British Columbia | 5 | | 7 | 12 |
| Alberta | 5 | | | 5 |
| Saskatchewan | 5 | | 6 | 11 |
| Manitoba | 5 | | 7 | 12 |
| Ontario | 5 | 8 | | 13 |
| Quebec | 5 | | 9.975 | 14.975 |
| New Brunswick | 5 | 10 | | 15 |
| Nova Scotia | 5 | 10 | | 15 |
| Prince Edward Island | 5 | 10 | | 15 |
| Newfoundland and Labrador | 5 | 10 | | 15 |
| Northwest Territories | 5 | | | 5 |
| Yukon | 5 | | | 5 |
| Nunavut | 5 | | | 5 |

GST = goods and services tax; HST = harmonized sales tax; PST = provincial sales tax; QST = Quebec sales tax.

a The rates shown do not yield comparable tax burdens for all jurisdictions. For example, GST and HST allow input tax credits for underlying taxes, eliminate sales tax on exports, and also cover a wider range of goods and services than PST.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

## PROVINCIAL AND TERRITORIAL BUDGETS BY JURISDICTION

Table 10 summarizes the dates of the 2023-24 budgets for the various provinces and territories, the name and title of the person who delivered the budget, and the estimated budgetary surplus or deficit.

Table 11 sets out the research and development (R & D) tax credits in each province and territory available in 2023. The table details rates and indicates whether the credit is refundable and otherwise eligible for a carryforward period. In some cases, the credit is also available to an individual. An article in this feature in 2017 focused on the policy behind these subsidies from an economic viewpoint.[22]

The second part of this article shows, for each province and territory, selected fiscal figures, highlights of tax changes, and a narrative summary of tax changes with accompanying tables. The figures for any particular jurisdiction are difficult to compare across jurisdictions. Where relevant, and where the information is accessible, notes that refer to differences in accounting and/or presentation are appended

22 Daria Crisan and Kenneth J. McKenzie, "Tax Subsidies for R & D in Canada, 1981-2016," Finances of the Nation feature (2017) 65:4 *Canadian Tax Journal* 951-81.

**TABLE 10 Provincial and Territorial Surplus/(Deficit) Projections, Fiscal Year 2023-24**

| Province/territory | Budget date | Finance minister | Projected surplus/ (deficit) |
|---|---|---|---|
| | | | *millions of dollars* |
| British Columbia | February 28, 2023 | Katrine Conroy | (4,216) |
| Alberta | February 28, 2023 | Nate Horner[a] | 2,371 |
| Saskatchewan | March 22, 2023 | Donna Harpauer[b] | 1,018 |
| Manitoba | March 7, 2023 | Cliff Cullen | (363) |
| Ontario | March 23, 2023 | Peter Bethlenfalvy | (1,313) |
| Quebec | March 21, 2023 | Eric Girard | (1,625) |
| New Brunswick | March 21, 2023 | Ernie Steeves[c] | 41 |
| Nova Scotia | March 23, 2023 | Allan MacMaster[d] | (279) |
| Prince Edward Island | May 25, 2023 | Jill Burridge[e] | (98) |
| Newfoundland and Labrador | March 23, 2023 | Siobhan Coady[f] | (160) |
| Northwest Territories | February 8, 2023 | Caroline Wawzonek | 178 |
| Yukon | March 2, 2023 | Sandy Silver[g] | 48 |
| Nunavut | February 23, 2023 | Lorne Kusugak | (8) |

a President of the Treasury Board and minister of finance.
b Minister of finance and deputy premier.
c Minister of finance and Treasury Board.
d Minister of finance and Treasury Board.
e Minister of finance and chair of the Treasury Board.
f Minister of finance and deputy premier.
g Premier and minister of finance.

Source: Based on provincial and territorial budget documents cited in the source notes for tables 12-24.

to the tables; it is beyond the scope of this article to analyze differing accounting practices of each jurisdiction and the differences in those practices between jurisdictions. Notes to each table also refer to the jurisdiction's significant resource revenue, if any. The "tax highlights" box at the beginning of each provincial/territorial section contains some of the more important tax changes and, where possible, lists them in order of precedence. The narrative summaries of tax changes are categorized under the following eight headings:

1. ***Corporate income tax:*** rates, credits, deductions, inclusions, reporting, business income matters, and other items.
2. ***Personal income tax:*** rates, credits, deductions, inclusions, and other items. This category may include the taxation of unincorporated businesses.
3. ***Sales tax:*** HST, GST, PST, QST.
4. ***Excise taxes:*** alcohol, tobacco, cannabis, and carbon taxes.
5. ***Resource-related matters:*** resource deductions, credits, royalties, and other items.
6. ***Real estate taxes:*** land transfer taxes and property taxes.

**TABLE 11 Provincial and Territorial Research and Development (R & D) Tax Credits, 2023**[a]

| Province/territory | R & D tax credit rate (%) | Is credit refundable? | Unused credits: Carryback (taxation years) | Unused credits: Carryforward (taxation years) | Who can claim the credit? |
|---|---|---|---|---|---|
| Alberta[b] | 8 to 20 | ✓ | na | na | Corporation[c] |
| British Columbia | | | | | |
| Qualifying CCPC[d] | 10 | ✓ | na | na | Corporation |
| Other corporation | 10 | ✗ | 3 | 10 | Corporation |
| Manitoba | 15 | ✓[e]/✗ | 3 | 20 | Corporation |
| New Brunswick | 15 | ✓ | na | na | Corporation |
| Newfoundland and Labrador | 15 | ✓ | na | na | Corporation and individual |
| Northwest Territories | na | na | na | na | |
| Nova Scotia | 15 | ✓ | na | na | Corporation |
| Nunavut | na | na | na | na | |
| Ontario | | | | | |
| Innovation tax credit[f] | 8 | ✓ | na | na | Corporation |
| Business research institute tax credit[g] | 20 | ✓ | na | na | Corporation |
| R & D tax credit | 3.5 | ✗ | 3 | 20 | Corporation |
| Prince Edward Island | na | na | na | na | |
| Quebec[h] | | | | | |
| R & D wage tax/ credit[i] | 14 to 30 | ✓ | na | na | Corporation and individual |
| University R & D tax credit[j] | 14 to 30 | ✓ | na | na | Corporation and individual |
| Private partnership pre-competitive tax credit[k] | 14 to 30 | ✓ | na | na | Corporation and individual |
| Tax credit on fees paid to a research consortium | 14 to 30 | ✓ | na | na | Corporation and individual |
| Saskatchewan[l] | | | | | |
| Qualifying CCPC[m] | 10 | ✓ | na | na | Corporation |
| Other corporation | 10 | ✗ | 3 | 10 | Corporation |
| Yukon | 15[n] | ✓ | na | na | Corporation and individual |

CCPC = Canadian-controlled private corporation.

(Table 11 is continued on the next page.)

**TABLE 11 Continued**

a Provincial and territorial tax credits are government assistance for federal tax purposes and thus reduce expenditures eligible for the federal R & D deduction and federal tax credit.

b In the 2019 budget, the Alberta government withdrew the R & D tax credit. Eligible R & D expenses incurred in 2020 will no longer qualify for any Alberta R & D tax credit. Alberta's recovery plan released in late 2020 announced a new innovation employment grant (IEG), which is similar to the previous Alberta R & D tax credit and is available for Alberta R & D expenditures incurred after December 31, 2020. The IEG provides a refundable credit of a base 8 percent of the corporation's eligible Alberta R & D expenditures plus an incremental 12 percent of the corporation's eligible Alberta R & D expenditures that exceed its "base amount" of expenditures (generally the corporation's average eligible Alberta R & D expenditures for the two immediately preceding taxation years). The IEG is available on up to $4 million of eligible Alberta R & D expenditures for a corporation, which is subject to a grind if taxable capital employed in Canada exceeds $10 million.

c When R & D is carried on by a partnership, the R & D credit can generally be claimed by corporate partners except in Newfoundland and Labrador, Quebec, and Yukon, where an individual partner can also claim the credit. However, the credit cannot ever be claimed from a partnership that carries on its R & D in other provinces, such as Ontario (except for certain programs).

d British Columbia's refundable R & D tax credit is 10 percent of the lesser of (1) eligible BC R & D expenditures and (2) the federal R & D expenditure limit (to a maximum annual credit of $300,000).

e Manitoba's credit is (1) fully refundable for eligible R & D expenditures incurred in Manitoba by a corporation that has a Manitoba permanent establishment and a contract with a qualifying research institute, and (2) 50 percent refundable for in-house R & D expenditures.

f The Ontario innovation tax credit is available on up to $3 million of expenditures for a corporation that has taxable income under $500,000 and taxable capital under $25 million (to a maximum annual credit of $240,000). A corporation is eligible for a partial credit if its taxable income is over $500,000 but less than $800,000 or its taxable capital is between $25 million and $50 million. All current expenditures are eligible. Taxable income and taxable capital thresholds are set in the previous year on a worldwide associated basis.

g The Ontario business research institute tax credit applies to 20 percent of qualifying payments (up to $20 million annually on an associated basis) to an Ontario eligible research institute (to a maximum annual credit of $4 million).

h For all Quebec R & D tax credits, the following rates and conditions apply:
   1. Quebec Canadian-controlled corporations that have fewer than $50 million in assets can claim the 30 percent rate on up to $3 million of R & D wages and/or eligible R & D expenditures for each credit; if assets held are between $50 million and $75 million, the rate is gradually reduced to 14 percent, which is the rate for all other taxpayers. The rates are higher in certain cases. Asset thresholds are set in the previous year on a worldwide associated basis (consolidated).
   2. The tax credit rate is 14 percent for Quebec corporations controlled by non-residents. Asset thresholds do not apply.
   3. An exclusion threshold is allocated among the Quebec R & D tax credits proportionally to the amount of eligible expenditures of each R & D tax credit. For each R & D tax credit, the eligible R & D expenditures are reduced by the allocated exclusion, which varies depending on the company's assets: the exclusion is
      a. $50,000 for a corporation whose assets are $50 million or less,
      b. an amount that increases linearly between $50,000 and $225,000 for a corporation whose assets are between $50 million and $75 million, and
      c. $225,000 for a corporation whose assets are $75 million or more.

   Asset thresholds are set in the previous year and are not on an associated basis.

(Table 11 is concluded on the next page.)

**TABLE 11 Concluded**

i A payment may be eligible for the Quebec R & D wage tax credit if the payment was made to (1) an arm's-length subcontractor (up to 50 percent of the payment) or (2) a non-arm's-length subcontractor (100 percent for wages paid and 50 percent of a payment to an arm's-length subcontractor if the payment was made under the non-arm's-length contract).
j Quebec's university R & D tax credit may be available on 80 percent of a payment to an eligible entity such as a university, a public research centre, or a research consortium.
k For the Quebec private partnership pre-competitive tax credit, a qualified expenditure may include (1) wages paid relating to R & D, (2) 80 percent of a payment to an arm's-length subcontractor (generally excluding a university, a public research centre, and a research consortium contract), (3) payment for some materials, or (4) payment for an overhead (or proxy) amount.
l Saskatchewan's total refundable and non-refundable tax credits are capped at $1 million per taxation year.
m Saskatchewan's refundable R & D tax credit is 10 percent of the lesser of (1) eligible Saskatchewan R & D expenditures and (2) $1 million in qualifying expenditures (the maximum annual refundable credit is $100,000).
n Yukon's rate is 20 percent for R & D expenditures made to Yukon College.

Source: Based on table 11 in David Lin, "Survey of Provincial and Territorial Budgets, 2019-20," Finances of the Nation feature (2020) 68:1 *Canadian Tax Journal* 185-250, at 209-11, updated by the author to include changes since 2019.

7. ***Pensions:*** includes proposed studies.
8. ***Other:*** a catchall category that includes corporate capital tax, general anti-avoidance rule and other anti-avoidance initiatives, partnership and trust matters not covered above, and other items.

These categories have been selected for organizational purposes and for ease of reference only. Some categories may overlap (for example, categories 1, 2, 4, and 5).

## British Columbia (Table 12)

**Tax Highlights**

- No changes to corporate or personal income tax rates
- Introduction of a refundable renter's personal tax credit

### Tax Changes

#### *1. Corporate Income Tax*

The 2023 budget extends the interactive digital media tax credit for five years, to August 31, 2028.

#### *2. Personal Income Tax*

The 2023 budget increases the British Columbia family benefit permanently, effective July 1, 2023. The minimum benefit is increased to $775 for a family's first child, $750 for a second child, and $725 for each subsequent child. The maximum annual

**TABLE 12 Projected Revenues and Expenditures, British Columbia, Fiscal Year 2023-24**

| | February 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 77,690 |
| Total expenditures | (81,206) |
| Reserve | (700) |
| Surplus/(deficit) | (4,216) |
| Revenue sources | |
| Personal income tax | 15,953 |
| Corporate income tax | 5,938 |
| Sales tax | 10,187 |
| Other taxes | 13,246 |
| Total tax revenue | 45,324 |
| Federal transfers | 13,593 |
| Other revenues | 18,773 |
| Total revenues | 77,690 |
| Expenditures | |
| Education | 17,600 |
| Health | 30,927 |
| Debt servicing | 3,235 |
| Other expenditures | 29,444 |
| Total expenditures | 81,206 |

Notes: Expenditure figures were estimated by function. Revenue included commercial Crown corporation net income. The reserve represents $700 million of forecast allowance.

Source: British Columbia, Ministry of Finance, 2023 Budget, Budget Plan, February 28, 2023.

benefit is increased to $1,750 for a family's first child, $1,100 for a second child, and $900 for each subsequent child. A maximum annual supplement of $500 will also be provided to single-parent families. The maximum annual benefit is phased out for families with adjusted family net income over $27,354.

The 2023 budget also introduces a refundable renter's tax credit for eligible households that rent and occupy living accommodations in British Columbia for at least six months in a calendar year. For the 2023 taxation year, the tax credit will provide a maximum refundable tax credit of $400 for households with adjusted income up to $60,000. Households with adjusted income above $60,000 will receive a gradually reduced credit. The tax credit is fully phased out if adjusted household income is $80,000 or greater in 2023. These thresholds will be indexed to inflation each year. The tax credit will be available for any individual who has reached the age of 19 years and is a resident of British Columbia on December 31.

Further, the 2023 budget extends the farmers' food donation tax credit for three years, to the end of 2026.

### *3. Sales Tax*

The 2023 budget introduces an exemption from PST for the sale of automated external defibrillators, kits containing automated external defibrillators, and parts and services for automated external defibrillators, effective March 1, 2023.

The 2023 budget also amends the rules related to the collection obligations of online marketplace facilitators that were introduced in the 2022 budget. The rules are amended so that online marketplace services are taxable when an online marketplace facilitator provides the service to facilitate the sale or provision of non-taxable services. Further, the rules establishing when an online marketplace service is taxable are amended to align more closely with the place-of-supply rules used to administer federal GST.

### *4. Excise Taxes*

The 2023 budget increases the refund rates for international fuel tax agreement licensees to reflect scheduled increases in the carbon tax on April 1 of each year from 2023 to 2030.

The 2023 budget increases carbon tax rates by $15 per tonne of carbon dioxide equivalent emissions annually up to the rate of $170 per tonne in 2030. Further, effective April 1, 2024, large emitters will be exempt from the carbon tax and instead be subject to a BC output-based pricing system for emissions that exceed performance-based emission limits. The 2023 budget also allows for qualifying commercial greenhouse growers to claim a point-of-sale reduced carbon tax for purchases of natural gas and propane used for heating and generating carbon dioxide for increased crop productivity, effective April 1, 2023.

### *5. Resource-Related Matters*

No changes were announced.

### *6. Real Estate Taxes*

Police tax is a provincial property tax that helps with the recovery of British Columbia's costs of policing in rural areas and small municipalities with populations below 5,000. The 2023 budget sets the police tax rate to recover 33 percent of legislated costs, after policy-based reductions. On average, households will see an increased tax rate of up to $0.03 per $1,000 of assessed value.

Further, the 2023 budget exempts purchases of new purpose-built rental buildings from the 2 percent property transfer tax that is applied to the fair market value of the residential component of a taxable transaction in excess of $3 million, effective January 1, 2024. Purpose-built rental buildings are non-stratified buildings held as rentals, on a monthly basis or longer, for at least 10 years, where the residential portion of the building is held entirely for rental and has at least four apartments.

The average residential class school property tax is increased in 2023 by the province's inflation rate in the previous year, in accordance with longstanding policy, in place since 2003.

Non-residential school property tax rates are increased in 2023 by inflation plus tax on new construction, except for the rate for the industrial property classes, in accordance with longstanding policy, in place since 2005 (except for the 2020 year, when relief was delivered through a reduction in school tax rates for commercial properties, owing to COVID-19). The major industry class tax rate and the light industry class tax rate are to be set at the same rate as the business class tax rate, consistent with the policy announced in the 2008 budget.

The single rural area residential property tax rate is increased in 2023 by the province's inflation rate in the previous year, in accordance with longstanding policy. Similarly, rural area non-residential property tax rates increase by inflation plus the tax on new construction.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

The 2023 budget introduces a number of technical amendments to various tax acts for clarity and certainty.

## Alberta (Table 13)

**Tax Highlights**

- No changes to corporate or personal income tax rates
- Introduction of an agri-processing investment tax credit and an adoption expenses tax credit

### Tax Changes

#### *1. Corporate Income Tax*

The 2023 budget introduces an agri-processing investment tax credit, a non-refundable tax credit equal to 12 percent of eligible capital investments in the agri-food sector of at least $10 million made on or after February 7, 2023.

#### *2. Personal Income Tax*

The 2023 budget introduces an adoption expenses tax credit, a non-refundable tax credit equal to 10 percent of eligible adoption expenses, up to the maximum allowable amount of $18,210 for the 2023 taxation year. After 2023, this amount will be indexed annually.

#### *3. Sales Tax*

No changes were announced with respect to a PST. Alberta does not impose a general tax on retail sales.

**TABLE 13 Projected Revenues and Expenditures, Alberta, Fiscal Year 2023-24**

| | February 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 70,653 |
| Total expenditures | (66,782) |
| Reserve for contingency and COVID-19 | (1,500) |
| Surplus/(deficit) | 2,371 |
| Revenue sources | |
| Personal income tax | 14,069 |
| Corporate income tax | 5,911 |
| Sales tax | na |
| Other taxes | 5,012 |
| Total tax revenue | 24,992 |
| Federal transfers | 12,552 |
| Other revenues | 33,109 |
| Total revenues | 70,653 |
| Expenditures | |
| Education | 15,656 |
| Health | 26,446 |
| Debt servicing | 2,848 |
| Other expenditures | 21,832 |
| Total expenditures | 66,782 |

Notes: The budget was presented on a fully consolidated basis, which includes school boards, universities and colleges, health entities, and the Alberta Innovates corporations. The presentation of "education" expenditures was updated in the 2020-21 fiscal year to include expenditures for post-secondary education.

Source: Alberta, Ministry of Treasury Board and Finance, 2023 Budget, Budget Plan, February 28, 2023.

### *4. Excise Taxes*

On April 1, 2022, Alberta announced that collection of the 13 cents per litre fuel tax would be temporarily paused until June 30, 2022 and that the government would consider reinstating collection in stages.[23] Alberta's fuel tax relief program provides for fuel tax rates to be adjusted quarterly on the basis of the average price of a barrel of West Texas Intermediate (WTI) oil, with the average price being based on the 20 trading days of WTI oil price data leading up to the 15th day of the month preceding the start of the next quarter. Fuel taxes in Alberta are suspended when the average prices are at or above $90. A partial fuel tax of 4.5 cents per litre will be applied when the average prices are between $85.00 and $89.99. A partial fuel tax of 9 cents per litre

23 Alberta, Ministry of Treasury Board and Finance, "Relief at the Pumps Is Here for Albertans," *News Release*, April 1, 2022 (www.alberta.ca/release.cfm?xID=82260FD28353D-F066-B029-704D25E766253169).

will be applied when the average prices are between $80.00 and $84.99. The full fuel tax of 13 cents per litre will be applied when the average prices fall below $80.00. Furthermore, the fuel tax rates cannot increase by more than 9 cents per litre per quarter when oil prices fall. This fuel tax relief program provided full relief from the fuel tax throughout all of 2023, but on December 19, 2023, Alberta announced that collection and remittance of Alberta fuel tax would resume on January 1, 2024, at a rate of 9 cents per litre, owing to the declining price of WTI oil in the final quarter of 2023.[24]

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

Education property tax rates were previously frozen at 2019 levels owing to the COVID-19 pandemic, but the 2022 budget increased the education property tax requisition by 1.5 percent, to $2.5 billion, straying from the government's previous longstanding policy of increasing the education property tax requisition by the rate of population growth plus inflation. The 2023 budget freezes the education property tax requisition at the 2022 level of $2.5 billion. However, owing to an increase in the overall equalized assessment, the residential and farmland mill rate used to calculate the tax will decrease from $2.65 per $1,000 of equalized assessment to $2.56 per $1,000 of equalized assessment. The non-residential mill rate is also decreased from $3.90 per $1,000 of equalized assessment to $3.76 per $1,000 of equalized assessment.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## Saskatchewan (Table 14)

**Tax Highlights**

- Previously announced increase to the small business corporate tax rate

### Tax Changes

#### *1. Corporate Income Tax*

As previously announced in 2020, the temporary reduction in the small business corporate income tax rate was to begin phasing out in 2022, and the small business

24 Alberta, Ministry of Treasury Board and Finance, "Fuel Tax Relief: Statement from Minister Horner," *News Release*, December 19, 2023 (www.alberta.ca/release.cfm?xID=89505F92A3BB9-DDCB-F786-54DB624505857EDA).

**TABLE 14 Projected Revenues and Expenditures, Saskatchewan, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 19,678 |
| Total expenditures | (18,660) |
| Surplus/(deficit) | 1,018 |
| Revenue sources | |
| Personal income tax | 3,092 |
| Corporate income tax | 1,825 |
| Sales tax | 2,720 |
| Other taxes | 1,997 |
| Total tax revenue | 9,634 |
| Federal transfers | 3,555 |
| Other revenues | 6,489 |
| Total revenues | 19,678 |
| Expenditures | |
| Education | 4,036 |
| Health | 7,056 |
| Debt servicing | 812 |
| Other expenditures | 6,756 |
| Total expenditures | 18,660 |

Notes: Debt servicing is for general debt.

Source: Saskatchewan, Ministry of Finance, 2023 Budget, March 22, 2023.

corporate income tax rate was slated to increase from 0 percent to 1 percent on July 1, 2022. On August 23, 2022, Saskatchewan announced a four-point affordability plan[25] that extended the small business tax rate reduction, retroactive to July 1, 2022, and delayed the restoration of the rate to 2 percent until July 1, 2024. Accordingly, on July 1, 2023, the small business corporate tax rate increases from 0 percent to 1 percent.

The 2023 budget extends the manufacturing and processing exporter tax incentive by one year, to December 31, 2023.

The 2023 budget also enhances the Saskatchewan mineral exploration tax credit by increasing the tax credit rate from 10 percent to 30 percent.

### *2. Personal Income Tax*

No changes were announced.

25 Saskatchewan, Department of Finance, "Saskatchewan Announces Affordability Plan," *News Release*, August 23, 2022 (www.saskatchewan.ca/government/news-and-media/2022/august/23/saskatchewan-announces-affordability-plan).

#### *3. Sales Tax*

The 2023 budget provides new exemptions from PST for the following goods and services: labour costs to repair and install exempt medical equipment, storage buildings when used for storing produce grown commercially, boats with attached harvesting equipment when primarily used in rice farming, and rigs used for commercial geothermal drilling.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## MANITOBA (TABLE 15)

**Tax Highlights**

- Increase in the basic personal amount for individuals in 2023
- Increase in tax bracket thresholds for individuals in 2024
- Continued increase in the exemption threshold for the health and post-secondary education tax levy

### Tax Changes

#### *1. Corporate Income Tax*

The 2023 budget increases the exemption threshold for the health and post-secondary education tax levy from $2.00 million to $2.25 million of annual remuneration. In addition, the threshold below which employers pay a reduced rate on the levy is raised from $4.0 million to $4.5 million. Both changes are effective January 1, 2024. In addition, the 2023 budget indicates that if future fiscal updates show better than expected revenue performance, the health and post-secondary education tax levy rate for 2024 will be reduced from 4.3 percent to 4.0 percent on payroll between $2.25 million and $4.50 million, and from 2.15 percent to 2.00 percent on total payroll if payroll exceeds $4.50 million.

**TABLE 15 Projected Revenues and Expenditures, Manitoba, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 21,714 |
| Total expenditures | (21,877) |
| Contingency | (200) |
| Surplus/(deficit) | (363) |
| Revenue sources | |
| Personal income tax | 4,646 |
| Corporate income tax | 886 |
| Sales tax | 2,602 |
| Other taxes | 2,170 |
| Total tax revenue | 10,304 |
| Federal transfers | 7,299 |
| Other revenues | 4,111 |
| Total revenues | 21,714 |
| Expenditures | |
| Education | 3,679 |
| Health | 7,226 |
| Debt servicing | 1,288 |
| Other expenditures | 9,684 |
| Total expenditures | 21,877 |

Notes: The summary budget's government reporting entity included core government, Crown corporations, government business entities, and public sector organizations. The amount indicated as the health expenditure is for health, seniors, and long-term care. The 2023 budget includes $200 million of revenue contingency.

Source: Manitoba, Department of Finance, 2023 Budget, March 7, 2023.

The 2023 budget also enhances the interactive digital media tax credit by expanding eligible expenditures to include more flexible forms of employee compensation and incentives as eligible labour expenditures as of April 1, 2023. Bonuses tied to profits or revenues, stock options, and signing bonuses continue to be ineligible labour expenditures for the interactive digital media tax credit.

The 2023 budget also makes permanent the mineral exploration tax credit and the green energy equipment tax credit, which were scheduled to expire in 2023.

### *2. Personal Income Tax*

The 2023 budget increases the basic personal amount from $10,145 for the 2022 taxation year to $15,000 for the 2023 taxation year. The 2023 budget also proposes increases in Manitoba's tax bracket thresholds from $36,842 to $47,000 and from $79,625 to $100,000 for the 2024 taxation year, with a return to annual indexation in the 2025 taxation year.

#### *3. Sales Taxes*

No changes were announced.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

The 2021 budget introduced an education property tax rebate to phase out education property taxes that are included on annual property tax statements. The 2023 budget continues the phaseout by increasing the education property tax rebate. The rebate for residential and farm properties, calculated on the basis of gross education property taxes on property tax statements, increased from 25 percent in 2021 to 37.5 percent in 2022 and rises to 50 percent in 2023. Owners of all other properties (commercial, industrial, railway, institutional, pipelines, and designated recreational) will continue to receive a 10 percent rebate of gross education property taxes. Existing education property tax offsets, including the education property tax credit and advance, the seniors school tax rebate, the seniors education property tax credit, and the farmland school tax rebate will continue to be reduced as a result of the increase in the education property tax rebate.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## Ontario (Table 16)

**Tax Highlights**

- New manufacturing investment tax credit for businesses

### Tax Changes

#### *1. Corporate Income Tax*

The 2023 budget introduces a 10 percent refundable tax credit for capital investments in buildings, machinery, and equipment used in manufacturing or processing in Ontario by a Canadian-controlled private corporation with a permanent establishment in Ontario. The new manufacturing investment tax credit is available for qualifying investments in class 1 or class 53 properties used for manufacturing or processing in Ontario that become available for use on or after March 23, 2023, up to a limit of $20 million of qualifying investments per associated group per taxation year.

**TABLE 16 Projected Revenues and Expenditures, Ontario, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 204,367 |
| Total expenditures | (204,680) |
| Contingency | (1,000) |
| Surplus/(deficit) | (1,313) |
| Revenue sources | |
| Personal income tax | 55,982 |
| Corporate income tax | 24,668 |
| Sales tax | 35,350 |
| Other taxes | 28,222 |
| Total tax revenue | 144,222 |
| Federal transfers | 34,844 |
| Other revenues | 25,301 |
| Total revenues | 204,367 |
| Expenditures | |
| Education | 48,538 |
| Health | 81,009 |
| Debt servicing | 14,058 |
| Other expenditures | 61,075 |
| Total expenditures | 204,680 |

Notes: The figures included amounts for government business enterprises. Expenditures were shown by ministry. Education expenditures include expenditures from the Ministry of Colleges and Universities and the Ministry of Education. Health expenditures include expenditures from the Ministry of Health and the Ministry of Long-Term Care, which were reported separately for the first time in fiscal year 2020-21. Debt servicing is net of interest capitalized during construction of tangible capital assets of $573 million for fiscal year 2022-23.

Source: Ontario, Ministry of Finance, 2023 Budget, March 23, 2023.

### *2. Personal Income Tax*

No changes were announced.

### *3. Sales Tax*

No changes were announced.

### *4. Excise Taxes*

The 2023 budget proposes a single 12 percent basic tax rate on wine and wine coolers sold in off-site winery retail stores, including wine boutiques, effective July 1, 2023. This new single basic tax rate would replace four separate basic tax rates that currently apply to wine and wine coolers sold in off-site winery retail stores. This change is a response to a World Trade Organization settlement reached between Canada and Australia.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## Quebec (Table 17)

**Tax Highlights**

- Reduction of rates for the first two personal income tax brackets
- Introduction of new tax holiday for large investment projects

### Tax Changes

#### *1. Corporate Income Tax*

The 2023 budget introduces a new tax holiday for large investment projects carried out in Quebec by a corporation or partnership. The tax holiday will have a 10-year duration and will be calculated by applying a rate of 15, 20, or 25 percent to the cumulative total eligible expenditures related to the project. The applicable rate depends on whether the large investment project is carried out in a territory with low, intermediate, or high economic vitality. The cumulative total eligible expenditures cannot exceed $1 billion. To qualify for the tax holiday, the project must not be carried out in an excluded sector of activity, and the corporation or partnership must not carry out activities in an excluded sector. The project must also satisfy a requirement to meet a minimum $100 million investment threshold before the expiration of a 48-month investment period beginning on the date specified on the initial qualification certificate, as well as a requirement to maintain the threshold throughout the tax-free period applicable to the project. The application for the initial qualification certificate must be submitted to the minister of finance before significant expenditures for the project are incurred and no later than December 31, 2029. Taxpayers that are eligible for the tax holiday will also benefit from a holiday from the employer contribution to the health services fund. The new tax holiday eliminates the former tax holiday relating to the carrying out of a large investment project, effective March 21, 2023, and no new applications for the former tax holiday will be accepted.

**TABLE 17 Projected Revenues and Expenditures, Quebec, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 147,731 |
| Total expenditures | (147,856) |
| Provision for economic risks and other support and recovery measures | (1,500) |
| Surplus/(deficit) | (1,625) |
| Revenue sources | |
| Personal income tax | 43,126 |
| Corporate income tax | 13,192 |
| Sales tax | 27,290 |
| Other taxes | 9,128 |
| Total tax revenue | 92,736 |
| Federal transfers | 29,742 |
| Other revenues | 25,253 |
| Total revenues | 147,731 |
| Expenditures | |
| Education | 30,683 |
| Health | 59,015 |
| Debt servicing | 9,464 |
| Other expenditures | 48,694 |
| Total expenditures | 147,856 |

Notes: The figures were presented on a consolidated basis, showing general fund plus consolidated entities. The figures shown for expenditures were by department, except for debt servicing. The surplus/(deficit) presented excludes deposits of dedicated revenues in the Generations Fund, a fund dedicated exclusively to repaying Quebec's debt.

Source: Québec, Finances Québec, 2023-2024 Budget, Budget Plan, March 21, 2023.

The 2023 budget also introduces sector-specific changes to enhance the refundable tax credit for Quebec film or television production, the refundable tax credit for book publishing, and the refundable tax credit for the production of multimedia events or environments presented outside Quebec.

### *2. Personal Income Tax*

The 2023 budget reduces the tax rate for the first individual tax bracket from 15 percent to 14 percent and the tax rate for the second individual tax bracket from 20 percent to 19 percent. These rate changes are effective for the 2023 and subsequent taxation years. As a result of a decrease in the tax rate applied to the first individual tax bracket, the 2023 budget also proposes changes to the computation and base amounts of various personal tax credits that are calculated on the basis of the tax rate of the first individual tax bracket.

The 2023 budget also enhances the housing component of the refundable solidarity tax credit. As a result of the inflationary environment, the 2023 budget proposes doubling the indexation adjustment of the housing component of the solidarity tax credit, from 6.44 percent for the period from July 2022 to June 2023 to 12.88 percent for the payment period beginning July 1, 2023.

Further, the 2023 budget enhances the base amount of the non-refundable tax credit for volunteer firefighters and search-and-rescue volunteers, from $3,000 to $5,000, effective for the 2023 taxation year.

### *3. Sales Tax*

No changes were announced.

### *4. Excise Taxes*

The 2023 budget increases the duty on new tires for road vehicles from $3.00 to $4.50 for any new tire for which the diameter of the rim is less than or equal to 24.5 inches and the overall diameter is less than or equal to 33.0 inches, to $6.00 for any new tire for which the diameter of the rim is less than or equal to 24.5 inches and the overall diameter is greater than 33.0 inches but does not exceed 48.5 inches. This increased duty applies after June 30, 2023.

Further, the 2023 budget provides funding for the implementation of a computer system to manage the tax exemption of First Nations from taxes.

### *5. Resource-Related Matters*

No changes were announced.

### *6. Real Estate Taxes*

No changes were announced.

### *7. Pensions*

The 2023 budget introduces an option to stop paying Quebec Pension Plan (QPP) contributions for workers aged 65 years or older, and ends the obligation to contribute to the QPP for workers over 72 years of age. These changes come into effect on January 1, 2024.

### *8. Other*

The 2023 budget indicates that amendments will be made to tax legislation and regulations to give the minister of revenue the power to ask taxpayers whether they own or have used virtual assets (such as cryptocurrency) to carry out certain transactions during a taxation year or a fiscal year, and to request details about these transactions. These amendments will be effective from the date of assent to the bill implementing the measure.

## New Brunswick (Table 18)

**Tax Highlights**

- No new changes to corporate or personal income tax rates

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

#### *2. Personal Income Tax*

On November 1, 2022, New Brunswick announced a decrease in personal income tax rates that would apply for the 2023 and subsequent taxation years: the second tax bracket rate was reduced from 14.82 percent to 14.00 percent; the third tax bracket rate was reduced from 16.52 percent to 16.00 percent; the fourth tax bracket was eliminated and merged with the third bracket, at the new reduced rate of 16.00 percent; and the highest tax bracket rate was reduced from 20.30 percent to 19.50 percent.[26]

No further changes were announced in the 2023 budget.

#### *3. Sales Tax*

No changes were announced.

#### *4. Excise Taxes*

The 2023 budget reaffirms that New Brunswick will adopt the federal backstop for carbon taxation and terminate the provincial carbon-pricing system, as previously announced.[27] This change will be effective July 1, 2023.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

The 2022 budget introduced the following changes to property tax rates, to be phased in over a three-year period: a 50 percent provincial property tax rate reduction for non-owner-occupied residential properties (including apartment buildings and other rental properties) and a 15 percent provincial property tax rate reduction for other residential properties (including nursing homes) and non-residential

26 New Brunswick, Department of Finance and Treasury Board, "Additional Reductions to Personal Income Tax Rate Introduced," *News Release*, November 1, 2022 (www2.gnb.ca/content/gnb/en/news/news_release.2022.11.0614.html).

27 New Brunswick, Department of Environment and Local Government, "Province Opts for Federal Backstop on Carbon Pricing," *News Release*, February 16, 2023 (www2.gnb.ca/content/gnb/en/departments/elg/news/news_release.2023.02.0065.html).

**TABLE 18 Projected Revenues and Expenditures, New Brunswick, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 12,193 |
| Total expenditures | (12,152) |
| Contingency reserve | nil |
| Surplus/(deficit) | 41 |
| Revenue sources | |
| Personal income tax | 2,261 |
| Corporate income tax | 636 |
| Sales tax | 1,902 |
| Other taxes | 950 |
| Total tax revenue | 5,749 |
| Federal transfers | 4,602 |
| Other revenues | 1,842 |
| Total revenues | 12,193 |
| Expenditures | |
| Education | 2,393 |
| Health | 3,623 |
| Debt servicing | 627 |
| Other expenditures | 5,509 |
| Total expenditures | 12,152 |

Notes: Figures were shown on a main estimates basis. Expenditure figures were shown by department. Education and health expenditures exclude special-purpose account and special operating agencies expenses. Education includes both education and early childhood development and post-secondary education, training, and labour.

Source: New Brunswick, Department of Finance and Treasury Board, 2023-2024 Budget, March 21, 2023.

properties. In November 2022, New Brunswick accelerated the property tax rate reduction such that the full reduction is available for the 2023 year instead of being phased in over a three-year period.[28]

### *7. Pensions*

No changes were announced.

### *8. Other*

No changes were announced.

28 New Brunswick, Department of Finance and Treasury Board, "Property Tax Rate Reductions To Be Accelerated," *News Release*, November 1, 2022 (www2.gnb.ca/content/gnb/en/news/news_release.2022.11.0613.html).

## Nova Scotia (Table 19)

**Tax Highlights**

- No changes to corporate or personal income tax rates
- Expansion of "more opportunities for skilled trades" tax refund program

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

#### *2. Personal Income Tax*

The 2022 budget introduced a "more opportunities for skilled trades" tax refund, effective for the 2022 and subsequent taxation years. This measure provides a refund of personal income tax on the first $50,000 of earned income for individuals under 30 years of age who are employed and registered in selected skilled trades and occupations, with further details to be provided in regulations. To start, selected skilled trades and occupations include the manufacturing, computer and information technology, transportation, film, video, and service sectors in the province. The 2023 budget expands the program to include registered nurses, licensed practical nurses, and nurse practitioners who work for publicly funded employers or in continuing care and disability support programs, as well as nurses working in publicly funded schools as part of the school health partnership program.

#### *3. Sales Tax*

No changes were announced.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

**TABLE 19 Projected Revenues and Expenditures, Nova Scotia, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 14,169 |
| Total expenditures | (14,820) |
| Reserve and consolidating adjustments | 372 |
| Surplus/(deficit) | (279) |
| Revenue sources | |
| Personal income tax | 3,731 |
| Corporate income tax | 740 |
| Sales tax | 2,438 |
| Other taxes | 675 |
| Total tax revenue | 7,584 |
| Federal transfers | 4,814 |
| Other revenues | 1,771 |
| Total revenues | 14,169 |
| Expenditures | |
| Education | 2,581 |
| Health | 6,186 |
| Debt servicing | 767 |
| Other expenditures | 5,286 |
| Total expenditures | 14,820 |

Notes: Revenue-source figures were for general revenue fund only, with adjustments for consolidation. Expenditure figures were shown by department, general revenue fund. Education expenditures presented are for "education and early childhood development" and "advanced education" departmental expenses. Health expenditures presented are for "health and wellness" and "seniors and long-term care" departmental expenses.

Source: Nova Scotia, Department of Finance and Treasury Board, 2023 Budget, Budget Plan, March 23, 2023.

## Prince Edward Island (Table 20)

**Tax Highlights**

- Increases to various personal income tax credits, including the basic personal amount
- Personal income tax reform coming in 2024

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

**TABLE 20 Projected Revenues and Expenditures, Prince Edward Island, Fiscal Year 2023-24**

| | May 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 2,995 |
| Total expenditures | (3,093) |
| Supplementary appropriation | nil |
| Surplus/(deficit) | (98) |
| Revenue sources | |
| Personal income tax | 578 |
| Corporate income tax | 142 |
| Sales tax | 445 |
| Other taxes | 281 |
| Total tax revenue | 1,446 |
| Federal transfers | 1,215 |
| Other revenues | 334 |
| Total revenues | 2,995 |
| Expenditures | |
| Education | 570 |
| Health | 1,045 |
| Debt servicing | 163 |
| Other expenditures | 1,315 |
| Total expenditures | 3,093 |

Notes: Revenue and expenditure figures were consolidated. Expenditure figures were shown by department. The 2023 budget was presented based on reallocations to align with government department structural changes. As a result, the expenditure figures may not be directly comparable with those in prior years. Education expenditures include expenditures for "education and early years" and "workforce, advanced learning, and population" programs, whereas prior years included only "education and lifelong learning" expenditures.

Source: Prince Edward Island, Department of Finance, 2023 Budget, Budget Plan, May 25, 2023.

### *2. Personal Income Tax*

The 2023 budget proposes to increase the basic personal tax credit amount from $12,000 to $12,750 for the 2023 taxation year and to $13,500 for the 2024 taxation year. The income threshold for the low-income tax reduction program also increases from $20,000 to $20,750 in 2023 and to $21,500 in 2024.

The 2023 budget increases the senior tax credit from $3,764 to $4,679 and the income threshold for clawback of the credit from $28,019 to $30,879 for the 2023 taxation year. For the 2024 taxation year, the credit increases from $4,679 to $5,595 and the income threshold for clawback of the credit increases from $30,879 to $33,740.

The 2023 budget also increases the fitness and activity tax credit from $500 to $1,000 effective for the 2024 taxation year.

The 2023 budget indicates that the province will implement tax reform measures replacing the current three-bracket system plus surtax with a five-bracket system, to be effective for the 2024 taxation year.

#### *3. Sales Tax*

No changes were announced.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

The 2023 budget proposes to freeze property taxes for the 2023 taxation year and to reset property tax assessment rates for the 2024 taxation year to levels equivalent to those that applied in 2020.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## Newfoundland and Labrador (Table 21)

**Tax Highlights**

- No changes to corporate or personal income tax rates

### Tax Changes

#### *1. Corporate Income Tax*

The 2022 budget introduced an "all spend film and video production tax credit." This was previously a 30 percent refundable tax credit for total qualified production costs, up to a maximum credit of $10 million annually per project. The 2023 budget increases the rate of the tax credit from 30 percent to 40 percent.

The 2023 budget also increases the exemption threshold for the health and post-secondary education tax from $1.3 million to $2.0 million.

#### *2. Personal Income Tax*

The 2023 budget doubles the maximum amount of eligible fitness expenses for the physical activity tax credit, from $2,000 to $4,000.

**TABLE 21 Projected Revenues and Expenditures, Newfoundland and Labrador, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 9,689 |
| Total expenditures | (9,849) |
| Oil revenue risk adjustment | nil |
| Surplus/(deficit) | (160) |
| Revenue sources | |
| Personal income tax | 1,843 |
| Corporate income tax | 496 |
| Sales tax | 1,431 |
| Other taxes | 635 |
| Total tax revenue | 4,405 |
| Federal transfers | 2,229 |
| Other revenues | 3,055 |
| Total revenues | 9,689 |
| Expenditures | |
| Education | 1,397 |
| Health | 3,795 |
| Debt servicing | 723 |
| Other expenditures | 3,934 |
| Total expenditures | 9,849 |

Notes: The figure shown for total revenues includes net income of government business enterprises and partnerships. Expenditures were reported by department, except for debt-related expenses. Health expenditure covers "health and community services." Expenditures were a combination of current and capital account expenditures by department in the government reporting entity on a consolidated basis.

Source: Newfoundland and Labrador, Department of Finance, 2023 Budget, Budget Plan, March 23, 2023.

### *3. Sales Tax*

The 2022 budget temporarily eliminated the 15 percent PST on home insurance for policies entered into or renewed between April 7, 2022 and April 6, 2023. The 2023 budget permanently eliminates the 15 percent PST on home insurance.

### *4. Excise Taxes*

No changes were announced.

### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## YUKON (TABLE 22)

**Tax Highlights**

- No changes to corporate or personal income tax rates

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

#### *2. Personal Income Tax*

No changes were announced.

#### *3. Sales Tax*

No changes were announced.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

**TABLE 22 Projected Revenues and Expenditures, Yukon, Fiscal Year 2023-24**

| | March 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 1,871 |
| Total expenditures | (1,773) |
| Contingency | (50) |
| Surplus/(deficit) | 48 |
| Revenue sources | |
| Personal income tax | 98 |
| Corporate income tax | 27 |
| Sales tax | na |
| Other taxes | 46 |
| Total tax revenue | 171 |
| Federal transfers | 1,327 |
| Other revenues | 373 |
| Total revenues | 1,871 |
| Expenditures | |
| Education | 279 |
| Health | 528 |
| Debt servicing | 17 |
| Other expenditures | 949 |
| Total expenditures | 1,773 |

Notes: Amounts presented are based on non-consolidated reporting; the consolidated surplus was reported as $80 million. Consolidated reporting includes territorial corporations. The contingency reported represents a $50 million reserve for "anticipated expenses." The health figure includes an amount for social services. The debt-servicing figure shown represents expenditures on loan programs.

The Yukon government signed a devolution agreement with the federal government in 2003 to assume land and resource management responsibilities. Amendments to the resource revenue-sharing arrangement in 2012 ensured that more resource revenue generated in the Yukon would be available for use in the territory.

Source: Yukon, Department of Finance, 2023 Budget, Budget Plan, March 2, 2023.

## Northwest Territories (Table 23)

### Tax Highlights

- No changes to corporate or personal income tax rates

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

#### *2. Personal Income Tax*

No changes were announced.

**TABLE 23 Projected Revenues and Expenditures, Northwest Territories, Fiscal Year 2023-24**

| | February 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 2,485 |
| Total expenditures | (2,206) |
| Infrastructure contribution, deferred maintenance, and other reserves | (101) |
| Surplus/(deficit) | 178 |
| Revenue sources | |
| Personal income tax | 118 |
| Corporate income tax | 40 |
| Sales tax | na |
| Other taxes | 185 |
| Total tax revenue | 343 |
| Federal transfers | 1,993 |
| Other revenues | 149 |
| Total revenues | 2,485 |
| Expenditures | |
| Education | 382 |
| Health | 610 |
| Debt servicing | 27 |
| Other expenditures | 1,187 |
| Total expenditures | 2,206 |

Notes: Figures presented are the health and education expenditures by department; the education figure includes education, culture, and employment, and the health figure includes social services. The stated surplus was on a non-consolidated basis. The debt-servicing amount is assumed to be expenditures classified as "interest" in the summary of expenditures.

On April 1, 2014, the Northwest Territories took responsibility for the management of its land, water, and non-renewable resources. The Northwest Territories started to receive resource revenues under devolution in 2014-15; half is offset against federal territorial formula financing grants, up to 25 percent of the balance will be shared with Indigenous governments, and 25 percent of the balance will be saved in the Heritage Fund. The Northwest Territories and the federal government signed a devolution agreement on March 11, 2013.

Source: Northwest Territories, Department of Finance, 2023 Budget, Budget Plan, February 8, 2023.

### *3. Sales Tax*

No changes were announced.

### *4. Excise Taxes*

The 2023 budget increases the carbon tax rate from $50 per tonne of greenhouse gas emissions to $65 per tonne, effective April 1, 2023. The carbon tax rate is to increase annually by $15 per tonne of emissions until it reaches $170 per tonne on April 1, 2030.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

The 2023 budget indicates that property tax mill rates will be indexed to inflation, in keeping with past practice.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

## Nunavut (Table 24)

**Tax Highlights**

- No changes to corporate or personal income tax rates

### Tax Changes

#### *1. Corporate Income Tax*

No changes were announced.

#### *2. Personal Income Tax*

No changes were announced.

#### *3. Sales Tax*

No changes were announced.

#### *4. Excise Taxes*

No changes were announced.

#### *5. Resource-Related Matters*

No changes were announced.

#### *6. Real Estate Taxes*

No changes were announced.

#### *7. Pensions*

No changes were announced.

#### *8. Other*

No changes were announced.

**TABLE 24 Projected Revenues and Expenditures, Nunavut, Fiscal Year 2023-24**

| | February 2023 |
|---|---|
| | *millions of dollars* |
| Total revenues | 2,838 |
| Total expenditures | (2,796) |
| Supplementary requirements | (50) |
| Surplus/(deficit) | (8) |
| Revenue sources | |
| Personal income tax | 34 |
| Corporate income tax | 25 |
| Sales tax | na |
| Other taxes | 106 |
| Total tax revenue | 165 |
| Federal transfers | 2,527 |
| Other revenues | 146 |
| Total revenues | 2,838 |
| Expenditures | |
| Education | 321 |
| Health | 502 |
| Debt servicing | na |
| Other expenditures | 1,973 |
| Total expenditures | 2,796 |

Notes: Main estimates were prepared on a non-consolidated basis. Surplus/(deficit) was shown on a main estimates basis and not the public account basis, which funds revenues and expenditures. Expenditure figures appeared to be shown by department and include both operations and maintenance expenditures and capital expenditures. The budget does not present debt-servicing costs separately in the main estimates, and an amount that represents those costs cannot be reasonably determined.

Nunavut, Nunavut Tunngavik Incorporated, and the federal government signed a devolution agreement on January 18, 2024, with an effective transfer date of April 1, 2027. The implementation of the devolution agreement will have an impact on Nunavut's budget in the coming years as the territory works with the federal government to assume responsibility for Nunavut's public lands, natural resources, and rights with respect to water.

Source: Nunavut, Department of Finance, 2023 Budget, Budget Plan, February 23, 2023.

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# International Tax Planning

Co-Editors: Ken Buttenham and Ian Bradley*

## TAXATION OF PROFESSIONAL ATHLETES—STICKHANDLING THROUGH THE MAZE

*Bruce Sprague** and Daren Raoux****

Recent changes in Canadian tax laws have important implications for many professional athletes relocating to Canada from the United States or other countries. At the federal level, proposed changes to the alternative minimum tax, foreign-income reporting requirements, and a broad range of other taxes have introduced complexity and potential traps for the unwary. At the provincial level, the five provinces with a National Hockey League team have raised their top marginal tax rates over the last 10 years. Because the financial stakes can be high, understanding the tax laws and the tax-planning opportunities for professional athletes has become more important than ever. This article addresses some key income tax issues and planning opportunities for professional athletes earning income from the provision of cross-border services in Canada and the United States.

**KEYWORDS:** ATHLETES ■ RESIDENCE ■ SIGNING BONUS ■ RETIREMENT COMPENSATION ARRANGEMENT ■ ALTERNATIVE MINIMUM TAX ■ DEPARTURE TAX

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# Personal Tax Planning

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## ONLINE GAMING WINDFALLS—KNOW YOUR ODDS WHEN THE HOUSE IS THE CANADA REVENUE AGENCY

*Novaira Khan, Amy Dodds, Yanni Lu, and Sean McGroarty*****

Windfalls from online gaming have experienced an unprecedented surge in recent years, especially owing to the legalization of online gambling and single-event sports wagering. Recent court decisions have led to uncertainty between personal recreation and business activities in the digital gaming industry. This article explores the distinction between recreational and professional online gaming windfalls and whether these winnings are ultimately taxable.

**KEYWORDS:** WINDFALL PROFITS ■ ONLINE ■ GAMBLING ■ LOTTERIES ■ BUSINESS ■ INCOME

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# Planification fiscale personnelle

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## LES GAINS FORTUITS TIRÉS DE JEUX EN LIGNE — SACHEZ RECONNAÎTRE VOS CHANCES QUAND LA MAISON DE JEUX EST L'AGENCE DE REVENU DU CANADA

*Novaira Khan, Amy Dodds, Yanni Lu et Sean McGroarty*****

Les gains fortuits tirés de jeux en ligne ont connu un essor sans précédent au cours des dernières années, notamment en raison de la légalisation des jeux d'argent en ligne et des paris sur une seule épreuve sportive. Des arrêts récents ont créé de l'incertitude quant à la distinction entre les activités récréatives personnelles et les activités professionnelles dans l'industrie des jeux numériques. Cet article explore ce qui différencie les gains fortuits tirés d'une activité de jeu en ligne considérée comme récréative ou professionnelle, et examine si ces gains sont en fin de compte imposables.

**MOTS CLÉS :** GAINS FORTUITS ■ EN LIGNE ■ JEU DE HASARD ■ LOTERIE ■ ENTREPRISE ■ REVENU

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# Corporate Tax Planning

Co-Editors: Mark Brender,* Brian R. Carr,** Michael R. Smith,*** and Christopher J. Steeves****

## WHAT IS A TAX PLANNER TO DO AFTER DEANS KNIGHT?

*Brian R. Carr, Brittany D. Rossler, and Molly Martin*****

The authors of this article review the current jurisprudential landscape surrounding tax-avoidance cases, in both the general anti-avoidance rule (GAAR) and non-GAAR contexts, for the purpose of assisting tax planners. The authors begin by addressing the challenges of achieving perfect certainty in the interpretation of tax provisions other than GAAR. They discuss how the background of judges can affect the decision-making process. They then review recent non-GAAR jurisprudence, highlighting instances where courts reject unacceptable tax plans and underscoring the courts' generally unsympathetic stance toward aggressive tax plans that appear to defy common sense. The authors then analyze the Supreme Court of Canada's decisions in *Canada v. Alta Energy Luxembourg SARL* and *Deans Knight Income Corp. v. Canada*. They compare the two decisions in detail and suggest how taxpayers might respond to these seemingly divergent judgments. Turning to the recently proposed amendments to GAAR, the authors question the necessity of these changes, in light of the Supreme Court's recent guidance on the application of the provision in *Deans Knight*. The article concludes by offering practical suggestions for tax planners with the aim of equipping them to navigate GAAR in implementing tax plans.

**KEYWORDS:** GAAR ■ STATUTORY INTERPRETATION ■ TAX PLANNING ■ SUPREME COURT OF CANADA ■ ABUSE ■ CERTAINTY AND PREDICTABILITY

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# Current Tax Reading

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**Thomas R. Tørsløv, Ludvig S. Wier, and Gabriel Zucman, "The Missing Profits of Nations"** (2023) 90:3 *Review of Economic Studies* 1499-1534 (https://doi.org/10.1093/restud/rdac049) and associated website (https://missingprofits.world)

The purpose of this article is to estimate, using a new methodology that relies on statistics concerning foreign affiliates (FAs), how much of the profits of multinational companies is shifted to tax havens. FA statistics of this kind have been produced by the statistical agencies of most developed countries (including tax havens) since the beginning of the 2010s.

This article's key idea is that in tax havens, foreign firms are much more profitable than local firms. In particular, the ratio of pre-tax profits to wages is about 30-40 percent for local firms, but for foreign firms, the ratio is more than that by a factor of at least 10. For example, the ratio is 800 percent for foreign firms in Ireland; that is, foreign multinationals in that country book $8 of pre-tax profits in for every $1 paid to Irish employees.[1] The experience in high-tax countries, by contrast, is that foreign firms are slightly less profitable than local firms.

The premise set out above is used to produce a methodology for measuring profit shifting: the measure of the profit that has been shifted into any particular tax haven is the excess profits of foreign firms in that tax haven. More specifically, the authors compute the aggregate amount of profit that foreign firms in a tax haven (for example, Ireland) would make if they were just as profitable as local Irish firms, and they make this computation for each of 41 tax-haven countries and territories: 5 OECD countries (Belgium, Ireland, Luxembourg, Netherlands, and Switzerland) and 36 non-OECD countries and territories. The calculations are disaggregated by the foreign firm's country of origin. Thus, the calculations show how much profit is shifted from country *i* to country *j*, where country *i* is a non-tax-haven country and country *j* is a tax-haven country.

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1 At 1501. Pre-tax profits are reduced by net interest payments for the calculations in the article.

The overall finding is that in 2015, 36 percent of the profits made by multinationals outside the country where their parent companies were located were shifted to tax havens. US multinationals shifted more than half of their profits to tax havens, while other multinationals shifted about a quarter of their profits.[2]

The authors also estimate corporate tax revenue losses from profit shifting for each non-tax-haven country (and they estimate revenue gains for tax havens).[3] According to the most up-to-date figures from a website (missingprofits.world) associated with the author's research, the highest percentage of domestic revenue lost through global profit shifting is found in high-tax EU countries—for example, 22 percent for France, and 29 percent for Germany. In comparison, the United States loses 16 percent—and Canada 9 percent—of its domestic revenue through global profit shifting. EU tax havens account for 1 of the 9 percent, with the Netherlands accounting for half of that 1 percent. Non-EU tax havens account for the other 8 percent. These revenue figures should not be seen as implying that an attempt to tax this revenue would be completely successful. If, for example, countries were to seek to reduce profit shifting through the more stringent enforcement of transfer-pricing rules, the companies could move their profits by shifting their operations to low-tax countries.

It would be interesting to compare the results of the authors' research with estimates of the revenue potential of the OECD's proposed global minimum tax, which is a key part of the pillar 2 reform. One would want to calculate how much of the difference between the authors' revenue estimates and those for the proposed tax is owing to, among other factors, the difference in the tax base.[4]

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**Evert A. Lindquist and Robert P. Shepherd, "Spending Reviews and the Government of Canada: From Episodic to Institutionalized Capabilities and Repertoires"** (2023) 66:2 *Canadian Public Administration* 247-67 (https://doi.org/10.1111/capa.12532)

**Evert A. Lindquist and Robert P. Shepherd, *Smarter Government for Turbulent Times*, C.D. Howe Institute Commentary no. 652** (Toronto: C.D. Howe Institute, 2024)

This *Canadian Public Administration* article—supplemented, in part, by a C.D. Howe Institute commentary written by the same authors and published soon after the article—followed the announcements, in the 2022 and 2023 federal budgets, that the Treasury Board would launch a "strategic policy review" of public expenditures.

2 At 1500.

3 At 1523, table 3. However, the figures cited in this paragraph are from the associated website.

4 The OECD released an updated revenue estimate in January 2024: Organisation for Economic Co-operation and Development, "Economic Impact Assessment of the Global Minimum Tax: Summary" (January 2024) (www.oecd.org/tax/beps/summary-economic-impact-assessment-global-minimum-tax-january-2024.pdf).

This review was no doubt provoked by the unprecedented increase in the peacetime government expenditure triggered by the COVID-19 pandemic. The article involves three lines of inquiry: it (1) examines past federal spending reviews, going back to the Neilsen Task Force of the 1980s; (2) analyzes international best practices for spending reviews; and (3) provides an early appraisal of this latest effort by the Treasury Board. Such spending reviews would complement the reports of the auditor general in the process of identifying opportunities for improving the effectiveness of government programs.

The article distinguishes between two types of reviews: (1) spending reviews, whose purpose is to review efficiency and cost-effectiveness, create fiscal space for new initiatives, reprioritize existing expenditures, and achieve better value for money; and (2) strategic reviews, which have the broader aims of improving governmental performance and improving longer-term public policy outcomes.[5] The article proceeds to examine a number of design considerations for spending reviews and strategic reviews, and, turning to the literature in the area, it highlights findings about the most successful approaches to such reviews. In particular, "bottom-up" reviews (led by spending departments and agencies) and "arm's length" reviews (led by an independent review body such as the central treasury or the Department of Finance) have not been as effective as reviews that deploy a "joined-up approach," whereby the spending departments and agencies coordinate with central agencies in designing and conducting the review.[6]

Three major review exercises are examined. The authors reach back to the Nielsen Task Force of 1984-1986, on the basis that it shaped the design and conduct of future spending reviews. A major cause of the ultimately disappointing results of that task force was that its relatively independent teams of external experts had insufficient time and information to fully work through the alternative options for program delivery and management. In contrast, the 1994-96 Program Review was a public-service-only exercise led by temporary secretariats at the centre, with the active involvement of the prime minister and the secretary to cabinet. The OECD and independent experts have considered the Program Review an international exemplar, perhaps because it did not simply involve across-the-board cuts, and because it led to the elimination of the federal deficit, followed by 11 years of surpluses and a smaller public service. The article notes, however, that the 1994-1996 Program Review also caused considerable dislocation throughout the public service, and many gaps in public policy. More recent reviews under the Harper government (2007-2010 and 2011) followed a similar pattern of being centrally driven, but with more secrecy and a heavy reliance on consulting firms.

The article, identifying options for the improvement of Canadian review processes, provides brief accounts of actions taken in various countries, with Denmark

5 At 251, table 1.

6 At 252.

and the Netherlands cited as exemplars in the current international context. The main conclusions are that Canadian spending reviews could be

- more open, by involving external experts and public consultations;
- more forward looking, as opposed to focusing on short-term cost reductions and efficiency improvements;
- more ambitious, by involving multiple levels of government; and
- more effective, through the creation of standing review capabilities and repertoires.

The article emphasizes that the episodic expenditure reviews are the "Canadian style" but should not be.[7] It identifies Australia and the Netherlands as countries that have particularly effective regular and systematic processes.

The authors note that whether a review should be comprehensive or targeted remains an important design question, but they observe that governments do not have to choose one approach or the other. They advocate that the government commit to a program of annual reviews and then determine, for each budget cycle, how comprehensive or targeted the review should be. The government would be building up its "spending review muscles" and developing the expertise and institutional memory needed to produce effective reviews.[8] On the other hand, the downside of launching an annual review program is that such reviews are ripe for critical commentary in social media and elsewhere.

The authors apparently see some reason for current optimism, noting that the imperatives informing expenditure reviews have shifted considerably from the Harper era to the Trudeau era. Public sentiment increasingly favours seeking evidence that current spending is efficient and effective, and national programs recently introduced have, accordingly, been complemented by tight expenditure management.

The article's early appraisal of the Trudeau government's current spending review is that it (1) relies on repertoires similar to those employed by the Harper government, (2) does not seem to involve the direct participation of political leaders, and (3) "will likely be sporadic, untargeted, and lead to across-the-board cuts."[9] Whether the article's predictions will be borne out is unclear as yet, because little information has been released. In January 2024, after the publication of the article in *Canadian Public Administration*, the government announced that this year's supplementary estimates will report on travel and professional services reductions for 2023-24 and that the main estimates for 2024-25 will list the remaining phase 1 reductions.[10]

7 At 262.

8 At 263.

9 At 262.

10 Treasury Board of Canada, "Refocusing Government Spending to Deliver for Canadians" (www.canada.ca/en/treasury-board-secretariat/topics/planned-government-spending/refocusing-government-spending.html).

The article published in *Canadian Public Administration* was completed in May 2023. The C.D. Howe commentary, published in February 2024, covers much of the same material. New information in the commentary includes

- a section making the case for annual spending reviews,
- a discussion of new developments in the current government's expenditure review,
- an expanded section on international comparisons, and
- more information on the approach to expenditure reviews recommended for Canada.[11]

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**Marianne Laurin, Derek Messacar, and Pierre-Carl Michaud, "Financial Literacy and the Timing of Tax-Preferred Savings Account Withdrawals"** (2023) 42:2 *Journal of Accounting and Public Policy* 1-18

RRSP withdrawals are common: for working-age savers as a whole, one dollar is withdrawn each year for every five dollars contributed.[12] Since RRSP withdrawals are taxable, one would expect that, as a matter of tax planning, individuals would make RRSP withdrawals in years when their marginal tax rate is low. However, because some knowledge of one's marginal tax rate is required to implement this strategy, this effect may be observed only in individuals with greater financial knowledge.

This study tests these hypotheses, using data for the years covered by Statistics Canada's 2014 Canadian Financial Capability Survey, supplemented by information from the tax returns of survey respondents for the years 2012 to 2016. Financial literacy was measured by means of 14 objective questions testing knowledge of financial concepts (such as inflation), various types of financial products, the stock market, and interest rates. Individuals are divided, on the basis of their survey answers, into two groups: a group of individuals with high financial literacy, and a group with low financial literacy. Then, using regressions with a variety of control variables, the relationship between RRSP withdrawals and financial literacy is examined. One of the most important control variables is income: if individuals with low marginal tax rates are withdrawing more RRSP funds in a particular year, it may not be a matter of tax planning: rather, they may have lower incomes in that year and thus have a greater need for funds.

The results confirm the tax-planning hypothesis for people with high financial literacy: a negative and statistically significant relationship exists between individuals' RRSP withdrawals and their effective marginal tax rates. For individuals with low financial literacy, however, the relationship is much weaker and sometimes not

11 See, respectively, C.D. Howe Institute commentary no. 652, at 4-6, 8-9, 9-12, and 16-19.

12 At 1.

statistically significant (that is, any relationship observed between the two variables could be caused by chance alone).

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**M. Martin Boyer, Philippe d'Astous, and Pierre-Carl Michaud, "Tax-Preferred Savings Vehicles: Can Financial Education Improve Asset Location Decisions?"**
(2022) 104:3 *Review of Economics and Statistics* 541-56
(https://doi.org/10.1162/rest_a_00973)

The authors of this article conducted a survey involving 3,000 residents of Ontario and Quebec aged 35 to 55. The purpose of the survey was to discover whether being shown short videos about the Canadian tax and transfer system improved the decision making of survey respondents when it came to choosing between registered retirement savings plans (RRSPs) and tax-free savings accounts (TFSAs). What was being tested, essentially, was whether respondents understood the following two-part principle and could apply it in practical situations: (1) choosing the RRSP would be beneficial if their effective marginal tax rate decreased from the time of contribution to the time of withdrawal, and (2) choosing the TFSA would be better otherwise.

The survey began with questions about demographics (age and gender, for example), financial literacy, respondents' past use of RRSPs and TFSAs, and respondents' preferences (risk aversion and rate-of-time discount). This stage was followed by an "education intervention" that divided survey respondents into three groups. The tax treatment group was shown a video on RRSPs and TFSAs, while the "means-testing treatment" group was shown that video along with a second video on how tax transfers and credits depend on income at older ages. The control group was shown neither video. After the videos were shown, respondents' knowledge of RRSP and TFSA rules was tested. Finally, respondents were presented with a choice experiment in which a windfall gain was required to be wholly invested in either an RRSP or a TFSA and withdrawn with accumulated investment income at age 70. Respondents had to make choices for six possible scenarios reflecting the respondent's financial situation at age 70—scenarios that included elements such as old age security (OAS) and guaranteed income supplement (GIS) benefits.

The conclusion of the study is that respondents who were exposed to either type of education intervention showed greater knowledge of RRSP and TFSA rules and made contribution choices that increased their after-tax income. On average, respondents increased their discounted welfare by about 4 percent of the contribution amount.[13]

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13 For related research, see Leslie Berger, Jonathan Farrar, Ruth Pogacar, and Lu Y. Zhang, "'Tax-Free': The Effect of a Heuristic Cue on the Choice Between a TFSA and an RRSP" (2023) 71:1 *Canadian Tax Journal* 1-32.

**Helen Miller, Thomas Pope, and Kate Smith, "Intertemporal Income Shifting and the Taxation of Business Owner-Managers"**
(2024) 106:1 *Review of Economics and Statistics* 184-201
(https://doi.org/10.1162/rest_a_01166)

Tax policy analysts often observe that setting tax rates for owner-managers and their companies involves a trade-off: because incomes based on the investment of capital accrue disproportionately to high earners, higher rates are desirable in order to advance the redistribution of income and wealth; at the same time, these higher rates can produce large efficiency losses by discouraging savings and investment. This article's linking of the UK tax returns of privately held companies with the personal tax returns of their owner-managers for the 2005-2015 period casts doubt on this observation. For the two tax rules examined, the large responses to taxation are caused by tax-motivated intertemporal income shifting rather than by changes in real business activity.

The first form of intertemporal income shifting examined by the authors is one that involves the management of personal taxable income so as to be near the higher rate threshold of approximately UK£40,000 (approximately Cdn$70,000). At this threshold, the personal tax rate rises by 20 percentage points. The article examines companies that have one director and one shareholder, and it shows that a sharp bunching occurs at this level of personal taxable income: 16 percent of owner-managers are "sometimes bunchers," and 6 percent are "consistent bunchers."[14] The fact that not all owner-managers are "bunchers" is taken as evidence that income shifting comes with costs; for example, personal consumption needs may be in excess of the higher rate threshold.

The question, though, is whether owner-managers are adjusting their work effort (and thus the total income they generate) in order to arrive at this level of personal taxable income or whether they are, rather, engaging in tax-motivated income shifting between the corporation and the owner-manager (perhaps by adjusting wage payments).[15] In the case of the former, one would expect to see a bunching of total income. Because no such bunching is observed, the income-shifting explanation is supported.

The second form of intertemporal income shifting examined by the authors is the systematic retention of corporate profits, because the tax rate on liquidation (that is, the rate applicable to capital gains) is lower than the rate faced during the life of the company. For owner-managers with incomes above the higher-rate threshold, the amounts retained are large and increasing relative to the amount of total income earned. Although this does not qualify as income shifting if the retained funds are

14 At 197.

15 Income shifting to achieve a target level of corporate taxable income is not expected to occur, because 97 percent of closely held companies are subject to a flat "small companies" rate (at 189).

being used to expand the business, the data show that increases in retained profits above the higher income threshold are matched by an increase in current assets but not fixed assets. Further support for the income-shifting hypothesis is provided by a difference-in-differences statistical analysis of a 2010-11 policy reform that increased tax rates on higher-income individuals.

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**Robert Wardhaugh and Barry Ferguson, *The Rowell-Sirois Commission and the Remaking of Canadian Federalism*** (Vancouver: UBC Press, 2021)

The Royal Commission on Dominion-Provincial Relations (commonly known as the Rowell-Sirois commission—a short form derived from the names of the commission's two successive chairs, Newton Rowell and Joseph Sirois) grappled in the 1930s with problems that seem very familiar today: the constitution assigns the provinces expensive areas of jurisdiction such as education, transportation, health, and welfare; however, because the provinces' own revenue sources are limited, the federal government (today as in the 1930s) is often called on to help. This new history of the Rowell-Sirois commission brings to life the confounding situation facing Canada in the 1930s, when two provinces (Saskatchewan and Manitoba) were on the brink of defaulting on their debts, and the leading politicians of the time (chiefly Ontario Premier Mitch Hepburn and Prime Minister Mackenzie King) were in sharp conflict owing to their differing ideologies and personalities.

The commission's report, delivered in 1940, when Canada was at war, generally avoided suggesting constitutional amendments and instead recommended that the federal and provincial governments enter into voluntary agreements with each other, delegating or jointly administering functions. The federal government alone would impose personal and corporate income tax and succession duties. In return, the federal government would (1) pay back to the province the revenue that the province could have raised from taxing companies engaged in mining and oil producing; (2) take over the entire burden of relief for the employable unemployed; (3) bear the costs of provincial (and some municipal) debts; and (4) make grants to the provinces so as to enable them to deliver, if they chose to, the Canadian average level of social services without imposing exceptionally heavy taxes.

The commission's recommendations on corporate taxation were derived from its view that the system of corporate income tax at that time was "crippled and seriously distorted by the present division of jurisdiction."[16] The various provincial systems were described as "a chaos" that involved "complexity beyond belief"—problems that could be solved by the establishment of a uniform national tax.[17] Furthermore, the report's recommendations on the federal government taking over income taxes were designed to return the federation to its situation at the time of Confederation in

16 At 222.

17 Ibid.

1867, when the major taxes of the time (customs and excise) were exclusively assigned to the federal government.

The commission's report was shelved, but, according to this book, "it provided a storehouse of innovative ideas that redefined the nature of federal government and shaped policy—and thinking—about federalism for decades."[18] That these ideas were important in the five years following the report's release is amply demonstrated in the last quarter of the book, which deals with the situation during the period between the report's 1940 release and the year 1946—a period in which the federal government faced the problems of wartime and postwar financing, and the report was a major influence.[19] That these ideas were, as the authors of this book contend, influential in subsequent decades is, in the words of another reviewer of this book, "more asserted than demonstrated."[20] One wonders whether the commission's most influential contribution may have been its recommendation that the system of per capita grants from the federal government to the provinces (a system created at Confederation) be replaced with a system based on fiscal need. This replacement occurred decades later, with the launch of the equalization program in 1957. This issue, highly controversial at the time of Rowell-Sirois, continues to generate controversy today.

The book's last chapter, "Appraising Rowell-Sirois," traces the interpretation of Rowell-Sirois by academic observers over the years. The argument began to be made in the 1940s that Rowell-Sirois had laid the foundation for a more centralized and powerful federal government. This book's careful analysis, however, shows this argument to be based on a misreading of the commission's work: the commission was quite concerned with provincial autonomy, but it felt that Canada needed a flexible system of fiscal federalism in order for provinces to exercise that autonomy in the service of their residents' welfare.

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18 Inside front cover.

19 On this period, see also Colin Campbell and Robert Raizenne, *A History of Canadian Income Tax*, vol. 1, *The Income War Tax Act, 1917-1948* (Toronto: Canadian Tax Foundation and the Osgoode Society for Canadian Legal History, 2022), chapter 6.

20 Matthew Hayday, "Book Review: The Rowell-Sirois Commission and the Remaking of Canadian Federalism" (2022) 55:4 *Canadian Journal of Political Science* 1003-4, at 1004. Writing in 1953, a member of the commission, Henry Angus of the University of British Columbia, had a much less sanguine view: "I do not think that federal finance in Canada today would be very different from what it is if the Commission had never been appointed. . . . But perhaps—and this is the most that can be claimed—there is a healthier attitude towards these questions and a somewhat greater readiness to approach them without relying on outmoded doctrines." See H.F. Angus, "An Echo of the Past—The Rowell-Sirois Commission" (1953) 1:5 *Canadian Tax Journal* 439-49, at 443.

**Joel Slemrod and Yulia Kuchumova, "Gifts to Government"**
(2023) 30:2 *International Tax and Public Finance* 453-92

For more than 25 years, the personal tax return for residents in Ontario has included a line advising taxpayers that (in the wording of the current form), "You can help reduce Ontario's debt by completing this area to donate some or all of your 2023 tax refund to the Ontario opportunities fund."[21] The existence of this line on the form, responsible for raising about $100,000 to $200,000 a year, answers in the affirmative the rhetorical question with which this research article begins: "Would anyone in their right mind voluntarily give money to the government?"[22] The rest of the article provides both a theoretical and an empirical examination of this phenomenon. The empirical work uses American data.

Long-established public finance theory holds that individuals will not voluntarily make contributions to governments because they can "free ride"—that is, individuals can obtain for free the benefits of government goods and services ("public goods," to use the technical economic term). Taxes solve this free-riding problem: individuals collectively, through democratic institutions, decide that people do not have a choice in whether to contribute to the financing of the operations of government.

A more recent theory allows for the possibility of voluntary contributions: under the "warm glow" model, people experience a sense of satisfaction from helping others. This theory was originally developed to explain why people make contributions to charities, but it could be extended to governments: there may be significant "substitutability" between the purposes of some charities and the purposes of some governmental activities (for example, in the area of child welfare). Designated donations to particular areas of government may be particularly appealing to some individuals. For example, an individual nearing the end of their life might give the land they have lived on to government so as to have its natural beauty permanently preserved as a park.[23] Also, the individual may value the free choice associated with making donations as opposed to paying (mandatory) taxes.

21 For the 2023 return, this is line 46500 (see CRA form T1, "Income Tax and Benefit Return" (2023) (www.canada.ca/content/dam/cra-arc/formspubs/pbg/5006-r/5006-r-23e.pdf). Donations will not be processed if the amount is less than $2 (see Government of Ontario, "Ontario Opportunities Funds" (www.ontario.ca/page/ontario-opportunities-fund#section-1). According to a review of previous tax returns on the Canada Revenue Agency website, the line appears to have first appeared on 1997 tax forms (see CRA form T1, "Income Tax and Benefit Return" (1997) (www.canada.ca/en/revenue-agency/services/forms-publications/tax-packages-years/archived-income-tax-package-1997/ontario/5006-r.html).

22 At 454. The amounts are from Haydn Watters, "Donations To Curb Ontario Government's Debt Rose During COVID-19," *CBC News*, April 27, 2022 (www.cbc.ca/news/canada/hamilton/ontario-opportunities-fund-debt-province-1.6431518).

23 This argument is less applicable to financial gifts, because money is fungible. In other words, the fact that an individual donates money to a particular government program does not necessarily mean that more total money is spent on that program; the government could simply reduce its own spending on that program. Nevertheless, the ability to designate the donation may add to the warm-glow effect.

The first part of this article provides a theoretical model for investigating the implications of the warm-glow effect of giving to government in a context where tax evasion is possible. The major question addressed is whether some individuals might choose both to evade taxes and to make donations to government. One of the conditions necessary for this to occur is that the warm glow of transferring money to the government as a gift exceeds the warm glow of transferring the money through tax payments (perhaps for the reasons cited above). The other condition, roughly speaking, is that the individual either highly values donating to the public good or is sufficiently rich that the cost of making a donation (cost measured in terms of the personal value of the private goods forgone) is relatively low.[24]

The empirical part of the article uses US Treasury data to construct a data set of gifts to the US federal government since 1914, along with some data regarding subcategories of gifts, with the large items being gifts to reduce the debt and gifts to the military. No attempt is made to link these gifts data with tax evasion; there are no suitable data for this type of analysis.

Gifts intended to reduce the government's debt are strongly associated with wars, perhaps because of the "we're in this together" mentality that prevails at such times.[25] Thus, a graph showing the ratio of gifts to government as a percentage of gross domestic product has a sharp spike in 1947 and 1948: the dollar value of such gifts in 1947 and 1948 was $12 million and $8 million, respectively, but it fell to $0.15 million in 1949 and to even less thereafter.[26] Gifts to the military, measured as a proportion of gross domestic product, also spiked during the Second World War, with much smaller gifts made at the time of the Gulf War and at the beginning of the Afghanistan war.

Generally, gifts to the government have been vanishingly small in comparison with tax revenues. For example, gifts to reduce the debt in 2019 totaled $5 million—less than 0.0006 percent of federal tax collections in that year. Still, one wealthy Texan gave $420 million "to my beloved country" when she died in 1960.[27]

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24 At 462, proposition 3.

25 Purchases of "war bonds" carrying below-market interest rates are similar but are not studied in the paper.

26 At 468. All dollar figures in this review are in US currency.

27 At 467.