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CANADIAN TAX JOURNAL
REVUE FISCALE CANADIENNE

PEER-REVIEWED ARTICLES

The Impact of Mandatory RRIF Withdrawals on Seniors' Income Security — *Amin Mawani*

POLICY FORUM

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Understanding the Efficacy of Tax Credits for Charitable Donations in Canada — *Ross Hickey, A. Abigail Payne, and Justin Smith*

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Current Tax Reading — *Jinyan Li and Michael Veall*

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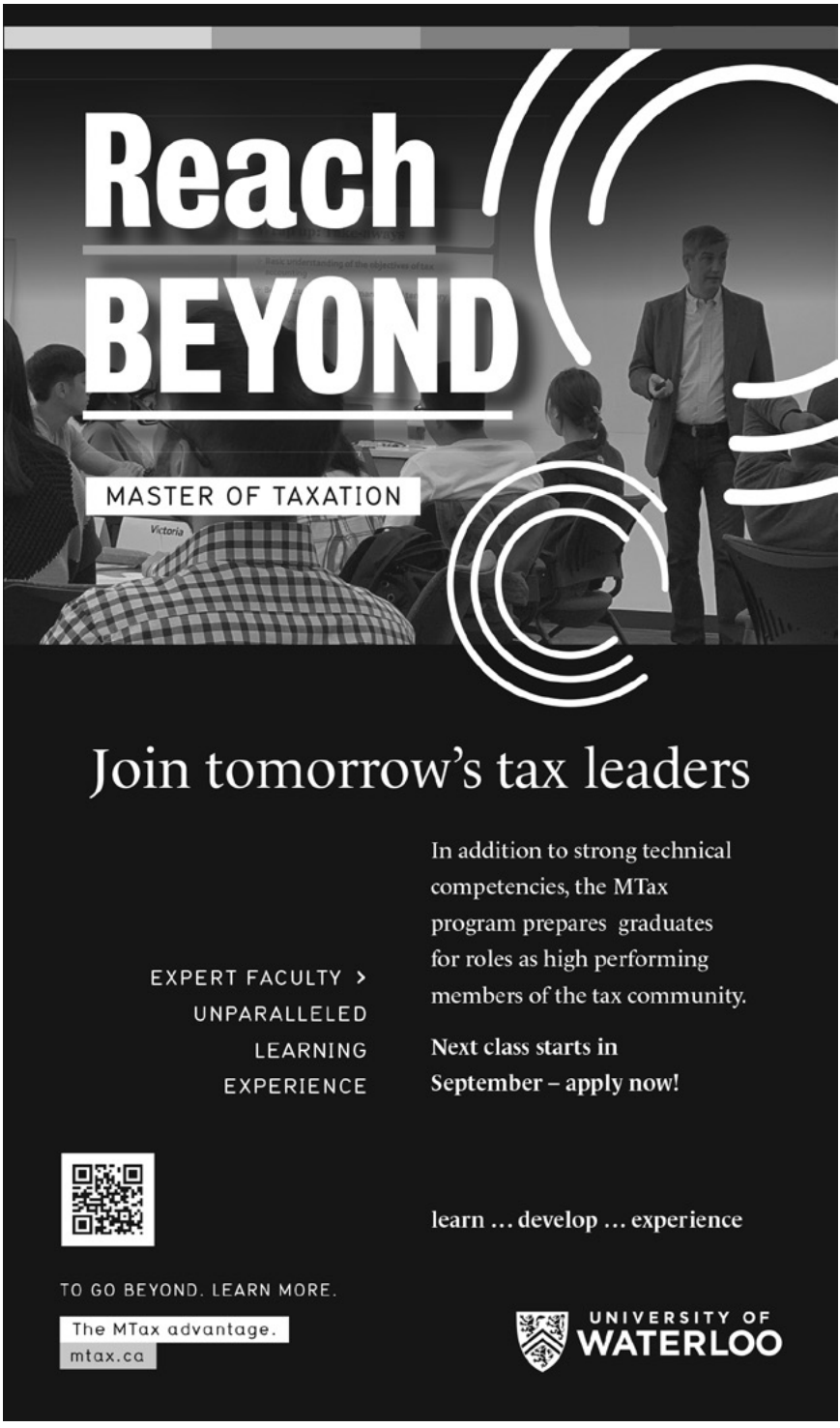
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The Canadian Tax Foundation, an independent, not-for-profit research and educational organization, is seeking proposals for books in the areas of taxation and public finance.

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

Appel de propositions de livres

La Fondation canadienne de fiscalité (FCF) / Canadian Tax Foundation, un organisme sans but lucratif indépendant de recherche et à caractère éducatif, souhaite recevoir des propositions de livres dans les domaines de la fiscalité et des finances publiques.

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 :

Heather Evans
Directrice exécutive et chef de la direction
Canadian Tax Foundation / Fondation canadienne de fiscalité
145 Wellington Street West, Suite 1400
Toronto, Ontario M5J 1H8

hevans@ctf.ca

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 :

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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*

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

YOUNG PRACTITIONER FOCUS CONFERENCE (VIRTUAL)
September 4, 2024

PERSPECTIVES OF THE JUDICIARY—PART III
Montreal, September 5, 2024

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

COCKTAIL DE LA RENTRÉE
Montreal, September 18, 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 Foundation
145 Wellington Street West
Suite 1400
Toronto, Canada M5J 1H8
Telephone: 416-599-0283
Toll Free: 1-877-733-0283
Facsimile: 416-599-9283
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La Fondation canadienne de fiscalité
1250, boul. René-Lévesque ouest
Bureau 2935
Montréal (Québec) H3B 4W8
Téléphone : 514-939-6323
Télécopieur : 514-939-7353
Internet : 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 Scopus, 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 Scopus, 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 $430.00 a year, except that special member rates apply as follows: (a) $216.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) $216.00 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) $185.00 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.

Les décideurs et administrateurs gouvernementaux respectent depuis longtemps l'objectivité de la FCF, son attention aux questions fiscales de l'heure, sa préoccupation envers l'amélioration du système fiscal canadien et son importante contribution au développement des politiques fiscales.

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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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The Impact of Mandatory RRIF Withdrawals on Seniors' Income Security

Amin Mawani*

PRÉCIS

Certains ont plaidé récemment en faveur d'une hausse de l'âge auquel les Canadiens doivent convertir leurs régimes enregistrés d'épargne-retraite (REER) en fonds enregistrés de revenu de retraite (FERR) ainsi qu'en faveur d'une réduction des taux de retrait minimum annuel des FERR, voire de l'élimination des retraits minimums obligatoires des FERR.

Cet article soutient que les retraits obligatoires des FERR à partir de 71 ans ne menacent pas la sécurité de revenu de la plupart des aînés canadiens pendant leur retraite. Les retraits forcés d'un FERR n'ont pas à entraîner une désépargne importante. Compte tenu des montants modestes accumulés dans les REER et les FERR par la plupart des Canadiens, les sommes retirées chaque année de ces régimes sont probablement nécessaires pour subvenir aux besoins de consommation des retraités et ne sont donc pas limités par les règles de retrait obligatoire. Les stratégies de planification fiscale de base, telles que le réinvestissement des retraits d'un FERR dans des comptes d'épargne libre d'impôt, peuvent réduire davantage le coût des retraits obligatoires.

Dans un souci de simplicité et afin de réduire le fardeau de la conformité, cet article propose également que les détenteurs d'un FERR ayant accumulé au plus 200 000 $ d'épargne (soit l'équivalent du 75^{e} centile des soldes des FERR) soient exemptés des retraits annuels obligatoires. Bien que certains aient plaidé en faveur de l'élimination complète des retraits obligatoires, une telle mesure n'est pas soutenable du point de vue de la politique fiscale. Le report indéfini de soldes d'épargne-retraite plus importants pourrait permettre aux Canadiens fortunés d'utiliser cette épargne à des fins de planification successorale et constituerait une mesure régressive. En outre, le fait de conserver une fortune dans des comptes à imposition différée tout en demandant la sécurité de la vieillesse (SV) en raison d'un faible revenu mettrait en péril la viabilité du programme de SV. La SV n'a pas été conçue pour résister à l'admissibilité des personnes âgées riches en actifs, mais réticentes à retirer leurs actifs de retraite accumulés grâce à l'épargne à imposition différée.

* Of the Schulich School of Business, York University, Toronto (e-mail: amawani@schulich.yorku.ca).

ABSTRACT

There has been recent advocacy for raising the age at which Canadians must convert registered retirement savings plans (RRSPs) to registered retirement income funds (RRIFs), and for reducing the annual minimum RRIF withdrawal rates or even eliminating mandatory minimum RRIF withdrawals.

This article argues that mandatory RRIF withdrawals starting at age 71 may not be a threat to income security during retirement for most Canadian seniors. Forced RRIF withdrawals do not have to result in any significant dissavings. Given the modest amounts accumulated in RRSPs and RRIFs by most Canadians, the amounts withdrawn each year are likely necessary for consumption and therefore are not likely constrained by the mandatory withdrawal rules. Basic tax-planning strategies such as reinvesting RRIF withdrawals in tax-free savings accounts can further reduce the cost of mandatory withdrawals.

In the interest of simplicity and reducing the compliance burden, this article also suggests that RRIF holders with up to $200,000 of accumulated savings (equivalent to the 75th percentile of RRIF balances) should be exempted from mandatory annual withdrawals. While some have argued for complete elimination of mandatory withdrawals, such a measure is not supportable from a tax policy perspective. Indefinite deferral of larger retirement savings balances may allow wealthy Canadians to use those savings for estate-planning purposes and would be a regressive measure. Furthermore, retaining wealth inside tax-deferred accounts while claiming old age security (OAS) because of low income would jeopardize the sustainability of the OAS program. OAS was not designed to withstand eligibility for seniors who are asset-rich but reluctant to draw down retirement assets that were accumulated with tax-deferred savings.

KEYWORDS: OAS ■ RRIF ■ RRSP ■ TFSA ■ WITHDRAWALS

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INTRODUCTION

Canada's Department of Finance recently undertook a study of registered retirement income funds (RRIFs) to examine how the current mandatory withdrawal rules affect Canadians' retirement income.[1] Industry organizations have joined in the call for a review of how rates of return, inflation, and longevity are affecting Canadians' retirement security.[2] Advocacy and pressure for change largely revolve around raising the age at which individuals must convert their registered retirement savings plans (RRSPs) to RRIFs and reducing the annual minimum RRIF withdrawal rates. Potential motives for lobbying include the desire to lower tax rates (by deferring income inclusion), to reduce complexity (in having to estimate minimum withdrawal rates), and to safeguard longevity (by avoiding the forced depletion of savings required to fund the years of retirement).

This article examines the impact of the current RRIF withdrawal rules on Canadians, arguing that, for the great majority of seniors, the impact is relatively modest. The effects of mandatory withdrawals to the RRIF rules are concentrated among the highest-income seniors. To illustrate this, the article considers the example of a $1 million accumulated RRIF account balance. A $1 million balance is 12 times larger than the median balance and also substantially larger than the $600,000 RRIF balance owned by a 95th percentile RRIF holder at the end of 2019.[3] Even with this very large balance, the analysis in this article shows that, for most planholders, the amount required to be withdrawn each year is likely necessary to fund current consumption, and therefore, in such cases, the use of RRIF savings is likely not constrained by the mandatory withdrawal rules. The article also discusses self-help remedies that can alleviate the cost of early withdrawals, such as the reinvestment of at least some of the withdrawn funds in a tax-free savings account (TFSA). Government data indicate that many Canadians—including those in the 70-plus age category—continue to have unused TFSA contribution room.[4]

RRSPs and RRIFs are designed to help Canadians save for retirement and to be drawn upon for retirement income. As a result, contributions to RRSPs are not allowed beyond age 71, at which time an RRSP must be converted to a RRIF in order to preserve the deferral of tax on the accumulated savings. Starting at age 71, RRIFs are subject to

1 Canada, House of Commons, "Registered Retirement Income Funds and Minimum Withdrawal Requirements—Report to Parliament," Sessional Paper no. 8525-441-34 (https://calu.com/wp-content/uploads/2023/06/Registered-Retirement-Income-Funds-and-Minimum-Withdrawal-Requirements-Report-to-Parliament-EN.pdf).

2 The discussion in this article does not identify all of the alternative proposals put forward by industry organizations to the Department of Finance. Rather, this article discusses and critiques the idea of eliminating annual minimum RRIF withdrawals, and argues that such withdrawals are not as costly for most seniors as is commonly maintained.

3 Statistics Canada. Custom request based on Statistics Canada, "Survey of Financial Security (SFS), 2019" (www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=2620), reproduced and distributed on an "as is" basis with the permission of Statistics Canada.

4 Government of Canada, "Tax-Free Savings Account Statistics 2021 Edition (2019 Tax Year)" (https://open.canada.ca/data/en/dataset/122b7e62-fcb7-4a2a-b2cb-2d745845eef3).

mandatory annual minimum withdrawals that increase with age. The mandatory minimum withdrawals ensure that such tax-assisted savings are used to provide retirement income and are not delayed indefinitely for estate-planning purposes. At a combined estimated cost of $25.8 billion in forgone federal tax revenues in 2023, RRSPs and RRIFs constitute one of Canada's largest tax expenditures.[5] This tax expenditure is intended to be used strictly for tax-assisted retirement savings and income, and not for estate planning.

While RRSPs offer Canadians significant opportunities for tax deferral, less than 25 percent of eligible taxfilers contribute on a regular basis. The median amount contributed in 2021 was $3,890, the highest level on record.[6] Canadians aged 65 and over held an average of $224,000 and a median of $100,000 in their RRSPs, RRIFs, and locked-in retirement accounts combined at the end of 2019.[7] Such modest balances imply that annual RRIF withdrawals, both mandatory and discretionary, will be of limited magnitude for most seniors. The exemption of small accumulated balances from mandatory annual minimum withdrawals would not result in the diversion of RRIF savings to estate-planning vehicles, and could be afforded at a negligible cost to the treasury. This article therefore recommends that RRIF holders with up to $200,000 of accumulated savings (equivalent to savings for RRIF holders in the 75th percentile) be exempted from mandatory annual withdrawals. To maintain neutrality between current and future consumption, all RRIF withdrawals from portfolios of up to $200,000 would continue to be fully taxed upon withdrawal. However, the timing of withdrawals from such smaller portfolios would not be mandated by age.

Modest RRIF balances are mainly attributable to low contributions to RRSPs during the individual's working years. RRSP statistics for 2021[8] show that a total of 6.3 million taxpayers (representing 22.4 percent of all 28 million taxfilers) made a median RRSP contribution of $3,890 while earning a median employment income of $71,210. By comparison, the 2021 median and average incomes of all taxfilers were $41,000 and $55,900, respectively.[9] Thus, RRSP contributors earn significantly more than the average or median Canadian taxfiler.

A 2020 Statistics Canada survey shows that 47.9 percent of Canadians expect no income from retirement savings plans.[10] RRSP savings may even be contraindicated

5 Canada, Department of Finance, *Report on Federal Tax Expenditures: Concepts, Estimates and Evaluations 2023* (Ottawa: Department of Finance, 2023).

6 Statistics Canada table 11-10-0044-01 (formerly CANSIM table 111-0039), "Selected Characteristics of Tax Filers with Registered Retirement Savings Plan (RRSP) Contributions."

7 Statistics Canada table 11-10-0016-01 (formerly CANSIM table 205-0002), "Assets and Debts Held by Economic Family Type, by Age Group, Canada, Provinces and Selected Census Metropolitan Areas, Survey of Financial Security (x 1,000,000)."

8 Statistics Canada table 11-10-0044-01, supra note 6.

9 Statistics Canada table 11-10-0055-01 (formerly CANSIM table 204-0001), "High Income Tax Filers in Canada."

10 Statistics Canada, "Financial Expectations of Retired Canadians," *The Daily*, December 13, 2022, at 5, table 4 (www150.statcan.gc.ca/n1/en/daily-quotidien/221213/dq221213b-eng.pdf).

for very low-income Canadians since withdrawals from such savings would directly claw back guaranteed income supplement (GIS) benefits received during retirement. Vettese[11] shows that a couple earning a combined annual income of $50,000 would be better off (in terms of retirement income) if they saved 4.2 percent of their earned income in TFSAs compared to saving 10 percent of their earned income in RRSPs (even though RRSP legislation allows tax-deductible contributions of up to 18 percent of earned income). Mandatory withdrawals, longer lives, and lower returns have significantly less impact than low RRSP savings on the premature depletion of retirement savings for most senior Canadians.

Lower accumulated average RRSP balances are consistent with the evidence that most Canadians seem to prefer an immediate receipt of income over continued growth and tax deferral in their Canada Pension Plan (CPP). A *Globe and Mail* survey of 946 Canadians conducted in November 2023 found that 34 percent started taking their CPP benefits at age 60, 19 percent at age 65, and only 16 percent at age 70.[12] Delaying CPP is often the best alternative for most healthy Canadians since each month of delay past age 65 increases the benefit by 0.7 percent per month (or 8.4 percent per year). Delaying CPP benefits is therefore equivalent to earning a risk-free annual after-tax return of 8.4 percent on the accumulated CPP balance. Yet most Canadians give up this opportunity by claiming their CPP benefits earlier than the financially optimal time.

To reiterate, 47.9 percent of Canadians do not expect to have any income from RRSPs in retirement.[13] Of the remaining 52.1 percent who do have RRSPs (and are likely to eventually have RRIFs), Statistics Canada estimates show that 2,070,570 Canadians over the age of 70 withdrew an average of $10,645 from RRIFs in 2020, with 41 percent withdrawing more than the minimum.[14] Those withdrawing more than the minimum were obviously not constrained by the mandatory RRIF withdrawal rules since the excess withdrawals were entirely discretionary. RRIF holders who withdraw excess amounts likely do not have any significant savings outside their tax-sheltered plans or are withdrawing earlier than required in order to avoid old age security (OAS) clawbacks. This conclusion is consistent with Department of Finance projections (in 2013) that by 2030, 90 percent of Canadians will hold all of their financial assets in tax-sheltered savings vehicles.[15]

11 Frederick Vettese, "Should Low-Income Canadians Save for Retirement?" *The Globe and Mail*, July 4, 2023 (www.theglobeandmail.com/investing/personal-finance/retirement/article-should-low-income-canadians-save-for-retirement).

12 Brenda Bouw, "What Triggers Canadians To Take Their CPP Benefits When They Do?" *The Globe and Mail*, January 23, 2024 (www.theglobeandmail.com/investing/globe-advisor/advisor-news/article-what-triggers-canadians-to-take-their-cpp-benefits-when-they-do).

13 Statistics Canada, supra note 10.

14 Statistics Canada table 11-10-0044-01, supra note 6.

15 Canada, Department of Finance, *Tax Expenditures and Evaluations 2012* (Ottawa: Department of Finance, 2013), at 31-45.

With 41 percent of the 52.1 percent of Canadians who have RRSPs or RRIFs not being constrained by the mandatory annual minimum withdrawal rules, at most 30.7 percent of RRIF holders (59 percent × 52.1 percent) may be constrained by those rules. Exempting 75 percent (or those with RRIF balances of up to $200,000) of this 30.7 percent group implies that less than 7.7 percent (25 percent × 30.7 percent) of RRIF holders with accumulated RRIF balances higher than $200,000 would be subject to mandatory minimum withdrawals. The additional annual tax on the mandatory minimum withdrawals from RRIFs (based on estimates from a much larger portfolio used as an example later in this article) is modest compared to the relative size of the RRIF account balance. Individuals with larger RRIF balances are likely to have less need to rely on RRIF withdrawals for retirement income, and therefore may be more likely to use the preserved funds for estate-planning purposes. In the absence of mandatory withdrawals, a subset of this group could also potentially apply for OAS while keeping their RRIF savings intact.

The arguments for maintaining mandatory annual RRIF withdrawals for RRIF holders with large balances are similar to Kesselman's arguments against expanding TFSA contribution limits:[16] the benefits are skewed in favour of high income earners who have likely exhausted all of their tax-sheltered contribution room and therefore have investment income outside tax-sheltered plans.

Women are more likely to be represented in the group exempted from mandatory RRIF withdrawals because of lower incomes (compared to those of men) and therefore lower dollar contribution limits,[17] lower RRSP participation rates, and ultimately lower accumulated RRSP and RRIF balances. Statistics Canada data from 2020 show that "female tax filers (20.1%) were less likely overall to make contributions to an RRSP than male tax filers (24.6%)," with a "median RRSP contribution of $2,960 for women and $4,280 for men."[18] Exempting more women than men from mandatory RRIF withdrawals may be justified on the ground that women statistically have longer life expectancies than men.[19]

The remainder of this article is organized as follows. First, I provide a brief overview of the policy objectives of RRIFs. I then develop an illustrative fact scenario to derive a high-end estimate of the potential cost of mandatory withdrawals. Next, I describe the provincial tax and social benefit implications of RRIF withdrawals, and then explore a policy recommendation to exempt RRIF balances of up to $200,000 from mandatory annual withdrawals. I discuss some well-known tax-planning strategies that

16 Jonathan Rhys Kesselman, *Double Trouble: The Case Against Expanding Tax-Free Savings Accounts* (Ottawa: Broadbent Institute, 2015).

17 Melissa Moyser, *Measuring and Analyzing the Gender Pay Gap: A Conceptual and Methodological Overview* (Ottawa: Statistics Canada, 2019).

18 Statistics Canada, "Registered Retirement Savings Plan Contributions, 2020," *The Daily*, April 1, 2022 (www150.statcan.gc.ca/n1/en/daily-quotidien/220401/dq220401a-eng.pdf).

19 Statista, "Life Expectancy at Birth in Canada from 2011 to 2021, by Gender" (www.statista.com/statistics/970534/life-expectancy-at-birth-in-canada-by-gender/).

can alleviate the cost of mandatory annual RRIF withdrawals. I also offer some comments on the government's perspective on RRIF withdrawals. A brief concluding section summarizes the key points made in the article.

POLICY OBJECTIVES

RRIFs were introduced in the 1978 federal budget with the policy objective of allowing RRSP holders to continue sheltering income earned on their retirement savings "while retaining the basic principle that RRSP funds are intended to be used for retirement income."[20] Prior to 1978, RRSP holders had to withdraw all of the funds upon reaching age 71 and pay taxes at their marginal tax rates, or buy a life annuity from a life insurance company. The requirement to commence withdrawals from RRSPs and RRIFs at age 71 makes such plans equitable with registered pension plans (RPPs) offered by employers.[21]

The Department of Finance temporarily relaxed the mandatory minimum RRIF withdrawal rules on two occasions when financial markets suffered significant losses owing to extraordinary events: first in 2008, during the global financial crisis; and again in 2020, in response to the impact of the COVID-19 pandemic. These changes were designed to alleviate hardship for seniors who experienced a decline in the value of their RRIF portfolios, and would have been further disadvantaged by the accelerated depletion of their retirement savings. Also, in 2015, the Department of Finance revised the RRIF withdrawal schedule established in 1992, to reflect the increased longevity of Canadians.

Mandatory RRIF withdrawal rules were principally designed to safeguard the government's intended objective of enhancing Canadians' financial security in retirement and to preclude the use of tax-assisted retirement savings for the purpose of estate planning. Canadians with high net worth already benefit disproportionately from tax-advantaged retirement and pension savings. They are also more likely to have benefited from the capital gains exemption on the sale of a principal residence compared to Canadians with lower net worth. In the absence of mandatory annual withdrawals, high-income Canadians could continue to compound their investments at pre-tax returns (instead of after-tax returns) for as long as they live,[22] for the benefit of their heirs. In contrast, low-income Canadians are likely to need all of the funds withdrawn under the mandatory RRIF withdrawal rules to meet their consumption requirements during retirement, and are often not able to strategize tax deferrals. Preventing the misuse of tax preferences for retirement income through strategic estate planning remains a legitimate policy goal.

20 Canada, Department of Finance, 1978 Budget, Budget Papers, April 10, 1978, at 40.

21 One alternative is to make RRIFs more like RPPs in that RRIFs could terminate upon the death of the RRIF holder. This would incentivize RRIF holders to exhaust their RRIF balance prior to expected death rather than use it for estate planning.

22 Or even longer if the deceased RRIF holder had designated a surviving spouse as a direct beneficiary of the RRIF.

Seniors advocates have lobbied for the elimination of all mandatory RRIF withdrawals.[23] However, the current rules arguably do not cause economic harm for most RRIF holders, who may need to withdraw more than the minimum required for their annual consumption. As illustrated in the next section, the cost of a forced withdrawal is modest even when the accumulated RRIF balance is more than five times higher than the average RRIF amount accumulated by an 83-year-old senior. Universal elimination of mandatory minimum RRIF withdrawals would mostly be a windfall for wealthy seniors, who probably do not need their RRIF savings to pay for ordinary living expenses during retirement. Moreover, lobbying on this issue may detract from efforts to address other more important issues, such as the clawback of OAS benefits for seniors with modest incomes.

EXAMPLE OF THE COST OF MANDATORY WITHDRAWALS

If the RRIF funds withdrawn under the mandatory minimum withdrawal rules are needed for consumption in the same year as the withdrawal, the forced withdrawal policy is not constraining to taxpayers, since they would have withdrawn such amounts for consumption regardless of the rules. If, however, the amounts withdrawn are not consumed in the same year and instead are reinvested outside a tax shelter, the taxpayer is not indifferent as to when the RRIF withdrawals are made. This is because the longer the funds are invested inside the RRIF, where the annual returns are sheltered from tax, the less time they will be reinvested outside the RRIF, where the annual returns may be subject to tax.

Let us consider 83-year-old Adam, who has an accumulated balance of $1 million in his RRIF.[24] Under the current rules, Adam must withdraw at least $73,800 (7.38 percent of $1 million)[25] in the taxation year in which he turns 83.

If Adam needs at least $73,800 in pre-tax income for annual consumption,[26] and has no other assets that can be easily liquidated, the cost of the forced RRIF withdrawal is zero, since Adam would have withdrawn this amount even in the absence of the mandatory withdrawal rules.

However, let us assume that Adam needs only $63,800 in pre-tax earnings for his annual consumption. In this context, Adam is being forced to withdraw $10,000

23 See, for example, CanAge, *Voices of Canada's Seniors: A Roadmap to an Age-Inclusive Canada* (Toronto: CanAge, August 2020) (www.canage.ca/wp-content/uploads/2021/03/CanAge_VOICES_Roadmap_2020.pdf).

24 The $1 million RRIF balance used in this illustration is larger than the 95th percentile RRIF holder's balance of $600,000, as described in the introduction to this article.

25 If Adam were married to a younger spouse, he could elect to use a lower minimum withdrawal percentage based on his spouse's age. See the discussion below under the heading "Tax Strategies To Alleviate the Impact of Mandatory RRIF Withdrawals."

26 $73,800 in pre-tax income translates to $59,721 in after-tax income (or just under $5,000 per month), assuming no other income.

earlier than he needs to—at a marginal tax rate of just under 30 percent in Ontario.[27] If he were not forced to make the minimum withdrawal, Adam could leave the $10,000 in his tax-sheltered RRIF to earn an assumed pre-tax return of 5 percent, or $500. This $500 would be taxed on eventual withdrawal even in the absence of the mandatory withdrawal rules.

Once funds are withdrawn from the RRIF, Adam can reinvest outside the RRIF shelter without any limit and can earn an after-tax return of 3.5 percent (a 5 percent pre-tax return less a tax rate of 30 percent). A 3.5 percent after-tax return on $10,000 would yield $350, or $150 less than the $500 that Adam could have earned annually inside the RRIF.

This $150 annual burden on the early forced RRIF withdrawal can be avoided if the $10,000 excess amount is reinvested in a TFSA. (The prevalence of unused TFSA contribution room at all age and income levels is discussed later in this article.)

In addition, Adam will have to pay tax on the $10,000 excess amount withdrawn from the RRIF some years earlier than he would if the minimum withdrawal rules were not in place. For example, if (in the absence of the mandatory withdrawal rules) Adam did not withdraw this $10,000 for another six years, the tax cost of withdrawing six years earlier than necessary would be $761 (assuming annual interest rate of 5 percent), as shown below:

Income tax paid on early RRIF withdrawal made today:	
$10,000 × 30 percent marginal tax rate	$3,000
Present value of tax paid if RRIF withdrawal made at the end of six years = $3,000/$(1.05)^6$	$2,239
Incremental income tax paid in present-value terms if early withdrawal is forced	$ 761

The cost of the mandatory RRIF withdrawal—$761 where the RRIF balance yields 5 percent per year—falls to $629 if the yield is 4 percent and rises to $885 if the yield is 6 percent. RRIF holders who can earn higher rates of return can benefit more from not having to make early withdrawals.[28] The tax cost of early mandatory RRIF withdrawals does not depend on the form of the return—whether interest, dividends, or capital gains—since pre-tax returns in all forms remain equally tax-sheltered while inside the RRIF and equally taxed when withdrawn. However, for a given rate of return, investments yielding returns in the form of tax-favoured capital gains may be riskier compared to investments yielding returns in the form of fully taxed interest income.

The $761 incremental tax burden (at a 5 percent yield) over six years amounts to about $127 per year, resulting in a total cost of early forced withdrawals of $277 per

27 Ernst & Young, "2023 Personal Tax Calculator" (www.eytaxcalculators.com/en/2023-personal-tax-calculator.html).

28 While the decision to invest rather than consume is based on expected returns, the (tax) cost of early withdrawals is based on actual returns.

year ($150 + $127) on a RRIF balance of $1 million.[29] This calculation highlights the point that forced RRIF withdrawals do not have to result in any significant dissavings. The annual cost would be lower for RRIF holders younger than age 83 and higher for RRIF holders older than age 83, since the mandatory annual minimum withdrawal rate increases monotonically with the RRIF holder's age.

Table 1 shows that the annualized cost of a one-time mandatory withdrawal of $10,000 from a RRIF ranges from $253.80 to $292.86, representing an incremental cost of less than 3 percent per year. The annualized cost is reduced to a range of $103.80 to $142.86 (representing an incremental cost of less than 1.5 percent per year) if the RRIF holder has sufficient unused TFSA contribution room. Such an incremental annualized cost would be imposed only on the 7.7 percent of RRIF holders with accumulated balances that exceed $200,000.

The 1.5 to 3 percent annualized cost shown in table 1 should be viewed in light of the tax treatment of investment income earned inside RRSPs and RRIFs. Assuming that the individual's marginal tax rate at the time of an RRSP contribution (t_0) is identical to the tax rate at the time of an RRSP or RRIF withdrawal (t_n), the investment returns on RRSPs and RRIFs are essentially exempt from income taxation.[30] More specifically, a $1 consumption sacrifice that is invested in an RRSP yields an investment of $1/(1 − t_0) that generates a pre-tax return of r percent, with the entire accumulated amount being taxed at the marginal tax rate of t_n at the end of period n. This yields the following equivalence, with the expression on the right-hand side showing essentially tax-exempt investment returns:[31]

$$\frac{\$1}{(1-t_0)}(1+r)^n(1-t_n) = \$1(1+r)^n. \tag{1}$$

Equation 1 also reminds us that investment in spousal RRSPs can be a wealth-enhancing tax-planning strategy, since the contributions are deductible currently (at time 0) at the marginal tax rate of the higher-income spouse (A) (t_{A0}), while the withdrawals are taxed upon retirement (or at time n) at the marginal tax rate of the lower-income spouse (B) (t_{Bn}). This amplifies the after-tax return over the life of the RRSP, yielding a rate of return better than a tax-exempt rate.

A taxpayer contributing a median amount of $3,890 per year (at the beginning of each year) to his RRSP and earning an annual return of 5 percent would accumulate $493,407 after 40 years. After conversion of the RRSP to a RRIF, the incremental cost of the mandatory RRIF withdrawals would amount to less than $138 per year,

29 If the $277 annual tax cost in this example were reduced with the help of professional tax advice at $250 per hour plus goods and services tax/harmonized sales tax, the entire annual benefit of the advice would be nullified by its cost.

30 If the tax rate at withdrawal (t_n) is less than the tax rate at contribution (t_0), an RRSP contribution can yield an even better return than a tax-exempt investment.

31 The right-hand side expression in equation 1 does not have a tax-rate variable, t, indicating that accumulated returns are not dependent on taxes.

TABLE 1 Annualized Cost of a $10,000 Mandatory Early RRIF Withdrawal

(A) Year	(B) Tax on early mandatory excess RRIF withdrawal [($10,000 × 30%)/(1 + 0.05)^n]	(C) Cost of early RRIF withdrawal [$3,000 – (B)]	(D) Annualized tax cost of early withdrawal (C)/(A)	(E) Annual return inside RRIF or TFSA ($10,000 × 5%)	(F) Annual return outside RRIF or TFSA ($10,000 × (1 – 0.3)5%]	(G) Difference in annual after-tax return (E) – (F)	(H) Total annualized cost of early RRIF withdrawal (D) + (G)
				dollars			
0 Taxes if withdrawn today	3,000.00						
1 Taxes if withdrawn 1 year from now	2,857.14	142.86	142.86	500.00	350.00	150.00	292.86
2 Taxes if withdrawn 2 years from now	2,721.08	278.92	139.46	500.00	350.00	150.00	289.46
3 Taxes if withdrawn 3 years from now	2,591.52	408.48	136.16	500.00	350.00	150.00	286.16
4 Taxes if withdrawn 4 years from now	2,468.12	531.88	132.97	500.00	350.00	150.00	282.97
5 Taxes if withdrawn 5 years from now	2,350.60	649.40	129.88	500.00	350.00	150.00	279.88
6 Taxes if withdrawn 6 years from now	2,238.66	761.34	126.89	500.00	350.00	150.00	276.89
7 Taxes if withdrawn 7 years from now	2,132.07	867.93	123.99	500.00	350.00	150.00	273.99
8 Taxes if withdrawn 8 years from now	2,030.48	969.52	121.19	500.00	350.00	150.00	271.19
9 Taxes if withdrawn 9 years from now	1,933.86	1,066.14	118.46	500.00	350.00	150.00	268.46
10 Taxes if withdrawn 10 years from now	1,841.70	1,158.30	115.83	500.00	350.00	150.00	265.83
11 Taxes if withdrawn 11 years from now	1,754.03	1,245.97	113.27	500.00	350.00	150.00	263.27
12 Taxes if withdrawn 12 years from now	1,670.52	1,329.48	110.79	500.00	350.00	150.00	260.79
13 Taxes if withdrawn 13 years from now	1,590.93	1,409.07	108.39	500.00	350.00	150.00	258.39
14 Taxes if withdrawn 14 years from now	1,515.16	1,484.84	106.06	500.00	350.00	150.00	256.06
15 Taxes if withdrawn 15 years from now	1,443.00	1,557.00	103.80	500.00	350.00	150.00	253.80

RRIF = registered retirement income fund; TFSA = tax-free savings account.

n = years.

Note: The calculation of the annualized cost is based on an assumed investment return of 5 percent and a marginal effective tax rate of 30 percent.

or half of Adam's $277 annual cost (since the accumulated portfolio of $493,407 is about half the size of Adam's accumulated RRIF portfolio of $1 million) illustrated in the earlier example. The low-income RRIF holder would also earn higher after-tax returns outside the RRIF owing to his lower annual marginal tax rate.

The $1 million RRIF balance used as an illustration here is more than five times greater than the average balance of $190,000 for all RRIF holders.[32] Those with accumulated balances closer to the mean or median are likely not constrained by the forced withdrawal rules, since they likely require more than the minimum RRIF withdrawals just to meet their annual consumption needs. For example, an 83-year-old RRIF holder with an average RRIF balance of $190,000 would be required to withdraw at least 7.38 percent, or $14,022 annually. This individual would likely need a larger amount for annual consumption and may have to withdraw more from the RRIF (even in the absence of mandatory withdrawal rules) or from other savings.

The mandatory RRIF withdrawals do not impose a significant cost on most Canadian retirees. Forced withdrawals may impose a high cost on a small subset of seniors who have large balances in their RRSPs or RRIFs. However, those individuals can likely afford to withdraw funds from their sheltered savings a few years earlier than they otherwise would to meet their consumption needs, and can continue to save by reinvesting some or all of those funds in TFSAs or in non-registered accounts.

PROVINCIAL TAX AND SOCIAL BENEFIT IMPLICATIONS

The discussion above considers only federal tax and benefit clawback implications of mandatory RRIF withdrawals. For many Canadian seniors, there are also provincial tax and social benefit implications. For example, in most provinces, seniors residing in long-term-care (LTC) facilities pay accommodation charges based on their income. In general, under provincial systems for assessing the subsidization of LTC facilities, single residents are required to pay 100 percent of their income (over some minimum amount) toward the cost of their accommodation up to the full amount of that cost.[33] Seniors in this situation (or their heirs) would be rationally reluctant to withdraw any amounts from their RRIFs since such withdrawals would go directly to the cost of paying for LTC.

There are various inequities in relying only on income reported on the T1 income tax return to assess accommodation subsidies for LTC facilities. For example, capital gains are taxed on realization while unrealized capital gains remain untaxed. In addition, 100 percent of interest income is included in income, whereas only 50 percent of realized capital gains may be considered to be income in determining accommodation subsidies. RRIF and RRSP withdrawals are considered to be income, whereas TFSA withdrawals are not. The inequity may be amplified to the extent that

32 Statistics Canada, supra note 3.

33 Frances Woolley, *Long-Term Care Financing: What's Fair and Sustainable?* IRPP Study no. 92 (Montreal: Institute for Research on Public Policy, 2023).

wealthier seniors can afford to put in place lifelong tax planning that enables them to report lower incomes during retirement, and therefore enjoy larger accommodation subsidies.

One solution to the means-tested provincial social benefit described here is to include an asset test to determine accommodation subsidies for seniors in LTC. Quebec is the only province that currently assesses accommodation subsidies on the basis of both income and assets.[34] Quebec's web-based simulation provides an estimate of an LTC resident's personal contribution to the monthly accommodation costs based on both income and assets, with a detailed breakdown of tax-sheltered and non-sheltered assets.[35] The implicit assumption in requiring both an income and an asset test is to ensure that an LTC resident does not rely on provincial subsidies while preserving personal assets to achieve estate-planning objectives.

EXEMPTING RRIF HOLDERS WITH ASSETS OF UP TO $200,000 FROM MANDATORY WITHDRAWALS

As discussed above, RRIF holders with balances of up to $200,000 (those in the 75th percentile at the end of 2019[36]) are likely not constrained by mandatory withdrawal rules since they likely need such withdrawals (or more) for annual consumption; they are also likely to exhaust their retirement saving balances over their expected lifetime. To reduce both complexity and the compliance burden for those individuals, the Department of Finance could provide a permanent exemption from mandatory annual withdrawals where RRIF balances do not exceed $200,000 at age 71.[37] Such a measure would exempt approximately 75 percent of RRIF holders. The resulting revenue loss to the treasury is likely to be limited since the exemption would exclude (high-tax-rate) wealthy seniors who may pursue tax deferral for estate-planning purposes. Proposals to delay (even by a few years) forced RRIF withdrawals for everyone would impose a higher cost on the treasury.

The compliance burden of determining annual minimum withdrawals may be heavier for RRIF holders with low accumulated balances. Financial institution and investment custodians do not currently impose administrative fees for reminding RRIF holders of their minimum withdrawal obligations, or for automatically withdrawing

34 Ibid.

35 Régie de l'assurance maladie du Québec, "Estimate the Amount of Your Contribution" (www.ramq.gouv.qc.ca/en/citizens/aid-programs/accommodation-a-public-facility/estimate-amount-contribution).

36 Statistics Canada, supra note 3.

37 A RRIF holder withdrawing more than the required amount could still be "globally constrained" even though the holder may appear not to be "locally constrained." A rational RRIF holder could withdraw slightly more than the amount required for consumption in one year to avoid withdrawal of much more than required in the following year (when higher marginal tax rates are anticipated).

the mandatory minimum amount by the end of each calendar year and depositing the funds in the individual's account; however, such fees could be introduced in the future. Furthermore, financial literacy scores, as well as the confidence and ability to make sound financial decisions, decline with age, even in the absence of dementia.[38] This suggests the importance of automating retirement planning as much as possible, especially after age 80. Allowing seniors to shelter their savings inside RRIFs by a few years longer would also offer greater protection against inflation, since after-tax real rates of return on investments are higher inside RRIFs than outside.

Vettese shows how a couple with $500,000 in RRSPs and $200,000 in TFSAs can receive GIS payments for the period between age 65 (when eligibility begins) and the age when they start withdrawing from their RRSPs and claiming their CPP benefits.[39] This example reflects the general tax-planning technique to preserve tax-sheltered savings and thereby report low income to qualify for income-tested benefits. GIS remains a popular program, with 35.1 percent of seniors aged 65 and over receiving this benefit in 2015.[40]

There is also evidence that wealthier Canadians live longer[41] and therefore may enjoy a greater deferral. For example, Milligan and Schirle report that "Canadian men in the top earnings ventile live eight years (11 percent) longer than do men in the bottom ventile."[42] Age-specific mortality rates are negatively correlated with socioeconomic status. Therefore, those with longer lives have disproportionately higher wealth levels at earlier ages. This implies that while low earners may have more of their income replaced with income-tested benefits such as OAS and GIS in their senior years than high earners will, any resulting advantage may be offset by the low earners having fewer years of life (on average) to collect those benefits.

In a submission to the Department of Finance on potential changes to the RRIF legislation, the Conference for Advanced Life Underwriting (CALU) recommended

38 See Kathleen Coxwell, "Age-Related Financial Vulnerability: Why Making Financial Decisions Might Be More Difficult as You Get Older," *NewRetirement*, January 26, 2023 (www.newretirement.com/retirement/age-related-financial-vulnerability-why-making-financial-decisions-might-be-more-difficult-as-you-get-older); and Michael S. Finke, John S. Howe, and Sandra J. Huston, "Old Age and the Decline in Financial Literacy" (2016) 63:1 *Management Science* 213-30.

39 Frederick Vettese, "Can a Couple with $700,000 in Assets Collect the Guaranteed Income Supplement?" *The Globe and Mail*, June 20, 2023 (www.theglobeandmail.com/investing/personal-finance/retirement/article-can-a-couple-with-700000-in-assets-collect-the-guaranteed-income).

40 Edouard Imbeau, *Take-Up Rate of the Guaranteed Income Supplement: Findings from Tax and Program Administrative Data, Technical Report Prepared for the Evaluation of the Take-Up of the Guaranteed Income Supplement* (Ottawa: Employment and Social Development Canada, January 2018).

41 Frederick Vettese, "Two Mistakes People Make When Calculating When To Start CPP Based on Life Expectancy," *The Globe and Mail*, November 15, 2022.

42 Kevin Milligan and Tammy Schirle, "The Evolution of Longevity: Evidence from Canada" (2021) 54:1 *Canadian Journal of Economics* 164-92.

allowing "RRIF holders to exclude up to $160,000 (indexed) from the application of the RRIF minimum payment formula until the RRIF holder attains age 85."[43] CALU justifies this amount as being "similar to the result achieved by purchasing an Advanced Life Deferred Annuity (ALDA)."[44] Effective January 1, 2020, tax rules permit transfers from an RRSP[45] or a RRIF[46] to an ALDA,[47] which is a contract for a life or joint-life annuity that must be purchased before the year in which the planholder reaches the age of 85. The first ALDA was introduced in the marketplace by Desjardins Group in December 2023. An ALDA allows retirees to delay RRSP or RRIF withdrawals (and the corresponding taxes) until age 85. Retirees can transfer up to 25 percent of their RRIF or RRSP balances (up to a maximum of $170,000 in 2024) to an ALDA, thereby offsetting longevity risk.[48] A later start means that the annuity payments are higher under ALDA. For example, a standard life annuity purchased for $160,000 at age 71 would pay $1,079 per month commencing at age 71, while an ALDA at a rate of 5.25 percent would pay $4,875 per month commencing at age 85.[49] Instead of a maximum 5-year deferral period option available under standard annuities, ALDAs offer a deferral period ranging from 5 years to 30 years.

While CALU is proposing that all retirees be exempted from mandatory RRIF withdrawals of up to $160,000 over the retiree's remaining lifetime, this article is recommending a more progressive measure such that only retirees with cumulative RRIF balances not exceeding $200,000 would be exempt from mandatory withdrawals.

Robson and Laurin also call for "establishing an exemption threshold for which withdrawals below a specified value are not mandatory."[50] They recommend an annual amount of $8,500 indexed to inflation be withdrawn tax-free by all RRIF holders. A proposal to exempt any RRIF withdrawals from taxation fails to achieve tax neutrality across time periods. Furthermore, such a move is regressive, since only relatively higher-income individuals can afford to save and defer consumption. Again, the measure

43 Conference for Advanced Life Underwriting (CALU), "Re: Department of Finance Study on Registered Retirement Income Funds (RRIFs)," submission to the Department of Finance, March 1, 2023 (https://calu.com/wp-content/uploads/2023/06/Submission-by-the-Conference-for-Advanced-Life-Underwriting-on-RRIF-study-final.pdf), at 4.

44 Ibid., at 3.

45 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"), subsection 146(16).

46 Subsection 146.3(14.1) of the Act.

47 CRA form, "Direct Transfer from a Registered Plan To Purchase an ALDA."

48 RRIF holders with modest balances will be reluctant to lock away 25 percent of their registered savings until age 85.

49 Mark Burgess, "Product News: Desjardins Brings First ALDAs to Market," *Advisor*, December 6, 2023 (www.advisor.ca/investments/products/product-news-desjardins-brings-first-aldas-to-market).

50 William B.P. Robson and Alexandre Laurin, *Live Long and Prosper? Mandatory RRIF Drawdowns Raise the Risk of Outliving Tax-Deferred Saving*, C.D. Howe Institute Commentary no. 641 (Toronto: C.D. Howe Institute, 2023), at 3.

proposed in this article is more progressive in that it would provide an exemption from all age-specific mandatory withdrawals for RRIF accounts with accumulated balances of up to $200,000 without exempting any withdrawals from annual income taxation.

Alleviating mandatory annual minimum RRIF withdrawals for most seniors would be welfare enhancing since most seniors are reluctant to draw down their retirement savings, even if those funds are needed for consumption. This is evident from the longstanding puzzle of why life annuities are unpopular among retired seniors. Potentially expensive health shocks in late life may be the risks that seniors insure against by holding assets in non-annuitized forms.[51] Smith, Soto, and Penner[52] show that retired households exhibit relatively little decline in financial assets, at least in the early decades of retirement. Poterba, Venti, and Wise[53] show that relatively few retiree households withdraw their housing equity to support their lifestyle in retirement. Furthermore, seniors who retain their housing wealth until very late in life are less likely to be concerned about the need to insure against longevity risk. Love, Palumbo, and Smith[54] create a measure of "annualized comprehensive wealth" and show that even for the median household, annualized comprehensive wealth rises with age in the early years of retirement.

In summary, exempting any RRIF withdrawals from taxation violates the tax policy objective of neutrality by treating immediate withdrawals and consumption differently than more distant withdrawals and consumption, since all RRSP contributions qualify for a tax deduction at the time of contribution. Other proposals presented to the Department of Finance seem to disregard the fact that RRSPs and RRIFs are retirement policy instruments and therefore, arguably, should not allow deferral until the holder's death. Some proposals disregard the critical role of maintaining progressivity within our tax system, and the connection between RRIF withdrawals and the OAS program.

TAX STRATEGIES TO ALLEVIATE THE IMPACT OF MANDATORY RRIF WITHDRAWALS

The effective impact of the mandatory RRIF withdrawal rules is relatively modest since there are well-known tax strategies available to all but the most affluent taxpayers. The opportunity to offset the tax cost of early withdrawal further supports the position that the existing RRIF rules are not much of a burden except for those

51 Moshe A. Milevsky, "Rethinking RRIF Withdrawals: New Rates and Methodologies for New Reality" (2014) 62:4 *Canadian Tax Journal* 971-83.

52 Karen E. Smith, Mauricio Soto, and Rudolph G. Penner, *How Seniors Change Their Asset Holdings During Retirement*, Retirement Policy Discussion Paper no. 09-06 (Washington, DC: The Urban Institute, October 2009).

53 James Poterba, Steven Venti, and David Wise, "The Composition and Drawdown of Wealth in Retirement" (2011) 25:4 *Journal of Economic Perspectives* 95-118.

54 David Love, Michael Palumbo, and Paul Smith, *The Trajectory of Wealth in Retirement*, CRR Working Paper no. 2008-7 (Chestnut Hill, MA: Center for Retirement Research at Boston College, 2008).

at the very top. The easiest planning strategy is to withdraw funds in a low-income year so that the marginal tax cost of withdrawal is low, even if the withdrawal is made before the RRSP holder turns 71. The lower income could arise from external shocks such as COVID-19, when employment income or dividends from investments may decline. The early withdrawals could be reinvested in a TFSA if contribution room is available, or in a non-registered account.

Withdrawing from an RRSP or RRIF before age 71 may also be advisable if the planholder would otherwise be bumped into a higher tax bracket at age 71 as a result of the inclusion of minimum RRIF withdrawals in income. This could happen if the retiree would otherwise be eligible for OAS, and additional RRIF withdrawals would increase the retiree's marginal tax rate. RRIF withdrawals prior to age 71 would also reduce the minimum (fully taxable) withdrawals required at age 71. For retirees with low or average RRIF balances (for example, up to $200,000), exhausting RRIFs or RRSPs in the early years of retirement may make them subsequently eligible for OAS benefits with lower clawbacks. Such RRIF balances could also be withdrawn before the retiree starts to claim CPP benefits, to minimize income subject to tax at relatively higher progressive rates.

If the minimum RRIF withdrawals are not required for current consumption, the retiree could withdraw the entire annual amount just before year-end so that annual dividends and interest income remain tax-deferred until the end of the year.

Another tax opportunity to keep in mind is that RRIF withdrawals are considered to be eligible pension income, thereby allowing recipients a pension tax credit that renders RRIF withdrawals of up to $2,000 each year effectively tax-free.

Withdrawals from a RRIF can be split with a spouse, allowing the recipient's spouse to report up to one-half of the RRIF withdrawal in his or her tax return. A sound tax-planning strategy is to withdraw enough so that both spouses can fully use the $2,000 pension tax credit each year. If this strategy were implemented by Adam (in the earlier example), he would have to pay income taxes on only $6,000 ($10,000 − [2 × $2,000 pension tax credit]), and the incremental tax burden from the early forced withdrawal would be reduced from $761 to $457, as shown below:

Income tax paid on early RRIF withdrawal made today:	
$6,000 × 30 percent marginal tax rate	$1,800
Present value of tax paid if RRIF withdrawal made at the end of six years	
$= \$1,800/(1.05)^6$	$1,343
Incremental income tax paid in present-value terms if early withdrawal is forced	$ 457

In this example, accessing the pension tax credit for both spouses would reduce the tax cost of forced minimum RRIF withdrawals by about 40 percent.[55]

Removing mandatory annual withdrawals for RRIF balances of up to $200,000 would also enhance the popularity of spousal RRSPs. For a retired couple, if one spouse

55 The new tax cost of $457 is approximately 60 percent of the previous tax cost of $761.

accumulated a RRIF balance of $400,000, those funds would be subject to mandatory RRIF withdrawals, whereas if each spouse accumulated a RRIF balance of $200,000, their savings would be fully exempt from mandatory RRIF withdrawals. Spousal RRSPs are excellent tax-planning vehicles, especially if there is a substantial difference in the spouses' respective marginal tax rates. Spousal RRSPs allow contributions to be deductible at the marginal tax rate of the higher-income spouse, while withdrawals are usually taxable at the marginal tax rate of the lower-income spouse. This usually yields an after-tax rate of return that exceeds the pre-tax return (as confirmed in equation 1 above).

Another tax-planning strategy is to make RRIF withdrawals consisting of investments that have declined in value and reinvesting the funds in a non-registered account, so that future potential capital gains are taxed at favourable rates. While this strategy does not reduce the tax on immediate withdrawal, it enables the taxpayer to enjoy any subsequent capital gains at half of the applicable marginal tax rates rather than being taxed at full marginal rates when withdrawals are made from subsequent appreciated RRIF balances.

If the RRIF holder has a younger spouse, the spouse's lower age can be used to determine the minimum RRIF withdrawals. If the spouse's age is to be used, the RRIF holder must elect accordingly, and the decision cannot be subsequently changed. This strategy will automatically reduce the amount of forced minimum withdrawals each year.

A younger spouse could also allow RRSP holders to launch a RRIF as early as age 65 and to begin splitting between the spouses up to 50 percent of RRIF income received. If a RRIF is launched early (for example, at age 65), the RRIF holder may also want to consider deferral of his or her CPP and corporate pension plan benefits until age 70. In the earlier example, if Adam's spouse were 65 years old, he could elect to base his RRIF withdrawals on his spouse's age. In this case, he would have to withdraw only 4 percent of the $1 million RRIF balance, or $40,000 per year, instead of 7.38 percent, or $73,800 per year. If Adam still needed $63,800 for his annual consumption, he would not be constrained by the mandatory RRIF withdrawal rules. Withholding tax would apply to RRIF withdrawals in excess of the mandatory minimum requirements.

If a spouse (instead of the estate) is directly named as a beneficiary of a RRIF, the balance can be transferred tax-free to the spouse's RRSP or RRIF. Bypassing the estate helps to avoid probate fees and enables the surviving spouse to continue growing investments on a tax-sheltered basis.

Many Canadian retirees enjoy potential eligibility for OAS while they continue to occupy a principal residence without incurring tax on imputed rent. Retirees with a professional incorporated business can retain excess income inside the corporation while claiming eligibility for OAS with lower distributed incomes.[56]

56 Financial advisers' guidance is exemplified in Alison MacAlpine, "How To Manage RRIF Withdrawals Tax-Efficiently To Avoid 'A Hefty Penalty,'" *The Globe and Mail*, February 13, 2023 (www.theglobeandmail.com/investing/globe-advisor/advisor-news/article-how-to-manage-rrif-withdrawals-tax-efficiently-to-avoid-a-hefty).

EARLY RRIF WITHDRAWALS TRANSFERRED TO A TFSA

Statistics on TFSAs for 2019 show that only 16.6 percent of TFSA holders in the 70-plus age category maximized their annual TFSA contribution in that year.[57] Unused cumulative contribution room existed at all income levels. The average cumulative unused TFSA contribution room was $40,781 across all income levels, $32,293 for TFSA holders earning between $150,000 and $249,999, and $23,596 for TFSA holders earning $250,000 or more.[58] Unused TFSA contribution room potentially allows RRIF holders to reinvest their mandatory withdrawals in a tax-deferred account, thereby reducing the cost of those withdrawals.

While seniors as a group have not exhausted their cumulative contribution room, relative to other TFSA holders a significantly higher proportion of seniors maximize their *annual* contribution room, likely because they have accumulated wealth to invest. The 2019 TFSA statistics show that 27.2 percent of all TFSA holders were in the 65-plus age group, and 48.4 percent of those seniors maximized their annual contribution in that year (compared to 9 percent of all TFSA holders).[59] The proportion of TFSA holders who maximized their annual contributions increased monotonically with increasing age, with the highest proportion of maximizers being in the 75-plus age group.

Seniors cherish their TFSAs because withdrawals are not taxable and therefore do not trigger clawbacks of government benefits such as OAS and GIS. Since TFSAs have been in existence only since 2009, the limited accumulated contribution room has not allowed today's seniors to build a substantial nest egg for retirement. However, seniors of tomorrow will have longer eligibility periods for TFSA contributions and longer periods of tax-free compounding, allowing them more opportunities to use these savings vehicles strategically.

Compared to RRSPs, TFSAs offer seniors greater flexibility in managing annual fluctuations in their financial needs. Withdrawals from RRSPs are included in taxable income in the year of withdrawal and may also trigger OAS and GIS clawbacks. Younger Canadians with funds available to invest can learn how to use both TFSAs and RRSPs for their retirement planning, and will have time to build up sufficient savings in both types of plans.

Seniors in the 75-plus and 70-plus age groups continue to have average unused TFSA contribution rooms of $23,218 (or 36.6 percent of accumulated contribution room of $63,500 as at the end of 2019) and $28,796 (or 45.3 percent of accumulated

57 Canada Revenue Agency, "Tax-Free Savings Account 2021 Statistics (2019 Contribution Year)," table 1A, "TFSA Holders by Age Group" (www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2019/table1a-en.pdf).

58 Ibid., table 3C, "TFSA Fair Market Value, Contributions, and Withdrawals by Total Income Class" (www.canada.ca/content/dam/cra-arc/prog-policy/stats/tfsa-celi/2019/table3c-en.pdf).

59 Canada Revenue Agency, supra note 57.

contribution room of $63,500 as at the end of 2019), respectively.[60] This implies that many seniors have the TFSA room available to shelter their RRIF withdrawals from annual income taxation, thereby reducing the cost of mandatory minimum RRIF withdrawals. However, many seniors who have unused TFSA contribution room may also have limited amounts accumulated in their RRSPs and RRIFs, and therefore may not be constrained by mandatory minimum RRIF withdrawals.

If RRIF balances end up being used for bequests, the rollover of early RRIF withdrawals into TFSAs can help to pay some of the tax on mandatory RRIF collapse or withdrawals. The payment of income taxes on early RRIF withdrawals and the reinvestment of after-tax amounts in TFSAs allow the planholder to continue to shelter investment income from annual income taxes until death. Smaller RRIF withdrawals are likely to be taxed at lower rates compared to lump-sum withdrawals of larger amounts at death (which may be taxed at marginal rates approximating 50 percent).[61]

Let us assume that Beth, who is 60 years old, withdraws from her RRIF an additional $11,667 beyond the mandatory minimum withdrawal, and that the excess amount is taxed at a marginal tax rate of 40 percent,[62] leaving her with $7,000 after tax.[63] The $7,000 transfer would exhaust her annual TFSA contribution room.[64] If Beth transfers identical amounts at the end of each year from her RRIF to her TFSA for the next 20 years (from age 61 to 80 inclusive), and if her investments within the TFSA also earn 5 percent, she will have accumulated a balance of $231,462 in her TFSA by age 80. If Beth then dies, $231,462 in after-tax funds (that is, the entire TFSA balance) will become available for distribution to her heirs.

By comparison, let us assume that Zahra, who is 60 years old, does not make the additional excess withdrawal and retains the $11,667 each year in her RRIF. Assuming an identical annual rate of return of 5 percent, Zahra's RRIF investments would grow to $385,780 after 20 years. However, upon Zahra's death at age 80, her heirs collectively would receive only $192,890 in after-tax funds (assuming that Zahra has a marginal tax rate of 50 percent at death) since the RRIF balance would be fully taxable at Zahra's marginal tax rate in the year of death. Beth's heirs receive 20 percent more than Zahra's heirs with this strategy of early RRIF withdrawals and reinvestment in a TFSA.

60 Ibid., table 3A, "TFSA Fair Market Value, Contributions, and Withdrawals by Age Group."

61 Upon a taxpayer's death, RRSPs and RRIFs are deemed to be disposed of at their fair market value. The proceeds are included as income in the terminal income tax return and taxed at the applicable marginal tax rates.

62 A combined federal-provincial marginal tax rate of 35 percent is triggered at an income of approximately $86,696 in Ontario, as shown by the Ernst & Young "2023 Personal Tax Calculator," supra note 27.

63 $\$11{,}667 \times (1 - 0.40) = \$7{,}000$.

64 This planning scheme becomes more beneficial as annual TFSA contribution limits increase over time, in increments of $500, owing to indexation for inflation.

The above analysis does not imply that Zahra is contributing $11,667 each year to her RRIF, since RRIFs do not allow any new contributions. Rather, Zahra makes no excess withdrawals over the 20-year period, and thus accumulates a balance of $385,780 in her RRIF, while Beth withdraws $11,667 from her RRIF each year and reinvests the after-tax withdrawn amount in a TFSA, to accumulate a TFSA balance of $231,462 after 20 years. The consumption sacrifice is held constant between these two alternatives for a sound economic comparison.

The above tax-planning strategy is limited to modest annual RRIF withdrawals that approximate the amount of newly created annual TFSA contribution room. The strategy does not work for large withdrawals (such as $100,000) that significantly exceed new annual TFSA contribution room created each year.

BENEFITS OF INVESTING RRIF WITHDRAWALS OUTSIDE TAX-SHELTERED ACCOUNTS

The investment of RRIF withdrawals in regular taxable accounts may offer investors other tax advantages. First, investments earning capital gains are not taxed until realization, an advantage not valued as highly inside a tax-sheltered account. Second, investments earning capital gains and dividends (subsequent to withdrawal from a RRIF) are taxed favourably even outside tax-sheltered accounts. Such tax-favoured growth is not entirely cherished inside sheltered plans, since all growth is fully taxable upon withdrawal. Third, any capital losses incurred outside tax-deferred accounts can be either offset against capital gains incurred in the previous three years or carried forward indefinitely. This loss offset feature may be more valuable for seniors, who may have shorter investment horizons that may not allow them to wait until markets recover.

All of the tax-planning strategies described in this article are reasonably easy to implement and can reduce the incremental income tax burden on forced annual minimum RRIF withdrawals for most seniors.

THE GOVERNMENT'S PERSPECTIVE

The government's perspective on RRIF withdrawals and the perspective of taxpayers are, for the most part, symmetrical. If all of the funds withdrawn from a RRIF are used for consumption in the year of withdrawal, allowing Canadians greater flexibility in making RRIF withdrawals may not cost the treasury any revenue loss in present-value terms if the cost of capital—the rate of interest paid by the government to borrow or invest—is approximately the same as that faced by the taxpayers.

For example, suppose that a 71-year-old taxpayer with a marginal tax rate of 35 percent has $1 million accumulated in her RRIF and is forced to withdraw 10 percent (or $100,000) in year 1. The government would collect $35,000 in taxes during year 1 from the forced RRIF withdrawal.

If the government did not insist on the $100,000 forced RRIF withdrawal, and the taxpayer earned an annual pre-tax return of 5 percent, the amount would grow to $105,000 by the following year and to $127,628 by end of year 5. Suppose that the taxpayer voluntarily decided (without any coercion from the RRIF rules) to make a

one-time withdrawal of $127,628 ($100,000 × $(1.05)^5$) in year 5. At a 35 percent marginal tax rate, the government would collect $44,670 in taxes in year 5.

If the government's rate of borrowing was also 5 percent, the present value of year 5 taxes in year 1 dollars would be $\$44{,}670/(1.05)^5 = \$35{,}000$. In other words, the treasury would receive the same income taxes in present-value terms if taxpayers were allowed to grow their savings at a sheltered rate for a little longer before withdrawing funds.

The reasoning above is based on the assumption that the entire annual amount withdrawn is consumed in the same year and not reinvested outside a sheltered plan. If the amount withdrawn is not consumed in the same year and instead is reinvested outside a tax shelter, the government will not be indifferent as to when RRIF withdrawals are made. This is because the longer the funds are invested inside the RRIF, where the government cannot tax annual returns, the less time they are invested in accounts generating returns that can potentially be taxed. Minimum withdrawal policies can be justified in such contexts.

CONCLUDING REMARKS

For most Canadian seniors, mandatory RRIF withdrawals starting at age 71 may not be a threat to income security during retirement. Given the modest amounts accumulated in RRSPs and RRIFs by most Canadians, the amounts required to be withdrawn each year are likely necessary for consumption, and therefore likely not constrained by the mandatory RRIF withdrawal rules.

Indefinite deferral of retirement savings would allow wealthy Canadians to use the funds for estate-planning purposes and would be a regressive measure. Furthermore, retaining wealth in tax-sheltered accounts while claiming OAS because of low reported income can jeopardize the sustainability of the OAS program. OAS was not designed to withstand the eligibility of seniors who are asset-rich but reluctant to draw down retirement savings that were accumulated with tax deferrals.

However, for RRIF holders with an accumulated balance of up to $200,000, exemption from mandatory annual minimum withdrawals can ease the complexity and compliance burden imposed by the current rules. The proposed exemption would not cost the treasury much in terms of forgone revenues, since RRIF holders with such modest balances would likely need to withdraw more than the minimum amount each year.

The delay or elimination of mandatory minimum RRIF withdrawals for planholders who have an accumulated balance of more than $200,000 would cost the treasury in two ways: first, by delaying the inclusion of income from tax-assisted retirement savings; and second, by increasing the burden on the OAS pension system because of the delayed withdrawal of RRIF savings. Retention of the minimum withdrawal requirement for wealthier RRIF holders safeguards the OAS program, allowing seniors with modest retirement savings to enjoy higher income-tested clawback thresholds. Preventing the misuse of retirement tax preferences for estate-planning purposes remains a legitimate policy goal.

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Policy Forum: Editors' Introduction—Tax Treatment of Charities

The Income War Tax Act of 1917[1] featured two provisions related to charities. First, paragraph 3(1)(c) allowed a deduction for contributions to the "[p]atriotic and Canadian Red Cross Funds, and other patriotic and war funds approved by the Minister." Second, paragraph 5(d) exempted from taxation the income of "any religious, charitable, agricultural, and educational institutions."

In the 100-plus years since, the appropriate tax treatment of charities and contributions made to charities has continued to occupy the attention of tax scholars and practitioners. The usual interplay of fairness, design efficiency, revenue leakage or sacrifice, and administrative considerations arises for the taxation of the charitable sector. Questions of fairness come into play when considering an adjustment to the tax burden of individuals who make charitable donations. Design efficiency matters if different structures for the tax treatment of charitable activity lead to different contribution behaviour by donors and different operating decisions or organizational forms for charities themselves. Revenue leakages can arise if insufficient attention is paid to transactions between taxable and exempt entities, as the plethora of cases dealing with "buy-low/donate-high" and leveraged donation schemes, and the legislative responses thereto, well attest. And of course revenue sacrifice makes little sense if the behaviour would have occurred anyway, in the absence of a tax benefit for charitable donations. As in other contexts, the administrative burden often increases when attempts are made to adjust fairness, maintain efficiency, and stem revenue leakage. All of this combines to make the tax treatment of charities a perennial lively topic. In this Policy Forum, we have brought together four articles to advance the debate.

The first article, by Ross Hickey, A. Abigail Payne, and Justin Smith, addresses the impact of the tax treatment of charitable contributions for individuals. The authors document large differences, across provinces, income levels, and time, in the generosity of the tax system for individuals making charitable contributions. They also provide an overview of evidence on how the structure of the tax break affects individual donation patterns, finding that lower-income individuals appear to be much more sensitive to the tax treatment of donations than are higher-income individuals. The article concludes with a recommendation to consider providing all donors with the same tax incentive by removing the existing $200 threshold that separates donations that can access a higher credit rate from those that cannot.

The second article, by Lori McMillan, shifts to the organizational level. McMillan focuses on the less-studied non-charitable non-profit sector. Her contribution details

1 SC 1917, c. 28.

the scope of the non-profit exemption before turning to the justifications for exemption of organizations in this sector. McMillan concedes that the exemption could be considered a structural feature of the tax system, but subscribes to the better view that characterizes the exemption as a tax expenditure. There are, however, competing ways of understanding the purpose of the exemption. McMillan concludes that the provision could be much better designed if the rationale for granting the exemption were clearer, noting that it is not sufficient to assume that the exemption "[is] good because non-profits do good things."[2] She also argues that self-declaration is an insufficient transparency requirement and that information returns of non-profits need to capture more data.

In the third article, Iryna Khovrenkov looks at the charitable foundation component of the charitable sector. Her article engages with the distinction between operating foundations, which deliver charitable programs directly, and grant-making foundations, which provide funds enabling others to perform charitable activities. The 13,000 charitable foundations in Canada face rules requiring them to make minimum annual disbursements in order to maintain their tax-exempt status. These rules are motivated by the idea that foundations benefiting from a tax exemption should not hoard their dollars without spending on charitable works; however, the disbursement quota is based on the size of the foundation's assets, regardless of the nature and purpose of the organization. Khovrenkov presents empirical evidence of differences in the focus and extent of charitable support provided by operating and grant-making foundations. For example, 33 percent of program expenditures by operating foundations are in the cultural sector compared to only 14 percent of grant allocations by grant-making foundations. Khovrenkov argues that disbursement rules based only on the size of a foundation's assets are not appropriate; instead, the rules should (as is the case in the United States) recognize the distinction between operating and grant-making foundations.

The forum concludes with an article by Kathryn Chan that critiques the process for challenging decisions of the Canada Revenue Agency's Charities Directorate, which is responsible for granting and revoking registered charity status. The article outlines the framework for appeals—which currently involves an internal appeals process (by notice of objection), the decision from which can be appealed to the Federal Court of Appeal—and reviews recommendations for reform, including the recommendations of the Special Senate Committee on the Charitable Sector. Chan points to recent judicial developments in administrative and Charter law that add urgency to the calls for reform. The article concludes with four proposals for reform, including one derived from English charity law.

Kim Brooks
Kevin Milligan
Daniel Sandler
Editors

2 Lori McMillan, "Policy Forum: Tax Exemption for Canadian Non-Charitable Non-Profits—More Information, Please!" elsewhere in this feature, at 344.

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Policy Forum: Understanding the Efficacy of Tax Credits for Charitable Donations in Canada

Ross Hickey, A. Abigail Payne, and Justin Smith*

PRÉCIS

Cet article décrit brièvement l'historique du traitement fiscal des dons de bienfaisance au Canada ainsi que la logique politique sous-jacente, et examine certaines tendances en matière de dons au fil du temps. À partir des données sur l'effet des modifications des taux d'imposition sur les dons, les auteurs montrent la sensibilité des Canadiens au crédit d'impôt pour les dons.

ABSTRACT

This article briefly describes the history of the tax treatment of charitable donations in Canada, and the underlying policy rationale, and examines some trends in donations over time. The authors show that Canadians are responsive to the donation tax credit, by reviewing the evidence on what happens to donations when the government alters the tax credit rates.

KEYWORDS: CHARITABLE DONATIONS ■ DONATIONS ■ NON-PROFIT ■ TAX CREDITS ■ TAX INCENTIVES ■ TAX POLICY

* Ross Hickey is of the Faculty of Management and the Faculty of Arts and Social Sciences, University of British Columbia, Kelowna, BC (e-mail: ross.hickey@ubc.ca); A. Abigail Payne is of the Melbourne Institute, University of Melbourne, Australia (e-mail: Abigail.payne @unimelb.edu.au); Justin Smith is of the Lazaridis School of Business and Economics, Wilfrid Laurier University, Waterloo, Ontario (e-mail: jsmith@wlu.ca). This research has been supported by the Social Sciences and Humanities Research Council (SSHRC grant #435-2018-1261) and the Canadian Research Data Centre Network. The services and activities provided by the University of British Columbia and southwest research data centres are made possible by the financial or in-kind support of the SSHRC, the Canadian Institutes of Health Research, the Canadian Foundation for Innovation, Statistics Canada, the University of British Columbia, and Wilfrid Laurier University. The authors have no conflicts of interest to declare.

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INTRODUCTION

Canadians who donate to charity are eligible for subsidies through the tax system in the form of non-refundable tax credits provided by the federal and provincial governments. Most donors are offered a two-tiered credit that gives a larger credit per dollar donated for giving in excess of a threshold, which is currently $200. In 2023, a donation of $100.00 would yield a combined federal-provincial credit as low as $36.14 in Ontario and as high as $55.00 in Alberta.[1] At the federal level, there is a third tier that increases the tax credit rate for income earners who are subject to the highest federal marginal income tax rate. The key motivation behind these credits is to lower the cost of giving and thereby, in theory, encourage larger donations. There is a sizable body of economic research showing that tax credits, deductions, and other ways of reducing the price of a donation do indeed increase giving. In this article, first we briefly describe the history of the tax treatment of donations in Canada and the underlying policy rationale. We then examine some trends in donations over time. Finally, we show that Canadians are responsive to the tax credit, by reviewing the data on what happens to donations when the government alters the tax credit rates.

BACKGROUND

Charitable donations in Canada were initially subsidized through the federal income tax statute in the form of a deduction.[2] The deduction was introduced for donors to a limited set of organizations connected to the war effort at home in 1917, removed in 1920, and reintroduced and expanded in 1930. The Report of the Royal Commission on Taxation ("the Carter commission")[3] provides an economic justification for the deduction for charitable donations. If the base that we wish to tax is "economic

1 "2023 Donation Tax Credit Rates, Canada & Provinces/Territories," *Taxtips.ca* (www.taxtips.ca/filing/donations/tax-credit-rates-2023.htm). It is assumed that the donor has enough tax owing to be eligible for the credit. Note that, starting in tax year 2023, the first $200 donated in Alberta is eligible for a 60 percent provincial credit, which is a far more generous rate than that provided by any other province.

2 Income Tax Act of 1917, SC 1917, c. 28, paragraph 3(1)(c).

3 Canada, *Report of the Royal Commission on Taxation*, vols. 1-6 (Ottawa: Queen's Printer, 1966-67) (herein referred to as "the Carter report").

power" over the allocation of resources, it follows that we do not wish to tax expenditures on charitable donations, because these represent a reallocation of economic power from the individual to the charity.[4] The deduction remained with some modest changes until 1988,[5] when a major tax reform was enacted, pursuant to which charitable donations became eligible for a non-refundable tax credit rather than a deduction. A key motivation for the switch to subsidizing donations with a tax credit is captured in a statement by the federal minister of finance in 1987: "[The] new tax credit for charitable giving has been designed to provide a substantial incentive for donations, particularly for low and middle-income earners."[6] A credit was considered fairer because its value is not tied to changes in the taxpayer's income; in contrast, a deduction creates a larger subsidy per dollar given for donors with higher marginal income tax rates. The Carter commission noted that a tax credit for charitable donations would be more appropriate "if equity were the only consideration."[7] However, the commission recommended that the deduction for donations be maintained so as to not "stifle charitable giving by upper income individuals and families."[8] The move to a credit with two tiers appears to have been a compromise between these two earlier positions.

In addition to making the subsidy fairer on the basis of income, the Canadian credit is simpler and creates fewer distortions than an outright deduction. Prior to the 1988 tax reform, there were 11 different marginal tax rates, which resulted in 11 different net costs of donating, depending on income. To make matters more complicated, the deduction itself could push donors into different tax brackets, creating uncertainty as to the true cost of giving. The non-refundable tax credit offered federally and in most provinces in 1988 consisted of a credit calculated at the lowest marginal tax rate up to a threshold (previously $250, now $200), and then calculated at the highest marginal tax rate for donations beyond that. This new tax credit schedule with a threshold meant that the majority of donors were only allowed to claim the lower rate while the majority of *dollars* (which came from the largest donors, who were also the highest earners) qualified for the higher rate.

We think that making the high tax credit rate available to all, or at least all low-income donors, should be a welcome proposal if increasing the generosity of Canadians is the objective of the tax credit.

4 Ibid., vol. 3, at 22.

5 For a review of the subsidy prior to 1988, see Rod Watson, "Charity and the Canadian Income Tax: An Erratic History" (1985) 5:1 *Philanthropist* 3-21.

6 Canada, Department of Finance, *Tax Reform 1987, Speech Delivered in the House of Commons by the Honourable Michael H. Wilson, Minister of Finance and Member of Parliament for Etobicoke Centre* (Ottawa: Department of Finance, June 18, 1987), at 5.

7 Carter report, supra note 3, vol. 3, at 222.

8 Ibid.

FACTS ON CHARITABLE GIVING IN CANADA

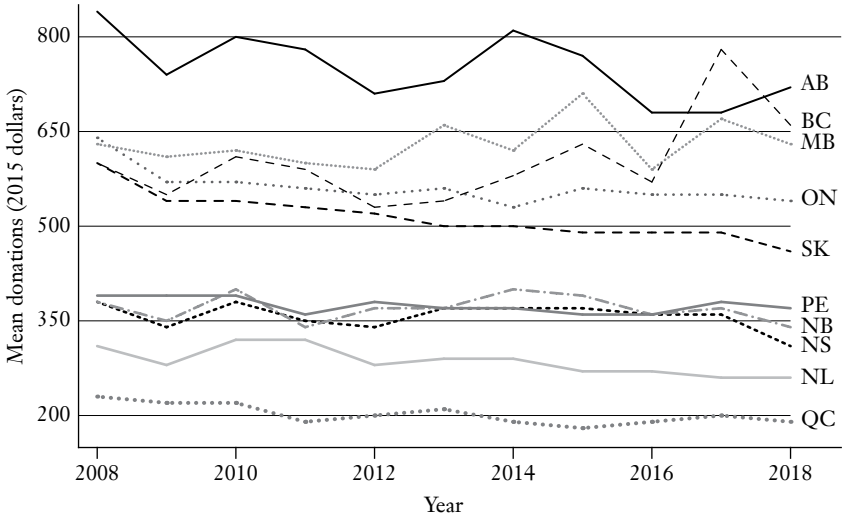
Relying on data from Statistics Canada's Longitudinal Administrative Databank (LAD), which is a 20 percent sample of taxfilers in Canada, we are able to provide some facts on giving trends across provinces and over time. The LAD contains much of the information from the T1 tax return, including income, taxes paid, tax credits, and deductions. While the data set is designed to follow people over time, in cases where individuals drop out of the sample because they leave the country or die, the data are refreshed so that each cross-section contains 20 percent of filers. One of the tricky parts of the tax credit system when it comes to analyzing the data is that donations are transferable between spouses for tax purposes. For this reason, we use households as the unit of observation, by summing donations made by spouses.

Figure 1 shows mean household donations in 2015 dollars for each province from 2008 to 2018. In most tax years, Alberta has the largest mean donation, and in all years, Quebec has the lowest. There is considerable variation across provinces, with the difference between the highest and lowest average donation ranging from $500 to $600. With the exception of slight declines in average donations by residents of Ontario and Saskatchewan, a slight increase for Manitoba, and a somewhat larger increase for British Columbia between 2008 and 2018, mean donations are generally stable throughout the sample period.

Figure 2 shows trends in the proportion of households that claimed the charitable donation tax credit across provinces over the period 2008-2018. There has been a steady decline since 2010 in the share of households that claim the credit, with most provinces showing a 7 percent drop across the sample period. The ranking of provinces based on the percentage of taxfilers claiming the credit is stable over time, with Manitoba having the highest credit claim incidence, at about 40 percent, throughout the 10-year period. The Atlantic provinces and Quebec consistently rank in the bottom five, with the lowest share—just over 27 percent—claiming the credit in New Brunswick in 2018. The decline in the number of donors is likely alarming for the charitable sector because donations are increasingly dependent on a more concentrated set of households that each give more. This is a pattern that does not seem sustainable over a longer period of time without eventually leading to lower average donations.

Looking across the income distribution, figure 3 shows that households in the top decile of income earners are the source of a significantly higher average level of donations than all lower parts of the distribution. Two additional facts are clear from this figure. First, giving has remained relatively constant for each of the bottom nine deciles over time, in spite of a decline in the percentage of taxfilers who reported donations across Canada between 2008 and 2018. Second, there is more variation in average donations within the top decile of the income distribution than there is within the bottom 90 percent of income earners—a trend that appears similar to the variation in the overall average donations shown in figure 1. Together these features tell us that changes in donations are driven by the top earners.

FIGURE 1 Mean Donations by Province, 2008-2018



AB = Alberta; BC = British Columbia; MB = Manitoba; ON = Ontario; SK = Saskatchewan; PE = Prince Edward Island; NB = New Brunswick; NS = Nova Scotia; NL = Newfoundland and Labrador; QC = Quebec.

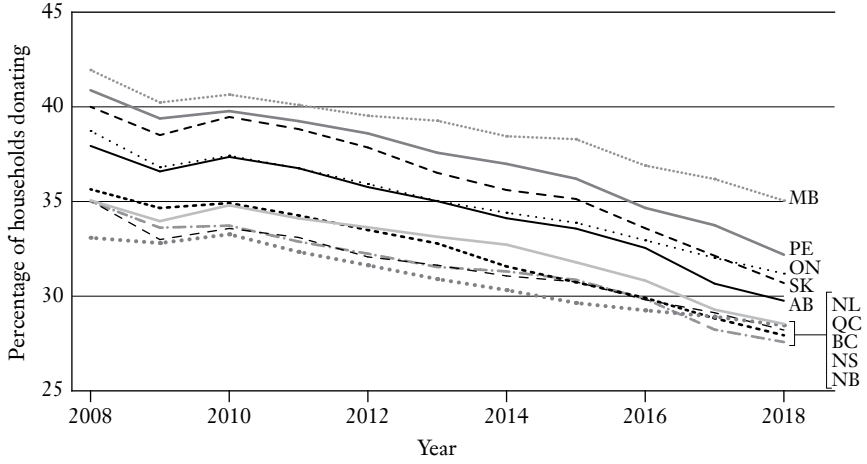
Source: Authors' estimates from Statistics Canada, Longitudinal Administrative Databank (LAD) (www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=4107&Item_Id=1523). The unit of observation is the household.

DONATION RESPONSE TO THE TAX CREDIT

Table 1 shows the number and percentage of Canadians who indicated that the donation tax credit affected their giving, according to responses to Statistics Canada's general social surveys in 2015 and 2018.[9] In 2015 and 2018, about one-quarter of the respondents said that the tax credit is a reason for giving more. Conversely, in both years, 16 percent of respondents said that the tax credit is a reason for *not* giving more—though it is not entirely clear whether this means that they feel that the tax credit is too low and they would give more if it were higher, or the tax credit itself dissuades them from giving. About one-half of people in the sample in both years said that the tax credit is at least a part of their decision on giving. From this descriptive evidence, we can see that many Canadians consider the tax credit when giving, though *how* it affects giving is a more complicated question.

9 Patric Fournier-Savard, Valerie du Plessis, and Geneviève Vézina, "General Social Survey, Cycle 27—Giving, Volunteering and Participating (GSS GVP)," version 1.0, *Statistics Canada Open License* (https://hdl.handle.net/11272.1/AB2/3EF03Q); Statistics Canada, "General Social Survey Cycle 33: Giving, Volunteering and Participating, 2018," version 1.0, *Statistics Canada Open License* (https://hdl.handle.net/11272.1/AB2/GBFDYG).

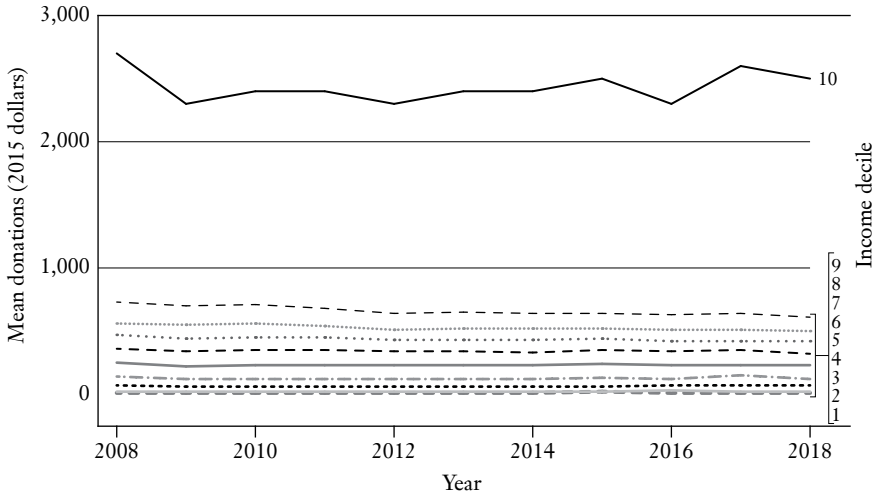
FIGURE 2 Percentage of Households Reporting Donations, by Province, 2008-2018



MB = Manitoba; PE = Prince Edward Island; ON = Ontario; SK = Saskatchewan; AB = Alberta; NL = Newfoundland and Labrador; QC = Quebec; BC = British Columbia; NS = Nova Scotia; NB = New Brunswick.

Source: Authors' estimates from Statistics Canada, Longitudinal Administrative Databank (LAD) (www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=4107&Item_Id=1523). The unit of observation is the household.

FIGURE 3 Mean Donations by Income Decile, Canada, 2008-2018



Source: Authors' estimates from Statistics Canada, Longitudinal Administrative Databank (LAD) (www23.statcan.gc.ca/imdb/p2SV.pl?Function=getSurvey&SDDS=4107&Item_Id=1523). The unit of observation is the household.

TABLE 1 Survey Evidence on the Importance of Tax Credits for Giving

	Frequency of reporting in the affirmative			
	2015		2018	
	percent	*no.*	*percent*	*no.*
Tax credit a reason for giving more	25	11,990	28	10,069
Tax credit a reason for not giving more	16	11,788	16	10,808
Tax credit part of decision on giving	47	11,801	49	10,352

Source: Authors' calculations from Statistics Canada, General Social Survey Cycle 27, Public Use Microdata Files, 2015, and Statistics Canada, General Social Survey Cycle 33, Public Use Microdata Files, 2018.

Fortunately, recent work by the three of us and two colleagues[10] ("Hickey et al.") sheds light on the direction and magnitude of the tax credits on tax-receipted donations in Canada. We show that while taxfilers in all quintiles of the household income distribution respond strongly to the tax credits, those at the top are less responsive than filers at the bottom. Figure 4 summarizes these results, showing the tax price elasticity of giving across the household pre-tax income distribution. The tax price of giving refers to forgone consumption from donating $1, and is equal to 1 minus the tax subsidy for giving. In Hickey et al., it is equal to 1 minus the combined federal-provincial tax credit for people who have taxes owing, and equal to 1 for those who owe no taxes.[11] The first five points on the *x*-axis are the five quintiles of the income distribution, and the last two are the top decile and top percentile. Each point shows the quantile-specific elasticity along with its 95 percent confidence interval.

The results show that taxfilers throughout the income distribution are responding to the tax credits made available to donors, and that the tax price elasticity of donations is decreasing in relation to income. Surprisingly, Hickey et al. find that income earners in the first and second quintiles are the most responsive to the tax credit, with elasticities of −2.93 and −4.02, respectively. A tax price elasticity of −1 indicates that donors pass on the entirety of the subsidy to charities; thus, the results suggest that donors at the bottom of the income distribution are donating significantly more than they get back as a tax credit. Estimates at the higher end of the income distribution converge around −1.[12]

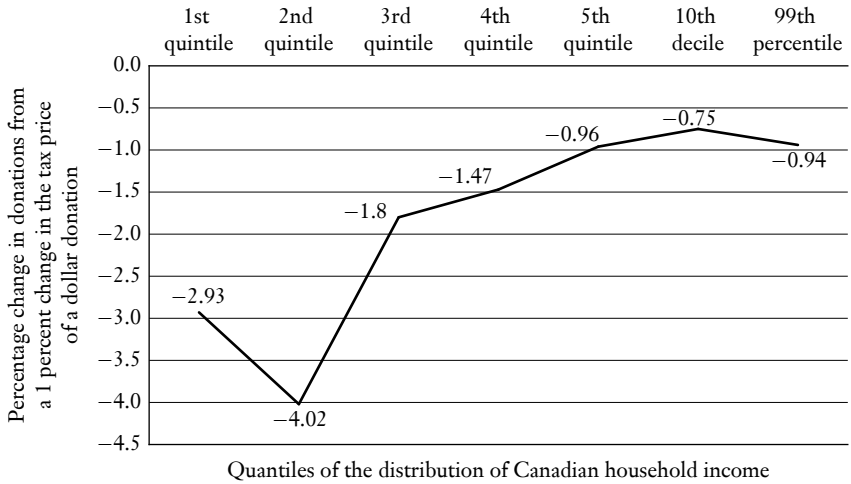
Why are the elasticities at the bottom of the income distribution so much larger? One reason is that people at the bottom of the distribution respond more strongly to changes in the tax credit rate, and may do so if the credit is more salient for them.

10 Ross Hickey, Bradley Minaker, A. Abigail Payne, Joanne Roberts, and Justin Smith, "The Effect of Tax Price on Donations: Evidence from Canada" (2023) 76:2 *National Tax Journal* 291-315.

11 Ibid.

12 Ibid.

FIGURE 4 Estimated Tax Price Elasticity of Giving Across the Canadian Income Distribution



Source: Estimates as reported in Ross Hickey, Bradley Minaker, A. Abigail Payne, Joanne Roberts, and Justin Smith, "The Effect of Tax Price on Donations: Evidence from Canada" (2023) 76:2 *National Tax Journal* 291-315, at 310, table 5, based on income data from 2001 to 2016.

There is some evidence for this explanation: Hickey, Minaker, and Payne[13] show that Canadian taxfilers respond positively to more salient tax credits available for donations. Additionally, Roberts[14] shows that the magnitude of the tax price elasticity of donations is affected by whether donations are crowded out or in by government expenditures. Larger tax price elasticities at the bottom of the income distribution might indicate complementarity of charitable causes for those givers. Duquette[15] shows that there is considerable variation across charities in the response of charity revenues to the tax price of giving.

The size of the elasticities might also be inflated for other reasons. For instance, households probably make donations from both their wealth and their income, and the income and wealth distributions do not line up very well at the bottom. More specifically, the 2023 study by Hickey et al.[16] uses a measure of income that excludes capital gains and losses, which could create a group of high-wealth individuals classified as low-income because they do not have substantial labour earnings. If those

13 Ross Hickey, Bradley Minaker, and A. Abigail Payne, "The Sensitivity of Charitable Giving to the Timing and Salience of Tax Credits" (2019) 72:1 *National Tax Journal* 79-110.

14 Russell D. Roberts, "Financing Public Goods" (1987) 95:2 *Journal of Political Economy* 420-37.

15 Nicolas J. Duquette, "Do Tax Incentives Affect Charitable Contributions? Evidence from Public Charities' Reported Revenues" (2016) 137 *Journal of Public Economics* 51-69.

16 Supra note 10.

individuals responded strongly to the tax price, that could drive the results from the study. Additionally, the estimates do not consider the strategic shifts over time in the reporting of charitable donations: Canadian taxfilers can carry forward charitable donations from previous years for up to five tax years. Saving up donations over time allows households to access the higher tax credit available for bigger donations. For large donors (most with high income), this is probably not a major concern, since most of their giving is subject to the higher rates. On the other hand, smaller donors have a stronger incentive to carry forward their donations because a series of small gifts would otherwise qualify only for the lower tax credit. Indeed, the websites of charities and even the Canada Revenue Agency (CRA) provide such advice.[17] If smaller donors were to shift the reporting of their donations across tax years in response to tax credit rate changes, this would appear as larger elasticities at the bottom quintiles of the income distribution to the extent that there are more smaller donors in the bottom quintiles.

The foregoing evidence suggests that donors become more generous in their charitable giving in response to an increase in the generosity of the tax credit available to them. That the tax credit appears to drive more generosity from lower income-earning households than from higher income-earning households is indicative of a greater capacity to generate relatively more donations—for a given reduction in revenue—if the tax credits more generously targeted lower income earners. But this one piece of evidence may be insufficient to motivate a change in policy.

To further examine how donors respond to the tax credit, we can look at the distribution of the amounts donated across the cutoff point of the two-tiered credit. In a recent article published in this journal, Hickey and Smith[18] use the LAD to examine the distribution of donations near the $200 threshold. They find a bunching of taxfilers at the $200 threshold in the tax credit schedule, where the generosity of the tax credit rate abruptly increases, which suggests that taxfilers might be paying attention to the structure of the credit.[19] On the other hand, there are also spikes at other round figures, so this could simply be round number bias.

Combined, these findings suggest that increasing the generosity of the tax credit at the bottom of the distribution of donations (for those near the threshold) can increase charity revenue with minimal impact on collected revenue. We also show that there has been a decline in the incidence of claiming the tax credit for charitable donations over the past 30 years. This further highlights the potential for using the tax system to boost citizen engagement with the charitable sector.

17 See, for example, the websites of CanadaHelps (www.canadahelps.org/en/tax-time) and of the Canada Revenue Agency, at "Line 34900—Donations and Gifts" (www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/line-34900-donations-gifts.html).

18 Ross Hickey and Justin Smith, "Policy Forum: Bunching in the Political Contribution Tax Credit Schedule—Theory, Evidence, and Policy" (2023) 71:4 *Canadian Tax Journal* 1083-94.

19 Ibid., at 1093, figure 5.

HOW SHOULD THE TAX CREDIT BE STRUCTURED?

There is no consensus in the academic economics literature on the optimal size of a tax rebate for charitable donations.[20] One reason is that there are considerable differences in how people respond to tax incentives. Furthermore, the impact of tax rebates on the overall provision of public goods is ambiguous when those goods are provided both publicly and privately. To fully appreciate the impacts of charitable tax credits on revenue and the provision of public goods, one must carefully consider the interaction between government grants, the direct provision of public goods by government, and donor behaviour. In the absence of theoretical guidance on the efficiency of the tax treatment of charitable donations, it may be best to consider other attributes of the policy environment. First, tax credits promote donating to charity as a pro-social and civic action on behalf of and directed by citizens. This display of autonomy and pluralism is important for a thriving democracy. Second, historically private charities have indicated to governments those causes that may best be absorbed by the state.[21] Third, the CRA dedicates significant resources to the regulation of charities to ensure that only those organizations that serve the public interest have the ability to issue tax receipts. If charities were not required to pass a social benefits test, the case for tax concessions for charitable giving would be weakened.

Removal of the $200 threshold in the tax credit rate schedule and the introduction of a single rate that applies to all donations made by donors outside the top federal marginal income tax bracket can enhance the equity of the tax system. Currently, donors who have already given more than $200 face a lower cost for giving more compared to otherwise equivalent individuals who have given less than $200. Because the amount donated is inversely related to price, additional gifts from large donors will be bigger, giving charities more of an incentive to pay attention, on the margin, to the interests of larger donors. If instead all dollars donated faced the same tax price, charities would have an incentive to treat donors more equitably on the basis of their prior donations.

CONCLUSION

A tax concession for contributions to charities has been encouraged through the personal income tax system in Canada for as long as we have had personal income taxation. But much has changed over the years since this concession was first granted. As times have changed, so has the way that the tax concession has been structured. The recent introduction of a higher tax credit rate for income earners who are subject to the highest marginal income tax rate has increased the complexity of the tax

20 For a good discussion, see Richard Steinberg, "The Design of Tax Incentives for Giving," in Henry Peter and Giedre Lideikyte Huber, eds., *The Routledge Handbook of Taxation and Philanthropy* (London, UK: Routledge, 2021), 178-98.

21 See Jonathan Gruber and Daniel M. Hungerman, "Faith-Based Charity and Crowd-Out During the Great Depression" (2007) 91:5-6 *Journal of Public Economics* 1043-69.

price schedule for both donors and charities. The evidence presented above shows that individuals are quite responsive to changes in the tax treatment of donations. At a time when the number of donors is decreasing and charitable organizations are becoming more reliant on large donors to pick up the slack, we suggest that a reduction in complexity, by removal of the $200 threshold in the tax credit schedule, can help Canada to better encourage donations by all Canadians.

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Policy Forum: Tax Exemption for Canadian Non-Charitable Non-Profits—More Information, Please!

Lori McMillan*

PRÉCIS

Au Canada, les organismes sans but lucratif et sans vocation de bienfaisance bénéficient d'une exemption fiscale, mais la raison d'être de cette exemption et les objectifs politiques ont été mal formulés depuis le début. Les données empiriques laissent penser que les principales sources de revenus du sous-secteur sont de nature commerciale et non des dons, ce qui dément certaines des hypothèses vagues sous-tendant l'exemption. Compte tenu de la nature commerciale d'un grand nombre de ces organismes et du manque d'informations facilement accessibles sur leurs activités, davantage d'informations sont nécessaires pour assurer l'équité fiscale entre les organismes commerciaux et les organismes sans but lucratif. Les objectifs politiques de cette exemption doivent également être précisés.

ABSTRACT

Non-charitable non-profit organizations in Canada enjoy tax-exempt status, but the rationale for exemption and the policy goals have been poorly articulated from inception. The empirical data suggest that the major sources of revenue for the subsector are commercial in nature, rather than donative, belying some of the vague assumptions underlying exemption. Given the commercial nature of a large number of these organizations, and the lack of readily available information on exactly what these organizations are doing, more information is needed in order to maintain tax equity between commercial and non-profit organizations. The policy goals for the exemption also need to be articulated.

KEYWORDS: EXEMPTIONS ■ NON-PROFIT ■ NON-PROFIT ORGANIZATIONS ■ TAX-EXEMPT ■ TAX-EXEMPT ORGANIZATIONS ■ TAX EXEMPTIONS

* Of Washburn University School of Law, Topeka, Kansas (e-mail: lori.mcmillan@washburn.edu).

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INTRODUCTION

"Tax exempt status is a privilege that should be closely regulated."[1] A tax exemption for non-profit organizations, as a tax expenditure, should be considered carefully and re-evaluated regularly—not just for the forgone revenue cost, but because it is important to evaluate the policy goals of the expenditure and to consider the reputational cost if the exemption were perceived as contributing to unfairness in our tax system. The urge to forgo this evaluation on the basis of some perception of the inherent "good" done by those in the non-profit sector might exist but should be resisted. Charities also are part of the sector, and undoubtedly "do good" as well, but in exchange for their tax expenditures, they are subjected to a great deal of oversight and must meet stringent requirements to qualify for and maintain their tax-exempt status. There is no valid reason to gloss over non-charitable non-profits while scrutinizing charities.

EVALUATION OF THE EXEMPTION FOR NON-PROFITS AS A TAX EXPENDITURE

Tax expenditures are embedded in taxing statutes to assist the government in pursuing social and economic policy goals. They are deviations from the benchmark norm of everyone paying their fair share of tax, and may take many forms, including, for

1 Canada, *Report of the Royal Commission on Taxation*, vol. 4 (Ottawa: Queen's Printer, 1966-67), at 138 (often referred to as "the Carter report"). The report recognized that "organizations have been extended exempt status over the years without the establishment of any clear principles as to why such exemption should be granted and who should receive it." Ibid., at 128-29.

example, lower tax rates, exemptions, and timing differences.[2] When a tax expenditure is given, typically there should be a compelling social reason or benefit to justify preferential treatment; otherwise, fairness concerns will arise over who is granted this treatment, from both horizontal and vertical equity perspectives. "A tax is just or fair only for a particular society and only to the extent that it supports and furthers the normative goals of that society."[3] This is why it is essential that tax expenditures be considered carefully and re-evaluated regularly.

To establish the context for the discussion in this article, it must be stated at the outset that the tax exemption for non-profits is a tax expenditure. That is, it is a deviation from a benchmark norm that would otherwise require these organizations to pay an appropriate level of tax on their income, rather than a recognition of an organic boundary of the taxing statute. While some might claim that non-profits are prohibited from making a profit,[4] it is clear from the language of the exemption provision that this is not the case. Paragraph 149(1)(l) of the Income Tax Act recognizes that non-charitable non-profits are capable of earning taxable income; indeed, it specifies that "[n]o tax is payable . . . on *the taxable income of*"[5] a non-charitable non-profit organization. If non-charitable non-profits could not earn taxable income, this provision would be meaningless, conflicting with the rules of statutory interpretation and defying common sense.

There is a big difference between not being allowed to earn a profit and not having a profit motivation, but this must be interpreted considering the plain language of the statute.[6] Profit is, in essence, the excess of revenue over expenditures, with some adjustments for book-tax differences. If an organization were required to dedicate an increasing amount of money to filling the gap between profits and revenues, rather

2 See Canada, Department of Finance, *Report on Federal Tax Expenditures—Concepts, Estimates and Evaluations 2023* (Ottawa: Department of Finance, 2023).

3 Marjorie E. Kornhauser, "Equality, Liberty, and a Fair Income Tax" (1996) 23:3 *Fordham Urban Law Journal* 607-61, at 608.

4 See, for example, Esmail Bharwani, "Maintaining Non-Profit Tax-Exempt Status Under Paragraph 149(1)(l)—Irreconcilable Differences," presented at the 2011 National Charity Law Symposium, Toronto, Ontario, May 6, 2011 (www.cba.org/cba/cle/PDF/CHAR11_Bharwani_Paper.pdf), at 1: "However, paragraph 149(1)(l) prohibits the entity from making a profit. This type of entity has enjoyed liberal interpretation of the term 'profit' from CRA over the years used in said provision of the *Income Tax Act*."

5 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"), paragraph 149(1)(l) (emphasis added). Unless otherwise stated, statutory references in this article are to the Act.

6 There is some doubt that the rules of strict construction still apply in interpreting an exempting provision of a taxing statute. In *LIUNA Local 527 Members' Training Fund v. Canada*, [1992] 2 CTC 2410 (TCC), at 2422, footnote 6, the court stated, "There has been an evolution in the rule of 'strict construction' of exempting provisions stated in *Wylie v. City of Montreal* (1887), 12 S.C.R. 384 at 386. See *Stubart Investments Ltd. v. The Queen*, . . . 84 D.T.C. 6305 (S.C.C.), at page 6323 . . . per Estey, J. Taxing statutes, including exempting provisions, must be read 'in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act[,] the object of the Act and the intention of Parliament.'"

than pursuing specific non-profit-related goals, common sense would tell you that there was no need to provide an exemption. Thus, making a profit must be allowed, as well as expected; otherwise, the constant diversion of resources into an organization that was not economically viable instead of directly supporting whatever cause was the object of the organization would be nonsensical. There is some question as to whether organizations with large surpluses will be disqualified from being a non-profit, and while the administrative guidance offered by the Canada Revenue Agency (CRA) indicates that large surpluses would disqualify entities from non-profit status,[7] case law shows that surpluses are a factor to consider.

The Canadian tax system focuses on the taxpayer when providing an exemption, and not on the type of income per se—that is, income is income, regardless of who earns it. This means that attention needs to be paid to the qualifications of the taxpayer being exempted, not to the income itself, except in certain specific circumstances.[8] The tax exemption for non-charitable non-profit organizations, then, is a real tax expenditure because, but for the exemption, their income would be taxed according to the benchmark norm.

THE NON-PROFIT SECTOR

The non-profit sector is a major part of the Canadian economy, accounting for 9 percent of Canada's gross domestic product in 2020.[9] The sector is extremely diverse, containing entities from hospitals to day cares, and universities to scouting organizations. The non-profit sector is sometimes referred to as the third sector, the voluntary sector, the independent sector, the community sector, or the civic sector, among other names.[10] This sector is what is left after the private sector and the public sector are excluded, and it has been treated—at least by some definitions—as a residual category for whatever does not fit within either the private or the public sector. Key players in the non-profit sector are charities, as well as non-charitable non-profit organizations. Given the residual nature of the sector, it is impossible to

7 Compare *BBM Canada (formerly BBM Bureau of Measurement) v. The Queen*, 2008 TCC 341, with the technical interpretation in CRA document no. 2009-0337311E5, November 5, 2009, which seems to have since been tempered by a technical interpretation in CRA document no. 2019-0825751E5, February 26, 2021.

8 For a deeper examination, see Lori McMillan, "The Concept of Income as Related to the Non-Charitable Nonprofit Subsector in Canada" (2010) 16:3 *Law and Business Review of the Americas* 457-80.

9 Statistics Canada, *Latest Developments in the Canadian Economic Accounts: An Overview of the Non-Profit Sector in Canada, 2010 to 2020* (Ottawa: Statistics Canada, 2022), at 4: "The gross domestic product (GDP) of total non-profit institutions was $185.8 billion in 2020, representing 9.0% of Canada's total GDP."

10 See Lester M. Salamon and Wojciech Sokolowski, "Beyond Nonprofits: In Search of the Third Sector," in *The Third Sector as a Renewable Resource for Europe: Concepts, Impacts, Challenges and Opportunities* (London, UK: Palgrave Macmillan, 2018), 7-48.

make assumptions about the purposes behind a non-profit organization, its role, or its merits that may be deserving of social support, without an examination of those purposes and their execution. The rest of this article focuses on non-charitable non-profit organizations (hereinafter referred to as "non-profits") and their exemption from federal taxation.

THE TAX EXEMPTION FOR NON-PROFITS

Legislative Provisions

As the less well-known cousins of charities, non-profits enjoy some privileges that are associated with their inclusion in the non-profit sector. While charities are exempt from federal income taxation,[11] and donations to them can also generate a tax credit for donors,[12] other non-profit organizations in Canada are merely exempt from federal income tax under paragraph 149(1)(l). That provision states:

> 149(1) No tax is payable under this Part on the taxable income of a person for a period when that person was
>
> . . .
>
> (l) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society or association the primary purpose and function of which was the promotion of amateur athletics in Canada;

There is no registration requirement for qualification, but rather an automatic exemption if the listed requirements are met, meaning that entitlement is self-declared. The organization cannot be a charity, and it must be organized and operated exclusively for a purpose other than profit, with no income or personal benefit inuring to the owner. If exempt under paragraph 149(1)(l), the organization may also be entitled to other exemptions, such as exemption from

> retail sales tax, goods and services tax, property tax and land transfer tax. An organization, who qualify [sic] as a section 149(1)(l) entity, will qualify for a complete income tax exemption under ITA [Income Tax Act] Part I and other tax (Parts I.3, IV, IV.1, VI, VI.1) (ITA 181.1(3)(c) and 227(14)).[13]

11 Paragraph 149(1)(f).

12 Subsections 118.1(1), 118.1(3), and 118.1(9).

13 François Brouard, "Note on Nonprofits and Charities Taxation," June 4, 2020, at 3 (https://carleton.ca/profbrouard/wp-content/uploads/NoteTAXNPOcharitiestaxation.pdf).

The other exemptions contained in section 149 are for municipalities,[14] Crown corporations,[15] registered charities,[16] pension trusts and corporations,[17] registered education savings plans,[18] registered disability savings plan trusts,[19] and similar entities or persons, exhibiting either a natural boundary of taxing authority or a strong social policy component. Most of the other exempt persons in section 149 are either entities that are wholly or mostly owned by a level of government, or have strong policy goals such as the funding of retirement, education, or disability. While not much is contained in the debates leading up to the original adoption of the substance of paragraph 149(1)(l),[20] the context of the section certainly suggests that there are commonalities between the entities that are included and the exemption thereunder, with the nearest analogy being charities. If there is a strong social policy goal for exempting non-profits, what is it? And do the requirements of the exemption ensure that this policy goal is met in exchange for exemption? These questions prompt a necessary evaluation of what the exemption gives against what it costs.

Definition of a Non-Profit for the Purposes of the Exemption

A non-profit is not defined in the Act, but the term has been judicially interpreted to include clubs, societies, and associations (including corporations),[21] running the gamut from informal to formal and encompassing almost all kinds of organizations.[22] The biggest constraint is on the distribution of profits, since no profit can be returned to the owners or organizers, or inure to their benefit.[23] This is how an entity can meet

14 Paragraphs 149(1)(c) and (d.6).

15 Paragraphs 149(1)(d), (d.1), (d.2), and (d.3).

16 Paragraph 149(1)(f).

17 Paragraphs 149(1)(o) and (o.1).

18 Paragraph 149(1)(r).

19 Paragraph 149(1)(u.1).

20 Canada's first income tax legislation, the Income War Tax Act, 1917, SC 1917, c. 28, provided an exemption for "5. (g) [t]he income of clubs, societies and associations organized and operated solely for social welfare, civic improvement, pleasure, recreation or other non-profitable purposes, no part of the income of which inures to the benefit of any stockholder or member."

21 *St. Catharines Flying & Training School v. MNR*, [1953] Ex. CR 259; rev'd 55 DTC 1145 (SCC).

22 With the exception of inter vivos trusts and partnerships: "Aside from an inter vivos trust, another exception to this is likely a registered partnership, which under business law must exist for a profit purpose. See *Continental Bank Leasing Corp. v. Canada* [1998] 2 SCR 298 (discussing the Partnerships Act, RSO 1980, c. 370, section 2 (Can.), which defines a 'partnership' to be carried on with a view to profit). However, an informal partnership would likely be classified as an association, since the term is sufficiently elastic, such that a formal partnership is likely to be the only other entity excluded from the benefit of the provision." Lori A. McMillan, "Noncharitable Nonprofit Organizations and Tax Policy: Working Toward a Public Benefit Theory" (2020) 59:2 *Washburn Law Journal* 301-32, at 301-2, footnote 3.

23 The phrase "personal benefit" seems to encompass only direct personal benefits conferred upon members, shareholders, and proprietors, by payments made out of income directly

the requirement that it is organized for a purpose other than profit, rather than having to structure the business so that it loses money.[24] In addition, although the entity must be organized for a purpose other than profit, profit is allowed (since otherwise the exemption would be pointless), but not as the first-line goal, as is the case for partnerships, for example, which are specifically organized to make a profit.

A wide variety of organizations have been determined by the courts to be eligible non-profits for the purposes of the exemption. For example, in *The Canadian Bar Insurance Association*,[25] an insurance corporation was found to qualify for the exemption. This business sold the same types of insurance products as those provided by for-profit entities in the insurance market, but because the goal of the entity was to provide affordable insurance to members of the Canadian Bar Association, it met the purpose-other-than-profit requirement. The Tax Court of Canada rejected a commercial activity test, and instead favoured a determination of whether the entity's predominant purpose was profit. Large reserves are required for an insurance business, and while such reserves are one factor in determining a profit purpose, if they were required for the specific business, they would not be evidence of a profit motivation. In *The Gull Bay Development Corporation*,[26] a highly commercialized logging operation that competed with for-profit entities qualified as a non-profit because the corporation's purposes were carefully crafted both to support the economic and social well-being of members of a First Nation band, and to undertake certain benevolent and charitable activities. Even though the corporation competed against private-sector entities, with high commercial activity, the Federal Court Trial Division had no problem

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to them or to other persons for their personal benefit. A reasonable salary or fee for services rendered to the organization is not a personal benefit, nor is reimbursement for expenses incurred in furthering the organization's activities; a marketplace exchange also does not trigger this constraint. See Ronald C. Knechtel, "Tax Treatment of Non-Profit Organizations," in *Report of Proceedings of the Forty-First Tax Conference*, 1989 Conference Report (Toronto: Canadian Tax Foundation, 1990), 35:1-19.

24 To determine whether an entity was organized for a non-profit purpose, the CRA will normally review the entity's constating documents. To determine whether an entity is operated for a non-profit purpose, the CRA will view several factors as contraindications, including operating a business in a commercial manner, in direct competition with taxable entities, and operating on a profit basis rather than cost-recovery basis. Providing goods and services to a non-discrete market segment will be viewed as an indicator of a for-profit purpose, and the accumulation of reserves in excess of reasonable requirements will earn the CRA's scrutiny. Any of these factors in combination may indicate to the CRA that the "operated exclusively" requirement is not met, such that the granting of the exemption is withheld; however, merely carrying on a trade or business connected with or directly attributable to the non-profit goals and activities of an entity will not generally be viewed as indicating a profit-motivated purpose. See Canada Revenue Agency form T4117, "Income Tax Guide to the Non-Profit Organization (NPO) Information Return," and *Interpretation Bulletin* IT-496R (Archived), "Non-Profit Organizations," August 2, 2001.

25 *The Canadian Bar Insurance Association v. The Queen*, 99 DTC 653 (TCC).

26 *The Gull Bay Development Corporation v. The Queen*, 84 DTC 6040 (FCTD).

finding that it was a qualified non-profit for exemption purposes. The requirement for the lack of a profit motive does not deter non-profits from setting up businesses that compete with private-sector industries, since the nature of the business itself, and the type of industry or market in which the business operates, are immaterial.

According to information returns, non-profits are classified into 11 categories by type:

1. recreational or social organizations
2. professional associations
3. organizations operated for civic improvement
4. agricultural organizations
5. educational organizations
6. multicultural organizations
7. arts or cultural organizations
8. low-cost housing organizations
9. residential condominium corporations or organizations
10. boards of trade or chambers of commerce
11. other.

These types of organizations are truly varied, and participate in many different industries, most of which—but not all—are obvious from the category name.

Entities Claiming the Exemption

There is a limited reporting requirement for certain non-profit entities, found in subsection 149(12), which enables a certain amount of information to be gathered about some of the entities enjoying the exemption under paragraph 149(1)(l). Subsection 149(12) states:

> (12) Every person who, because of paragraph (1)(e) or (l), is exempt from tax under this Part on all or part of the person's taxable income shall, within 6 months after the end of each fiscal period of the person and without notice or demand therefor, file with the Minister an information return for the period in prescribed form and containing prescribed information, if
>
> (a) the total of all amounts each of which is a taxable dividend or an amount received or receivable by the person as, on account of, in lieu of or in satisfaction of, interest, rentals or royalties in the period exceeds $10,000;
>
> (b) at the end of the person's preceding fiscal period the total assets of the person (determined in accordance with generally accepted accounting principles) exceeded $200,000; or
>
> (c) an information return was required to be filed under this subsection by the person for a preceding fiscal period.

The requirement to file does not apply to all entities enjoying the benefit of exemption. A review of the filed prescribed forms (T1044s) shows certain patterns, and while the latest published information is a bit dated, and a large number of organizations have no filing requirement, the patterns remain. Returns by T1044 filers

are predominantly from "other" entities,[27] and the largest proportion of revenue across all non-profit entities is from sales.[28] Gifts are a negligible part of the revenue of non-profits, as one would expect, since there is no tax credit for donations to non-profits as there is for donations to charitable organizations. The information included in these returns is not detailed or in-depth, but even so the lack of detail is apparent. We do not know what type of organizations are in the "other" category, nor do we get comfort from the strong predominance of sales revenue. Sales transactions are exactly what one expects to see in the private sector, and with entities such as the Canadian Bar Insurance Association competing with private-sector entities, the exemption for non-profit organizations can provide a competitive edge in some markets. Without further assurances from the data, what we are left with is entities making the majority of their income from sales, but we do not know what kind of entities these are since they do not fit within the other 10 categories of non-profit organizations. This is not enough security to ensure that a policy goal is being met, whether that is the tax policy goal of fairness or the goal of protecting the perception of faith that tax exemptions are provided for a good reason.

A REVIEW OF SOME THEORIES FOR THE EXEMPTION OF NON-PROFITS

There is no consensus on the specific normative or positive goals of the tax exemption for non-profits,[29] but scholars have enunciated various theories about why the exemption exists.

Bittker and Rahdert

Boris Bittker and George Rahdert advanced rationales for exemption supported by two pillars: income definition issues and ability-to-pay concerns. Their first rationale is premised on the assertion that the concept of "income" as we know it is incompatible

27 Lori A. McMillan, "Noncharitable Nonprofit Organizations in Canada: An Empirical Examination," in Kim Brooks, ed., *The Quest for Tax Reform Continues: The Royal Commission on Taxation Fifty Years Later* (Toronto: Carswell, 2013), 311-28, at 317, graph 2.

28 Ibid., at 321, graph 6. This is not just true in Canada. "While it is commonly believed that nonprofit organizations are supported chiefly by private charitable giving, in fact it is private fees and service charges that provide the largest share of total support. This is true, moreover, even in the United States, which is supposed to have the highest levels of private giving and the most highly developed private foundation sector." Lester M. Salamon and Helmut K. Anheier, *The Emerging Nonprofit Sector: An Overview* (Manchester: Manchester University Press, 1996), at 76.

29 As John Simon stated, "[w]hat is striking . . . is the degree to which the tax system's forays into the nonprofit realm have been unaccompanied by a coherent theory of intervention or by empirical support for intervention. The equity function is not grounded on an adequate rationale for or against a redistributional role for charity, or any empirical date about its redistributional impact." John Simon, "Tax Treatment of Nonprofit Organizations," in Walter Powell, ed., *The Nonprofit Sector: A Research Handbook* (New Haven, CT: Yale University Press, 1987), at 94.

with the non-profit sector.[30] Bittker and Rahdert assert that non-profit public service organizations are not appropriate targets for income taxation, and the exemption for these organizations is a recognition of the appropriate limits of the tax system. This assertion would mean that the exemption is intrinsic to the tax system, and therefore the non-taxation of these entities is not a preference or a tax expenditure; the revenues of these organizations do not form part of the proper normative tax base against which deviation is to be measured. Public service organizations pose a particular problem for income calculation because the existing tax system focuses on the concept of profit and imposes tax on net rather than gross income; it focuses on profit-seeking organizations and behaviours, and the principles that have evolved to reach taxable income are premised on an orientation toward profit maximization, which is not applicable in the case of non-profit public service organizations. The receipts earned by these non-profit organizations, such as dues, gifts, and bequests, cannot be reconciled with existing income concepts. Are dues business income? Are gifts and bequests excludable from income, or does the gift exclusion from income taxation apply only in a personal context? If gifts increase the endowment of an organization, are they a capital contribution? Bittker and Rahdert assert that the underpinnings of the tax system are not sufficiently elastic to address the unique questions raised by non-profit public service organizations. Expenses incurred for a purpose other than profit cannot be deducted in most tax systems; therefore, under regular income and expense computation principles, no expenses will ever be allowed for entities that are not profit-oriented. At the very least, regular principles must be expanded before the issues surrounding non-profit taxation can be addressed. Essentially, Bittker and Rahdert are saying that it is impossible to quantify the income of a public service organization under the existing tax regime, short of a massive overhaul of the concepts underlying income measurement. This, however, overstates the power of their theory: since income is a statutory construct to start with, amendments to reach a desired stream of revenue and to classify it as income are not excessively problematic.[31]

The alternative argument made by Bittker and Rahdert is that even if these income computation hurdles can be overcome or addressed, the appropriate tax rate for public service organizations cannot be determined; because the incidence of taxation is ultimately borne by these organizations, the appropriate ability to pay that must be considered is that of the actual beneficiaries of the organization's good works, rather

30 Boris I. Bittker and George K. Rahdert, "The Exemption of Nonprofit Organizations from Federal Income Taxation" (1976) 85:3 *Yale Law Journal* 299-358, at 348-49.

31 See, for example, Henry Hansmann, "The Role of Nonprofit Enterprise" (1980) 89:5 *Yale Law Journal* 835-901; Rob Atkinson, "Altruism in Nonprofit Organizations" (1980) 31:3 *Boston College Law Review* 501-639, at 579; Nina J. Crimm, "An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation" (1998) 50:3 *Florida Law Review* 419-62; and Mark A. Hall and John D. Colombo, "The Donative Theory of the Charitable Tax Exemption" (1991) 52:5 *Ohio State Law Journal* 1379-1476.

than the organization itself.[32] The problem that arises is that either the ultimate beneficiaries of these types of organizations are not specifically known at the time of income receipt, or they are too widely dispersed to allow for the collection of accurate information. Even a surrogate rate imposed on an entity in lieu of taxing the beneficiaries may result in overtaxation, so justice would be better served by exempting the organization from tax.

There is one key point that is often overlooked when discussing Bittker and Rahdert's income definition quandary: they aimed these concerns very squarely at public service organizations, which are oriented toward providing a general benefit to society. Mutual benefit organizations, under this theory, were appropriate objects of taxation to the extent that they reflected more than just collective actions that individuals could not exclude or deduct from their own ultimate tax liability if they carried out those actions directly themselves. In Canada, it is the source of revenue that determines whether a receipt is "income" to the recipient; the status of the recipient is irrelevant to a determination of income. As defined in paragraph 3(a) of the Act, a receipt will be income if it is derived from an office, employment, business, or property, period. It is not conceptually impossible to equate the solicitation of donations with the sale and marketing of the warm fuzzy feeling that is presumed to result from donating to a worthy cause. If needed, statutory provisions dealing with such receipts could be amended to include all donations in income from a business, while allowing full deduction for all expenses incurred to further the entity's non-profit public service goals, instead of requiring that deductible expenses be made for the purpose of producing income.

Bittker and Rahdert's musing that US legislation providing a tax exemption for non-profits reflected a given in society at the time of enactment rings true, and it is the most convincing reason for the original existence of the Canadian exemption, since it would explain the absolute dearth of commentary surrounding the provision.[33] However, societies change, and Canada has evolved from an agrarian society, with the main sources of transportation being horse and buggy and the railroad, to an industrial society whose members commonly travel by car and airplane.[34] In

32 Bittker and Rahdert, supra note 30, at 315.

33 American commentators also lament the lack of discourse and debate on the exemption for the non-profit sector in the United States, noting that it was accepted as a matter of course, as was the provision in English law on which it was modelled. See Chauncey Belknap, "The Federal Tax Exemption of Charitable Organizations: Its History and Underlying Policy," in *Research Papers*, sponsored by the Commission on Private Philanthropy and Public Needs, vol. 5 (Washington, DC: Department of the Treasury, 1977), 2025-44, at 2031.

34 As anecdotal support for this assertion, my maternal grandmother told me that by the age of 13 (which would have been around 1920), she regularly drove her parents' horse and buggy, which was her family's main form of transportation in Thamesville, Ontario. Cars were then a luxury for the average Canadian farming family. At about the same time, my paternal great-aunt had to hitch a ride on a freight train to attend high school two towns over; it was common, she said, for the train's crew to slow the train down when they saw children waiting by the tracks so that

many ways, we have become a far more permissive society, and our standards of "morality" have relaxed,[35] such that the internal societal policing that previously ensured that non-profits continued to serve the public interest no longer exists. This means that the benefits expected to be provided by these entities must now be expressly stated, rather than assumed through societal constraints.

Subsidy Theory

Another rationale for the tax exemption for the non-profit sector rests on the role of the sector in providing goods and services that would otherwise be provided by the government. This is known as subsidy theory or the "but for" theory: but for the non-profit sector, the government would be responsible for these tasks and therefore should pay for them.[36] This approach addresses the non-profit exemption in terms of the public benefit that these organizations provide by stepping into the shoes of government:

> The granting of tax-exempt status is aimed either at encouraging private organizations and public instrumentalities to take on a task that must be otherwise met by governmental appropriation or at fostering some activity regarded as fundamental or socially desirable.[37]

The underlying premise is that the mode of delivery, as well as the particular good or service, is socially desirable and/or beneficial. Subsidy theorists such as Stone explicitly recognize that the tax preference for the non-profit sector is a form of subsidy, and as a result "government does have a responsibility to all other taxpayers to make certain that these benefits are efficiently provided and applied to the intended purposes."[38] Subsidy theory does not justify an exemption from tax for non-profit business organizations, such as business leagues and better business bureaus, since one of their main purposes is to increase the revenue of their business members.[39] Subsidy theorists also believe that a tax exemption for organizations such as social

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they could hop on, and slow down again in the towns where there were schools, so that the children could jump off. As for me, I drive my own car, and I fly to various destinations around the world; the experiences of our respective generations couldn't be more different!

35 For example, in most Canadian communities today, a pregnancy outside marriage or a divorce in the family will no longer spell social ruin for both the individual and the other members of the family.

36 See, for example, Lawrence M. Stone, "Federal Tax Support of Charities and Other Exempt Organizations: The Need for a National Policy" [1969] *So. Calif. Tax Instit.* 27-78; or Hall and Colombo, supra note 31, at 1384.

37 See, for example, Paul E. Treusch, *Tax Exempt Charitable Organizations*, 3d ed. (Philadelphia, PA: American Law Institute, American Bar Association Committee on Continuing Professional Education, 1988), at 5.

38 Stone, supra note 36, at 40.

39 Ibid., at 59.

and country clubs is not desirable, because these entities supply specific services to their members only, and no broader social purpose is addressed.[40]

This theory does not address the method of support delivery, since an indirect subsidy is in many ways far less efficient than a direct one.[41] Subsidy theory is predicated entirely on the assumptions that these organizations and their goals are worthy of public support, the government is the one that should be delivering such support, and indirect subsidy is the most appropriate method of providing it.

This theory does not account for a subsidy for non-charitable non-profit organizations, since it cannot be said that all, or even most, non-profits occupy a position that government would have to fill if these organizations did not exist,[42] or that they pursue goals that are geared toward social benefit. In fact, many non-profits fill niches that the government has specifically refused to occupy or from which it has retreated.[43] Since subsidy theory deals with the provision of particular goods and services on behalf of the government, it would make sense for the subsidy for providing these goods and services to be available to anyone who will provide them, rather than concentrating on the non-profit form of organization as the requirement for the subsidy. If such were the case, the subsidy should be available to for-profit as well as non-profit firms,[44] since it is the provision of the good or service that is the goal, not the mere existence of these types of entities.[45]

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40 Ibid., at 61.

41 See, for example, Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985), at 95-96 and 106. Bittker lists the major issues that arise where an indirect subsidy is provided through the tax system: "[T]he value of the concession varies with the beneficiary's tax status, the impact of the program may be erratic and unpredictable, its cost cannot be accurately estimated or budgeted in advance, and its operation is covert rather than open to public inspection and criticism." Boris I. Bittker, "A Comprehensive Tax Base as a Goal of Tax Reform" (1967) 80:5 *Harvard Law Review* 925-85, at 926. See also Henry B. Hansmann, "Unfair Competition and the Unrelated Business Income Tax" (1989) 75:3 *Virginia Law Review* 605-35, at 614-21.

42 As an illustration, the US Supreme Court Chief Justice John Marshall stated that a certain post-secondary educational institution did not occupy an area that government would be in but for the school, but rather it occupied an area that would be *vacant* but for the school: *Dartmouth College v. Woodward*, 17 US (4 Wheat.) 518 (1819), at 647.

43 For examples, see Floyd Gordon, "Viewpoint—The Voluntary Sector in Canada's New Social Contract: More Responsibility but No Voice?" (1996) 13:2 *Philanthropist* 39-45. See also M. Hall and K.G. Banting, "The Nonprofit Sector in Canada: An Introduction," in Keith G. Banting, ed., *The Nonprofit Sector in Canada: Roles and Relationships* (Kingston, ON and Montreal: Queen's University, School of Policy Studies and McGill-Queen's University Press, 1999); and Kathy Brock and Keith G. Banting, *The Nonprofit Sector and Government in a New Century* (Kingston, ON and Montreal: Queen's University, School of Policy Studies and McGill-Queen's University Press, 2001).

44 But see Hansmann, supra note 41, at 617-18, footnote 40, for a different view: "First, the market for the service to be subsidized is insufficiently competitive to assure that for-profit firms would be forced to pass to their customers most or all of the benefit of the subsidy . . .

(Footnotes 44 and 45 are continued on the next page.)

Hansmann and Contract Failure

Hansmann advances the theory that non-profits have a useful purpose in addressing contract failure or in providing certain public goods or services,[46] and this usefulness means that a subsidy for these types of entities is merited.[47] In theory, the free market, guided by this omnipresent invisible hand, should supply goods and services at a level in price and quantity that will maximize social efficiency.[48] Hansmann's theory requires society's "inability to police producers by ordinary contractual devices."[49] This information asymmetry reduces the efficiency of the market; when the discipline of the market does not work properly, for-profit providers can charge excessive prices for inferior goods or services.[50] In such a situation, the usual market discipline can be augmented by the extra protection offered to consumers in the form of the non-distribution constraint inherent in non-profit organizations.[51] This assertion is based entirely on the power of the non-distribution constraint to keep the revenue produced by the entity inside the entity. The consumer is, as a result, not required

[and] [s]econd, for-profit firms, for reasons of asymmetric information or 'contract failure' will provide services of inferior quality to those offered by nonprofit firms." See also Anup Malani and Eric A. Posner, *The Case for For-Profit Charities*, John M. Olin Law & Economics Working Paper no. 304 (2d series) (Chicago: The Law School, University of Chicago, September 2006).

45 "Since medieval times, certain activities rating high in the scale of contemporary values have been accorded tax exemption. From the time when old world culture was first transplanted to America, charitable activities have been granted various forms of tax favors. The basic motive for these tax favors has been a wish to encourage activities that were recognized as inherently meritorious and conducive to the general welfare." Belknap, supra note 33, at 2039.

46 Public goods are defined as goods or services for which the cost of production is the same for one person as for all, and the enjoyment of which by one person does not interfere with the enjoyment by another; once the good or service has been provided to one person, there is no way to prevent others from consuming it. A classic example of a public good is the implementation of pollution controls for a cleaner environment. Weisbrod has argued that non-profits arise as private-market providers of public goods, but does not specify the context in which this may occur (such as Hansmann's theory of contract failure). See Burton A. Weisbrod, *The Voluntary Nonprofit Sector: An Economic Analysis* (Lexington, VA: Lexington Books, 1977).

47 Hansmann, supra note 31, at 845.

48 Ibid., at 843.

49 Ibid., at 845.

50 Henry Hansmann, "The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation" (1981) 91:1 *Yale Law Journal* 54-101, at 69. This could also happen in situations involving high transaction costs, as demonstrated in the Coase theorem. See R.H. Coase, "The Problem of Social Cost" (October 1960) 3 *Journal of Law and Economics* 1-44, at 15-19.

51 This theory rests on the existence of a non-distribution constraint, which prohibits the entity from distributing its profits to its "owners" or other stakeholders. Paragraph 149(1)(l) includes such a constraint, stating that (subject to one exception), in order for a non-profit to qualify for the exemption, none of its income may be payable to, or available for the personal benefit of, its shareholders, members, or proprietors.

to insist upon a detailed contract to get the desired good or service, because of the "fiduciary" relationship between a non-profit and its customers, nor will resources need to be wasted in policing or enforcing such a contract.[52] Other than the provision of public goods or services that are subject to contract failure, this theory offers no economic justification for the non-profit sector as a whole, and specifically offers no justification for those entities that do not engage in the provision of public goods or services, or provide such goods or services in situations of information asymmetry or otherwise, as is the case for the vast majority of non-charitable non-profits.

Hansmann and Capital Constraints

Hansmann has built on his theory of contract failure to advance another theory for tax exemption for the non-profit sector, based on the constraints experienced by the sector in raising appropriate amounts of capital.[53] As a result of the inherent restriction on profit distribution for equity, and difficulties with debt financing, the most stable source of financing for these organizations is retained earnings, and the tax exemption has the effect of increasing the pool of retained earnings available to an entity for this purpose. Retained earnings are likely to be proportionate to the degree to which demand for an entity's goods or services outstrips the entity's ability to supply them.[54] The tax exemption serves efficiency by promoting the provision of goods or services by non-profits in areas where consumers will be better served by such entities than by regular (private-sector) market provision.[55]

Miscellaneous Theories

Yet other theories have been proposed. Atkinson set out a social sciences-based altruism theory, resting the exemption on an "affirmative preference for something" that is the goal or aim of such organizations, and the societal metabenefits that arise by encouraging such organizations.[56] Brody[57] advanced a sovereignty theory that justifies a property tax exemption for elements of the non-profit sector as recognition of the sovereign or quasi-sovereign status of the entities operating in the sector. Under this theory, "independent power to govern" consists in the fact that the exemption leaves the sector free from government interference on many levels.[58] Crimm[59] focused on

52 Hansmann, supra note 31, at 845: "[W]e can view all nonprofits in much the same way that we have always viewed charitable trusts—that is, as fiduciaries."

53 Hansmann, supra note 50, at 72-74. Hansmann admits that this theory has flaws, but essentially argues that if there must be a reason for the exemption, this one is stronger than most.

54 Hansmann, supra note 50, at 74.

55 Ibid., at 72.

56 Atkinson, supra note 31, at 618.

57 Evelyn Brody, "Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption" (1998) 23:4 *Journal of Corporation Law* 585-630.

58 Ibid., at 588.

59 Crimm, supra note 31.

developing a rationale for the exemption based on economic theory, and argued that the justification for the exemption accorded to charitable non-profits rests on a form of risk compensation for these organizations. Her theory can similarly be said to address the rationale for non-charitable non-profit exemption; the tax exemption is a non-volatile expected return to compensate rational organizations for undertaking the provision of "inherently risky" public goods and services.[60]

CONCLUSION: THE NEED FOR MORE

While some entities in the charitable subsector might merit a subsidy on the basis of several of the theories outlined above, none of those theories explains why an exemption from tax is granted to non-charitable non-profits, with the only qualifying criteria being a non-distribution constraint and a purpose other than profit—particularly given the great range of industries and markets in which these entities operate. To improve the non-profit exemption, the purpose behind it must be enunciated clearly, and the exempting provision must be tailored to support this purpose with a minimum of deadweight loss.[61] A tautological assumption that "it's good because non-profits do good things" is not sufficient when guarding the public purse. We do not want a Canadian version of *MysteryBoy*,[62] an American case that involved a putative non-profit with the goal of advocating for the legalization of child pornography and "consensual" sexual relationships between adults and minors—a case that clearly illustrates the dangers of presumptive exemption. Since non-profit organizations in Canada self-declare their qualification for tax exemption, a MysteryBoy with a purpose that was contrary to public policy would not be screened out from claiming the exemption unless the claim was discovered and challenged by the CRA. Such a case would not encourage confidence in the tax system or further the perception of fairness.

Reconciling the Non-Profit Exemption with Policy Goals

With the data showing that sales (excluding membership fees) generate the majority of revenues for non-charitable non-profits, the justification for the exemption

60 Ibid., at 424-25.

61 There have been some half-hearted attempts in Canada at enunciating a clear purpose for the exemption. See, for example, Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ontario Law Reform Commission, 1989), at 162: "The state is concerned with bestowing a benefit—on a desired or meritorious social activity." In the US context, Belknap, supra note 33, at 2033-34, states, "The true explanation, and the only principle that affords a complete justification covering the entire (nonprofit exemption) . . . is that government relieves from the tax burden religious, educational, and charitable activities because it wished to encourage them as representing the highest and noblest achievements of mankind."

62 *MysteryBoy Incorporation v. CIR*, no. 21011-08X (USTC January 26, 2010). The entity was denied tax exemption in part because its purpose was contrary to public policy, as was discovered when it had to file a mandatory application for the exemption. Not all entities that think that they should be exempt merit public subsidy through tax expenditures.

becomes more tenuous. Since no theory on exemption addresses entities that mimic private-sector entities, and there are no data to show that the products sold either address information asymmetry or are public goods, there is no current normative theory to justify the exemption of these entities.[63] If, as the Ontario Law Reform Commission suggested, we are encouraging desired or meritorious activity,[64] where is the filter to ensure that this activity actually takes place? The types of reporting entities provide no guidance either, since the majority are in the undefined "other" category. Fairness demands that a coherent policy goal be enunciated, even if it is only a positive theory to explain what the exemption currently does. Fairness demands that some sort of benefit to society underpins special treatment. Perhaps, in the absence of other guidance or political will, we should go with the goal enunciated by the Ontario Law Reform Commission, and just establish that the purpose of the exemption is to encourage socially desired or meritorious activity.

Requiring Information Returns for All Claiming the Exemption

Once a goal has been established, the exemption can be examined to determine whether it meets that goal, and how to minimize deadweight loss. This might require registration to ensure that entities further the policy goal, rather than relying on self-declaration of entitlement. In the alternative, a statement declaring that the entity is organized for a socially desired or meritorious activity can be part of the information return, granting presumptive exemption under a "trust but verify" approach. While there is a legitimate worry about adding to the administrative burden of grassroots organizations in the non-profit sector, requiring a simple information return in exchange for exemption is not excessive. A statement of organizational purposes might be required, whether prior to exemption or as part of an information return, or, more formally, a copy of the entity's constating documents, capturing income estimates from different types of activities and explanations of what these activities are. Requiring an explanation of what "other" means, for income and for entity types, might be a start. Precision comes with the burden of extra cost, but good-faith estimates are cheap. It would be concerning if the people running a non-profit had no idea what the general finances of the entity were when asked to provide a general estimate.

Perhaps, with this reform, some currently exempt organizations might lose their entitlement. It is hard to say, because we know so little about the members of this particular sector. This reinforces the need for information returns to capture more

63 Some scholars discount the effect that exemption has on competition, stating that it is not a concern because the passive investments that non-charitable non-profits would otherwise make will basically have to provide a comparable rate of return in order to attract investors exiting the active businesses taken over by non-profits; therefore, theoretically, no economic harm is done by the exemption. However, some studies have found that the tax exemption for the non-profit sector is a significant advantage in competing with for-profit firms offering similar services. See Hansmann, supra note 28, at 24. Hansmann suggests that economic inefficiency alone is a justification for taxation. Compare Brody, supra note 57, at 609.

64 See Ontario Law Reform Commission, supra note 61.

data identifying the goals of the entities claiming the exemption. It is irresponsible to assume that an entity meets certain desirable goals that entitle it to the exemption without actually structuring the exemption to achieve those goals. The tax exemption for non-charitable non-profits is overdue for reconsideration and reform. Special treatment should come with a price paid to society, not just revenue forgone by society.

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Policy Forum: Half-Siblings or Close Cousins? Contrasting Operating and Grant-Making Foundations Through a Disbursement Policy Lens

Iryna Khovrenkov*

PRÉCIS

Presque toutes les fondations de bienfaisance au Canada sont assujetties à la règle sur le contingent des versements, qui les oblige à dépenser chaque année une part fixe de leurs actifs. En vertu des modifications apportées à la Loi de l'impôt sur le revenu en 2022, les fondations doivent dépenser un pourcentage plus élevé si leurs actifs dépassent un nouveau seuil prévu par la loi. Si la politique de versement fondée sur la valeur des actifs reconnaît la nécessité de soutenir durablement le secteur caritatif, elle ne tient pas compte de la diversité de la communauté des fondations au Canada. Comment interpréter ces obligations de versement pour les fondations qui financent leurs propres initiatives philanthropiques (fondations opérationnelles) par rapport à celles qui accordent uniquement des subventions (fondations subventionnaires)? Cet article examine en détail la distinction entre les fondations opérationnelles et les fondations subventionnaires au Canada, à l'aide de mesures clés tirées des données sur les fondations de l'Agence du revenu du Canada pour les années 2005 à 2018. Il s'interroge sur le lien existant entre les deux catégories d'organisations au regard d'obligations de versement identiques. En outre, cet article clarifie l'intention politique de l'exigence de versement existante, compte tenu du fait que le secteur des fondations au Canada est de plus en plus diversifié et que les fondations opérationnelles y sont plus nombreuses.

ABSTRACT

Almost all charitable foundations in Canada are subject to a minimum spending rule, requiring them to disburse a set portion of their assets annually. According to 2022 amendments to the Income Tax Act, foundations must spend at higher rates if their assets exceed a new statutory threshold. While the size-based spending policy recognizes the need for sustained support of the charitable sector, it overlooks the

* Of the Johnson Shoyama Graduate School of Public Policy, University of Regina (iryna.khovrenkov@uregina.ca). I am thankful to Kevin Milligan and Daniel Sandler for helpful comments and suggestions. The financial support of the Social Sciences and Humanities Research Council (SSHRC grant #895-2018-1014) is gratefully acknowledged.

diversity of Canada's foundation community. How can we make sense of these spending obligations for foundations that finance their own philanthropic initiatives (operating foundations) compared to those that solely provide grants (grant-making foundations)? This article takes a close look at the distinction between Canada's operating and grant-making foundations, using key measures from the Canada Revenue Agency's foundation data for the years 2005 to 2018. It questions how "related" the two categories of organizations are in the face of identical spending obligations. Additionally, this article clarifies the policy intention of the existing disbursement requirement, considering that Canada's foundation sector is becoming increasingly diverse and that operating foundations are gaining a stronger presence in this sector.

KEYWORDS: CANADA REVENUE AGENCY ■ FOUNDATIONS ■ TAX REGULATIONS ■ SPENDING

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INTRODUCTION

Recent amendments to the Income Tax Act have focused renewed attention on Canada's charitable foundations.[1] Canada is one of the few countries to impose minimum spending requirements on foundations, and the only one (to my knowledge) to have adopted a scaled disbursement policy, which considers foundations' ability to pay based on their asset size.[2] New rules that came into effect on January 1, 2023 added a new dimension to that policy: foundations with investment assets of more than $1 million are required to disburse a minimum of 5 percent of their assets, up from 3.5 percent, while foundations with assets equal to or less than $1 million and more

1 SC 2022, c. 19, section 34, amending the definition of "disbursement quota" in subsection 149.1(1) of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act").

2 The two other countries where foundations face minimum spending obligations are the United States and Australia. In the United States, all private foundations are subject to a 5 percent payout rate, regardless of their asset size: Internal Revenue Service, "Private Foundations" (www.irs.gov/charities-non-profits/charitable-organizations/private-foundations). Similarly, Australian foundations (public ancillary funds) face a 4 percent spending requirement after the first four years of operation: Australian Government, "Public Ancillary Funds" (www.ato.gov.au/businesses-and-organisations/not-for-profit-organisations/getting-started/in-detail/types-of-dgrs/l-z/public-ancillary-funds). Foundations in Europe are not subject to any spending obligations: Helmut K. Anheier, Sarah Förster, Janina Mangold, and Clemens Striebing, "Foundations in Germany: A Portrait" (2018) 62:12 *American Behavioral Scientist* 1639-69.

than $25,000 continue to disburse a minimum of 3.5 percent.[3] All other foundations are exempt from statutory disbursement obligations.[4]

The issue of a suitable minimum spending requirement has been much debated in the past and remains at the forefront of policy. As a regulatory tool, disbursement rates ensure that foundations share their accumulated wealth for public benefit. However, this requirement also seems to support a popular misperception that the foundation sector is primarily grant making, which undervalues the diversity of the foundation community as a whole. How do we make sense of the disbursement requirement for foundations that fund their own charitable programs (operating foundations) as compared with those that exclusively make grants (grant-making foundations)? In the United States, operating foundations fall under a separate classification of tax-exempt organizations and are subject to a different set of regulatory provisions under the Internal Revenue Code[5] than those that apply to grant-making foundations. Furthermore, US operating foundations are not subject to a minimum spending requirement, in contrast to grant-making foundations.[6] In this article, using data from Canada Revenue Agency (CRA) returns filed by operating and grant-making foundations for the period 2005-2018, I offer an empirical sketch of the two foundation types through the disbursement policy lens. I also provide an overview of the evolution of Canada's disbursement policy, followed by a brief discussion of the case of operating foundations.

As we will see, the past 15 years have seen substantial growth in the number of Canadian foundations that exclusively run their own charitable programs. These foundations are distinctive in the structure of their finances and in the scope of their activities. However, aside from small foundations that are exempt from the minimum spending requirement, the current disbursement policy treats all charitable organizations (including operating foundations) primarily as grant making.

EVOLUTION OF CANADA'S DISBURSEMENT POLICY FOR CHARITABLE FOUNDATIONS

Canada is home to almost 13,000 charitable foundations. A common understanding of foundations is that they are asset-holding entities required to make grants in support of the greater good. Canada's initial disbursement requirement, adopted in 1976, reinforced the grant-making function of foundations. With the goal of limiting the accumulation of money within foundations, the federal government required them to transfer legislated percentages of their assets and revenues as grants

3 Additionally, foundations are permitted to make grants to organizations other than those that are registered with the Canada Revenue Agency (non-qualified donees).

4 Subsection 149.1(1) of the Act, the definition of "disbursement quota."

5 Internal Revenue Code of 1986, as amended.

6 Stefan Toepler, "Operating in a Grantmaking World: Reassessing the Role of Operating Foundations," in Helmut K. Anheier and Stefan Toepler, eds., *Private Funds, Public Purpose* (New York: Springer Science+Business Media, 1999), 163-81.

to charities. These percentages were initially higher for foundations designated as private than for those designated as public. The classification of organizations by the type of founder was intended to allow the federal government to monitor foundations whose primary donors were closely related and most of the initial endowment of which came from a single source (that is, private foundations). Even if foundations were funding and delivering their own charitable programs, they were still subject to the same minimum spending requirement. The 1976 disbursement reform set the regulatory tone around foundation disbursements for the next 30 years, including the differential treatment of public and private foundations.

By the early 2000s, the type-based disbursement structure was no longer serving the growing foundation sector. The disbursement rates were outdated, and the rules for calculating the disbursement amounts were complex and administratively burdensome.[7] In 2004, for the first time, the federal government's revised disbursement rules reflected the size of foundations rather than their CRA designations. As shown in table 1, foundations with assets of $25,000 or less were exempt from the minimum spending requirement. All other foundations were subject to a 3.5 percent asset disbursement rate. The elimination of revenue disbursement rules that reflected unequal treatment of public and private foundations took place as part of the 2010 disbursement reform. This change marked an emerging shift in disbursement policy from a type-based to a size-based structure. Finally, the introduction of the 5 percent disbursement rate for foundations with investment assets exceeding $1 million, which came into effect on January 1, 2023, solidified a size-based approach to foundation spending. The new disbursement structure is represented graphically in figure 1. Even though a progressive payment policy considers funders' ability to pay while ensuring financial sustainability of the charitable sector, it continues to support a common assumption that foundations are predominantly grant-making institutions.

A COMPARATIVE PERSPECTIVE ON OPERATING FOUNDATIONS

A growing body of knowledge in the philanthropy field defines operating foundations as those that "primarily operate their own programs and projects."[8] Operating foundations are similar to the older form of independent funders, such as hospices and museums, in that they can further their charitable purposes without needing to rely on grantees.[9] These organizations blend elements of service delivery that are

7 Donald Bourgeois, "Eliminating the Disbursement Quota: Gold or Fool's Gold" (2010) 23:2 *Philanthropist* 184-89.

8 Helmut K. Anheier, *Foundations in Europe: A Comparative Perspective*, Civil Society Working Paper no. 18 (London, UK: London School of Economics and Political Science, Centre for Civil Society, 2001), at 5.

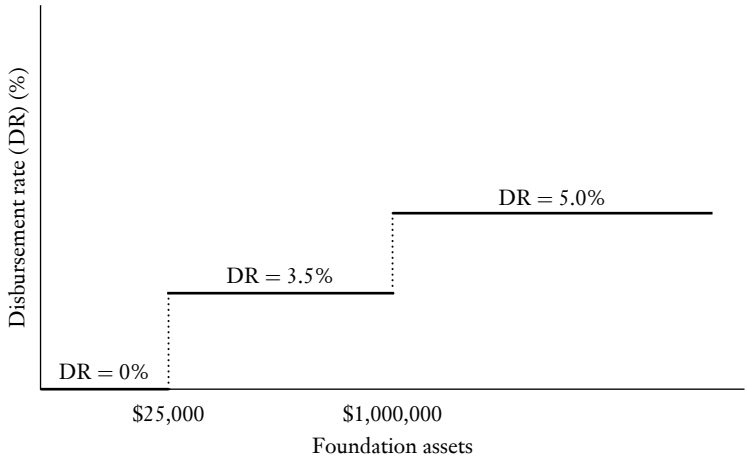
9 The top five foundations that are exclusively operating foundations in Canada are Holy Trinity Roman Catholic Separate School Division No. 22 in Saskatchewan; Roncalli International Foundation in Quebec; Casey House—Specialty Hospital for HIV and Moatfield Foundation,

TABLE 1 Amendments to Minimum Disbursement Rules for Canada's Charitable Foundations, 2004-2022

	Mandatory minimum disbursements		
	2004 amendments	2010 amendments	2022 amendments
Rules based on foundation type			
Private foundations . . .	**Assets:** Disburse 3.5 percent of average value of assets over previous two years (subject to size-based rules below). **Revenues:** Disburse (1) 80 percent of tax-receipted donations and 100 percent of gifts from other charities received in the previous fiscal year, and (2) 100 percent of 10-year gifts and bequests if spent in the current fiscal year.	**Assets:** 2004 rules apply. **Revenues:** All rules are eliminated.	No new measures based on foundation type.
Public foundations . . .	**Assets:** Same rules as for private foundations. **Revenues:** Disburse (1) 80 percent of gifts from other charities received in the previous fiscal year, and (2) 100 percent of 10-year gifts and bequests if spent in the current fiscal year.		
Rules based on foundation size . . .	**0 percent disbursement rate** for foundations with assets of $25,000 or less. **3.5 percent disbursement rate** for foundations with assets of more than $25,000.	No new measures.	**5 percent disbursement rate** for foundations with assets of more than $1 million; registered charities can disburse to non-registered charities. Otherwise, 2004 rules apply.

Source: Budget implementation bills SC 2005, c. 19, section 35 (royal assent May 13, 2005), and SC 2010, c. 25, section 37 (royal assent December 15, 2010); and economic statement implementation bill SC 2022, c. 19, section 34 (royal assent December 15, 2022), each amending the definition of "disbursement quota" in subsection 149.1(1) of the Income Tax Act.

FIGURE 1 Disbursement Rate Structure for Charitable Foundations, Effective January 1, 2023



Source: The definition of "disbursement quota" in subsection 149.1(1) of the Income Tax Act as amended by SC 2022, c. 19, section 34 (royal assent December 15, 2022).

typical for a non-profit with financial independence and are found, for example, in endowed charitable trusts.

In Canada, as in many other countries, the definition of an operating foundation has no legal weight (see table 2), and is mainly used as a functional definition by researchers to describe the types of foundation activities. One exception is the United States, where the Internal Revenue Service (IRS) defines operating foundations as those that "actively conduct their own charitable, educational, or other exempt programs and activities."[10] This subcategory of foundations was introduced in the Tax Reform Act in 1969, which also instituted the rule that operating foundations are "distinct from merely making grants to other organizations."[11] The same statute also established that operating foundations would not be subject to a minimum spending requirement (a 5 percent payout rate). Overall, US operating foundations face a less strict regulatory regime than that applied to grant-making foundations.[12]

Bayview Glen Independent School, both in Ontario; and Health Sciences Centre Foundation Inc. in Manitoba.

10 Internal Revenue Service, "N. Private Operating Foundations" (www.irs.gov/pub/irs-tege/eotopicn84.pdf), at 1.

11 Internal Revenue Service, *Tax-Exempt Status for Your Organizations*, publication no. 557 (Washington, DC: Department of the Treasury, 1992), revised January 1992; and Tax Reform Act of 1969, Pub. L. no. 91-172.

12 Stefan Toepler, "On the Problem of Defining Foundations in a Comparative Perspective" (1999) 10:2 *Nonprofit Management & Leadership* 215-25.

TABLE 2 The Prevalence of Operating Foundations in Selected Countries

Country	Legally classified	Share of foundation sector (percent)	Total number of foundations (operating and other)	Year of data
United States	Yes	4	86,989	2014
Sweden	No	10	14,500	2012
Canada	No	13	12,929	2018
Germany	No	24	20,566	2014
Switzerland	No	30	13,172	2016
Australia	No	50	6,059	2014
China	No	65	4,871	2015
Spain	No	75	14,120	2014

Source: Author's compilation from *American Behavioral Scientist* (2018) 62:12 and *American Behavioral Scientist* (2018) 62:13; and for Canada, from filings of CRA form T3010, "Registered Charity Information Return," data accessed at the Secure Empirical Analysis Lab, McMaster University, Hamilton, Ontario.

As shown in table 2, operating foundations have a strong presence in some European countries, and also in China and Australia. However, in the United States, operating foundations account for only 4 percent of the foundation sector, a share that has remained relatively constant since the early 2000s.[13] Operating foundations in Canada constitute a solid 13 percent of the foundation sector. As shown in figure 2, these foundations have experienced considerable growth in recent years, with their number almost doubling between 2005 and 2018. While grant-making foundations continue to occupy a larger share (43 percent) of the foundation sector, operating foundations are a robust segment of Canada's foundation community.[14]

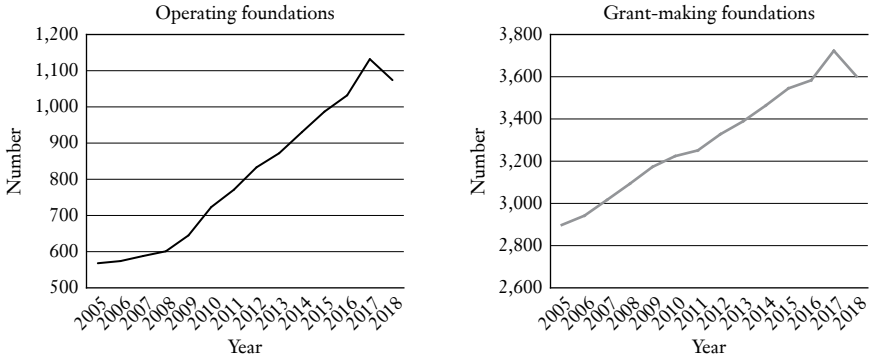
AN EMPIRICAL SKETCH OF CANADA'S OPERATING FOUNDATIONS: THEIR SIZE, SCOPE, AND FINANCIAL STRUCTURE

Lack of empirical evidence about the size and scope of operating entities in the foundation sector may lead to a policy oversight where decisions are based on the ready availability of information, such as exists for grant-making foundations. With the following empirical sketch of operating foundations, I shed light on the segment of the foundation sector that has been overlooked from the policy standpoint. This

13 Stefan Toepler, "Toward a Comparative Understanding of Foundations" (2018) 62:13 *American Behavioral Scientist* 1956-71. The reliability of data sources has been cited as the main reason for the low US figure.

14 "Mixed" foundations—those that spend on their own programs and engage in grant making—make up the remaining 44 percent of Canada's foundation sector. The definition of mixed foundations was developed by researchers for classification purposes (see Anheier, supra note 8).

FIGURE 2 Number of Operating and Grant-Making Foundations in Canada, 2005-2018



Note: Mixed foundations (those involved in both service delivery and grant making) are excluded.

Source: Author's calculations from filings of CRA form T3010, "Registered Charity Information Return," data accessed at the Secure Empirical Analysis Lab, McMaster University, Hamilton, Ontario.

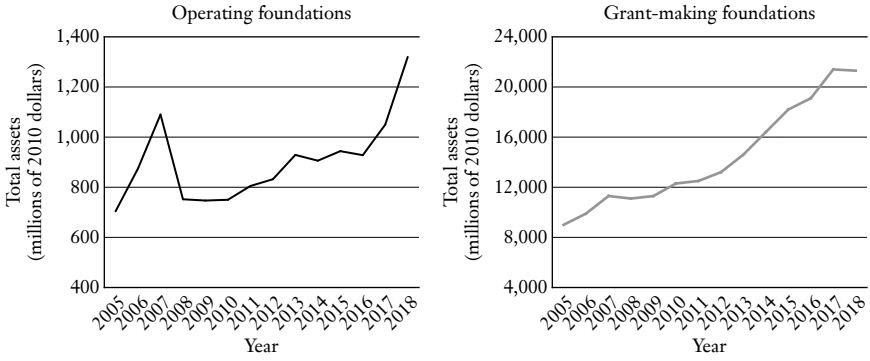
brief analysis excludes foundations that are involved in both service delivery and grant making.

The discussion that follows is based on foundation data collected for administrative purposes by the CRA. All charitable foundations must annually complete and submit to the CRA registered charity information returns (form T3010) in order to maintain their tax-exempt status.[15] These data are publicly accessible and available for the entire population of foundations, as opposed to only a sample, as in the United States. I select key financial measures for operating and grant-making foundations for the period 2005-2018, all of which are converted to 2010 dollars.

Since foundations are commonly viewed as asset-holding entities, the starting point for this empirical sketch is to illustrate total assets of Canada's operating and grant-making foundations. Figure 3 shows that total assets attributed to grant-making foundations amounted to more than $21 billion in 2018 and more than doubled between 2005 and 2018. In comparison, what is striking, but in some way expected, is that the total asset holdings of operating foundations were much smaller, being less than 1/15 the size of holdings of grant-making foundations, and they grew by only 2 percent, on average, during the same period.

15 While the CRA does not formally distinguish between grant-making and operating foundations, the T3010 form effectively recognizes the distinction in question C3 (line 2000): "Did the charity make gifts or transfer funds to qualified donees or other organizations?" If the answer is in the affirmative, the foundation must then fill out CRA form T1236, "Qualified Donees Worksheet/Amounts Provided to Other Organizations," providing detailed information about charity donees and their corresponding names and registration numbers, as well as grant amounts.

FIGURE 3 Total Assets of Operating and Grant-Making Foundations, 2005-2018



Source: Author's calculations from filings of CRA form T3010, "Registered Charity Information Return," data accessed at the Secure Empirical Analysis Lab, McMaster University, Hamilton, Ontario.

Looking to the scope of charitable activities by operating foundations, table 3 reveals that they are active in as many fields as grant-making foundations. It becomes clear when considering the respective shares of operating and grant-making foundations in the foundation sector that operating foundations concentrate in three areas: religious (17 percent), cultural (33 percent), and historical/libraries (29 percent). Major fields of activity for grant-making foundations are welfare (48 percent), education (26 percent), health (23 percent), and community (24 percent).[16] However, when we compare the distribution of spending on charitable programs by operating foundations with the distribution of grants by grant-making foundations, interesting differences begin to emerge. Grant-making foundations seem to predominantly allocate their grant dollars (more than 63 percent) to the welfare field. Spending by both types of foundation in the health field appears to be quite similar, as reflected in the respective shares of grants and operating expenditures. It is also interesting that in the field of education, although grant-making foundations had a larger presence, they allocated slightly under 5 percent in grant dollars, as compared with just over 37 percent of charitable expenditures allocated by operating foundations. In the remaining fields, with the exception of the "other" category, spending on charitable programs by operating foundations exceeds grant dollar allocations.

Turning to the financial structure of operating and grant-making foundations, as shown in table 4, it is evident that grant-making foundations are considerably better endowed, holding much larger assets than operating foundations. However, in the case of operating foundations, the size of assets is only a small part of the financial independence story, because these organizations seek funding from other sources, such

16 Grant-making foundations predominate (at 58 percent) in the "other" category, which includes disaster funds, employee charity funds, military units, and protection of animals.

TABLE 3 Support of Charitable Activities by Operating and Grant-Making Foundations, 2018

	Operating foundations		Grant-making foundations	
Charitable activity	Share of all foundations	Allocation of spending on charitable programs	Share of all foundations	Allocation of foundation grants
		percent		
Welfare	9	13.90	48	63.40
Education	14	37.10	26	4.90
Religious	17	4.30	15	1.90
Health	10	31.10	23	25.50
Community	9	6.00	24	3.10
Cultural	33	2.50	14	0.50
Historical/libraries	29	4.90	11	0.03
Other	8	0.20	58	0.70
Total		100.00		100.00

Note: Columns may not add up because of rounding.

Source: Author's calculations from filings of CRA form T3010, "Registered Charity Information Return," data accessed at the Secure Empirical Analysis Lab, McMaster University, Hamilton, Ontario.

as provincial governments. Table 4 indicates that, during the period 2005-2018, provincial government funding constituted 84 percent of the total revenues of operating foundations, on average, compared to only 0.3 percent for grant-making foundations. Additionally, operating foundations appear to be more "fluid" organizations in that their revenues seem to mostly translate to spending on charitable programs. With average total revenues of almost $772,000, operating foundations on average spent $530,000 on direct delivery of charitable services. Another important expenditure category for operating foundations is management and administration of the organization and of service delivery ($99,000 on average). While grant-making foundations on average realized $956,000 in total revenues, their average grants amounted to only $497,000. Interestingly, despite the considerable difference in the size of their respective financial resources, average contributions of operating foundations to the charitable sector seem to exceed charitable contributions in the form of grant dollars.

CONCLUDING REMARKS: HALF-SIBLINGS OR CLOSE COUSINS?

This article has shed light on a previously overlooked segment of the foundation sector in Canada, namely, operating foundations, in the context of the federal government's minimum disbursement policy. Unlike grant-making foundations, which disburse grants to support charitable programs external to their organization, operating foundations fund and deliver their own programs. Simple statistics presented in this article have revealed that these two types of foundations are distinct in how

TABLE 4 Descriptive Statistics for Key Financial Measures of Operating and Grant-Making Foundations, 2005-2018

	Operating foundations (organizations = 1,589, observations = 11,330)		Grant-making foundations (organizations = 5,104, observations = 46,232)	
	Mean	Standard deviation	Mean	Standard deviation
	$ 000s		*$ 000s*	
Total assets	1,115.7	6,121.6	4,358.5	18,600.0
Total revenues	771.7	6,421.1	956.0	5,707.1
Revenues from provincial governments	647.3	6,669.1	2.9	88.7
Total expenditures	696.5	5,813.6	622.0	3,874.9
Charitable program spending	530.4	4,734.4	nil	nil
Grants to charities	nil	nil	497.1	2,777.5
Spending on management and administration	99.1	1,144.1	39.5	232.6

Note: Dollar amounts are in thousands of 2010 dollars.

Source: Author's calculations from filings of CRA form T3010, "Registered Charity Information Return," data accessed at the Secure Empirical Analysis Lab, McMaster University, Hamilton, Ontario.

they conduct their charitable activities, despite sharing a few similar characteristics, such as economic independence, donor preferences, and tax exemption. The critical difference is that operating foundations resemble service-delivery organizations rather than commonly recognized funders.

Currently, Canada's operating and grant-making foundations face the same disbursement requirement, even though there are significant differences in their asset holdings and degree of engagement in various fields of charitable activity. Should the same regulatory regime apply regardless of differences in purpose and strategy? In jurisdictions other than Canada, the answer has been no. For example, operating foundations in the United States enjoy a full exemption from a minimum spending requirement, in addition to being legally recognized by the IRS. By adopting a separate legal regime for operating foundations, Canada would end the "grant-making bias" that currently disadvantages operating foundations. A policy change would also officially capture a growing organizational form and encourage diversity in the foundation sector. The Association of Fundraising Professionals in Canada has already called on the government to create "an equitable disbursement policy, based on foundations' activities."[17] Furthermore, exempting operating foundations from the

17 Christy Miller, Esther Lee, Tanya Rumble, and Dwaine Taylor, *AFP Canada Policy Position: Boosting Charitable Spending in Our Communities* (Toronto: Association of Fundraising Professionals (AFP) Canada, 2021), at 1 (https://afpglobal.org/sites/default/files/attachments/generic/Policy%20Position%20-%20AFP%20Canada%20-%20Boosting%20Charitable%20Spending%20in%20our%20Communities.pdf).

spending requirement could open the door to additional funding from grant-making foundations through an increase in the granting rate to 7 percent (or higher), as has been proposed by representatives of the philanthropic sector.[18]

A divergent approach to disbursement policy is not without its challenges. Since 44 percent of foundations are mixed (not exclusively operating or grant-making), they may be burdened with additional costly regulations. This approach could also create complexities for charitable organizations that sometimes perform grant-making activities, especially if the granting rate continues to increase. Weighing the pros and cons of such a policy change will require further evaluation and analysis.

18 Imagine Canada, "Consultation: Boosting Charitable Spending in Our Communities" (2021) (www.imaginecanada.ca/sites/default/files/disbursement-quota-submission-Imagine-Canada.pdf).

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Policy Forum: The Registered Charity Appeals Process—More Reasons (and a Few Proposals) for Reform

Kathryn Chan*

PRÉCIS

La procédure actuelle de contestation des décisions de la Direction des organismes de bienfaisance de l'Agence du revenu du Canada présente d'importantes lacunes, qui sont bien connues dans le milieu. Divers comités et universitaires ont exhorté le Parlement à accroître la transparence des processus décisionnels de la Direction et à créer une procédure d'appel plus accessible pour les organismes de bienfaisance enregistrés.

Dans cet article, l'auteure analyse deux développements qui rendent encore plus convaincants les arguments en faveur d'une réforme du processus d'appel des organismes de bienfaisance. Le premier est le remaniement par la Cour suprême du Canada du cadre de contrôle judiciaire dans l'affaire *Canada (Ministre de la Citoyenneté et de l'Immigration) c. Vavilov* (2019 CSC 65); le deuxième est la tendance à la contestation de droit public du régime des organismes de bienfaisance enregistrés devant les cours supérieures. L'auteure présente également des options possibles pour la réforme du modèle canadien actuel. Elle examine notamment si des éléments de la procédure de renvoi en vertu du droit anglais régissant les organismes de bienfaisance pourraient être intégrés dans le régime actuel des organismes de bienfaisance enregistrés dans la Loi de l'impôt sur le revenu du Canada.

ABSTRACT

The current process of challenging decisions of the Canada Revenue Agency's Charities Directorate has significant shortcomings, which are well known within the field. A series of committees and scholars have urged Parliament to increase the transparency of the directorate's decision-making processes and create a more accessible appeal process for registered charities.

In this article, the author discusses two developments that have made the case for reforming the charity appeals process even more compelling than before. The first is the Supreme Court of Canada's overhaul of the judicial review framework in *Canada*

* Of the Faculty of Law, University of Victoria (e-mail: kmchan@uvic.ca). The author thanks Akshaya Chandani and Allison Bilenkey for their research assistance and the editors of the *Canadian Tax Journal* for their editorial assistance.

(Minister of Citizenship and Immigration) v. Vavilov (2019 SCC 65); the second is the trend toward public-law challenges to the registered charity regime in the superior courts. The author also outlines possible options for reform of the current Canadian model. Among other things, she considers whether elements of the English charity-law reference procedure could be accommodated within the existing registered charity regime in Canada's Income Tax Act.

KEYWORDS: CHARITIES ■ APPEALS ■ FEDERAL COURT OF APPEAL ■ CANADA REVENUE AGENCY ■ ADMINISTRATIVE LAW ■ CANADIAN CHARTER OF RIGHTS AND FREEDOMS

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INTRODUCTION

Canada's de facto charities regulator, the Canada Revenue Agency (CRA), has extensive discretionary powers. Because the exercise of these powers can significantly affect an organization's reputation, financial viability, and ability to carry out its mission, it is crucial that organizations be able to question decisions of the CRA's Charities Directorate, and the processes by which they are reached. The current process for challenging the directorate's decisions has significant shortcomings, which are well known within the field. The costs of appealing are so high, and the prospects of success so low, that few organizations choose to challenge the Charities Directorate's decisions in court. In 2019, after hearing from experts and sector representatives, the Special Senate Committee on the Charitable Sector recommended that the government of Canada amend the Income Tax Act[1] to shift jurisdiction over registered charity appeals from the Federal Court of Appeal to the Tax Court of Canada.[2] The committee also recommended that the government "consider measures to assist organizations" that have had their registered charity status refused or revoked in appealing those decisions.[3] Despite repeated calls to implement these recommendations,[4] the government has not yet offered a concrete response.

1 Income Tax Act, 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, Special Senate Committee on the Charitable Sector, *Catalyst for Change: A Roadmap to a Stronger Charitable Sector*; *Report of Special Senate Committee on the Charitable Sector* (Ottawa: Special Senate Committee on the Charitable Sector, June 2019).

3 Ibid., at 18-19, recommendations 23 and 24.

4 See, for example, Canada Revenue Agency, Advisory Committee on the Charitable Sector, "Report #1 of the Advisory Committee on the Charitable Sector, January 2021" (www.canada

In this article, I build on the recommendations of the special Senate committee, arguing that the sector deserves an appeals process that is more accessible and transparent, and that will facilitate the development of new case law for charities. I begin by outlining the current framework for registered charity appeals and reviewing the arguments that have historically been made for its reform. I then discuss two developments since the special Senate committee report that, I argue, add further urgency to the charity appeals debate. The first of those developments is the Supreme Court of Canada's overhaul of the judicial review framework in *Canada (Minister of Citizenship and Immigration) v. Vavilov*;[5] the second is the trend toward public-law challenges to the registered charity regime in the superior courts. Both developments, I argue, have made the case for reforming the appeals process even more compelling than before. Finally, I outline possible options for reform of the current Canadian model. Among other things, I consider whether elements of the English charity-law reference procedure could be accommodated within Canada's existing statutory registered charity regime.

THE REGISTERED CHARITY APPEALS PROCESS

Commentators have for decades expressed concerns about the federal process for determining entitlement to registered charity status in Canada, as well as the related process for appeals. Prior to 2005, organizations that disagreed with the charitable registration and revocation decisions of the minister of national revenue's designated delegate, the CRA's Charities Directorate, appealed directly to the Federal Court of Appeal. The Income Tax Act directed the court to determine registered charity appeals "in a summary way,"[6] without the benefit of sworn evidence or findings of fact. Over time, a consensus emerged that this framework made the minister's decisions "essentially unreviewable."[7] The directorate did not report its decisions, and appeals to the Federal Court of Appeal were rare. Successful judicial appeals were almost unheard of. A series of reports issued between 1996 and 2000 recommended that Parliament increase the transparency of the Charities Directorate's decision-making processes and create a more accessible appeal process for registered charities.[8]

.ca/en/revenue-agency/programs/about-canada-revenue-agency-cra/corporate-reports-information/advisory-committee-charitable-sector/report-advisory-committee-charitable-sector-february-2021.html#h1).

5 2019 SCC 65.

6 Subsection 180(3).

7 Patrick Monahan and Elie S. Roth, "Federal Regulation of Charities" (2000) 15:4 *Philanthropist Journal* 29-54, at 29.

8 These reports included Ontario Law Reform Commission, *Report on the Law of Charities* (Toronto: Ministry of the Attorney General, 1996), and the Canada, Voluntary Sector Initiative, *Joint Regulatory Table* (Ottawa: Voluntary Sector Initiative, 2003). Arthur Drache and Laird Hunter recommended the establishment of a tribunal to make initial registration decisions, as well as a revised appeals process: Arthur B.C. Drache and W. Laird Hunter, "A Canadian Charity Tribunal: A Proposal for Implementation: Part I" (2000) 15:4

In 2005, Parliament amended the Income Tax Act to introduce an internal appeals process for registered charities. Today, the first step for an organization that wishes to challenge an unfavourable registration or revocation decision is to file a written notice of objection with the CRA's Appeals Branch, "setting out the reasons for the objection and all the relevant facts."[9] The Appeals Branch, which is responsible for resolving taxpayers' objections in a "timely, impartial and consistent" manner,[10] must consider the objector's submissions and notify the taxpayer in writing of its decision to vacate, confirm, or vary the assessment.[11] If the Appeals Branch confirms the original decision of the Charities Directorate officer, or fails to provide a response within 90 days, the second step is for the taxpayer to appeal the decision of the Appeals Branch, or the original decision of the Charities Directorate, to the Federal Court of Appeal.[12]

The addition of an internal appeals process has done little to alter the consensus about the "unreviewability" of the minister's decisions. In the almost two decades since the introduction of the notice of objection, there have been 21 unsuccessful (and only 1 partially successful) judicial appeals of decisions either to decline to register or to deregister a charity.[13] The last time the Federal Court of Appeal offered any substantive commentary on the common-law definition of a charity was in 2016, and the effect of that commentary was to distance Canadian law from the law in other common-law jurisdictions by denying that the prevention of poverty was a charitable purpose.[14] Registered charities have had only marginally more success in the internal appeals of registration and revocation decisions.[15] Moreover, the notice of

Philanthropist Journal 2-28. Monahan and Roth, supra note 7, concurred with the Ontario Law Reform Commission, supra, in recommending that jurisdiction over registered charity appeals be moved to the Tax Court of Canada.

9 Paragraph 168(4)(a).

10 Canada Revenue Agency, Corporate Audit and Evaluation Branch, "Tax Appeals Evaluation: Final Report," May 2012 (www.cra-arc.gc.ca/gncy/ntrnl/2012/txpplsvltn-eng.html).

11 Subsection 165(3).

12 Paragraph 172(3)(a.1).

13 The Federal Court of Appeal has set aside a charity registration decision in only one set of related appeals since 1999, and those appeals involved the statutory definition of a registered Canadian amateur athletics association, rather than the common-law definition of a charity: see *Tomorrow's Champions Foundation v. Canada (National Revenue)*, 2021 FCA 146; and *Athletes 4 Athletes Foundation v. Canada (National Revenue)*, 2021 FCA 145.

14 *Credit Counselling Services of Atlantic Canada Inc. v. Canada (National Revenue)*, 2016 FCA 193.

15 Between 2013 and 2018, the CRA's Appeals Branch closed 74 objections of refusal-to-register decisions. Of these, 49 were confirmed, 22 were vacated, and 3 were declared invalid. Between 2018 and 2023, the Appeals Branch closed 30 objections of refusal-to-register decisions. Of these, 11 were confirmed, 9 were vacated, and 2 were declared invalid; the remaining 8 decisions were classified as "other." Data sent from the Access to Information and Privacy Directorate to the Muttart Foundation on October 20, 2023, on file with author.

objection process is of little value to the broader sector since, despite early promises to the contrary,[16] the CRA's Appeals Branch does not publish any of its decisions.

The literature identifies several reasons why the sector has enjoyed so little success at the Federal Court of Appeal. First, the Federal Court of Appeal has not incorporated into its decisions the equitable principles that historically oriented the common-law courts toward the effectuation of charitable gifts.[17] Second, unlike in England and Wales, in Canada there is no public officer who intervenes in registered charity proceedings to represent the public interest in charity property. In practice, the attorney general of Canada acts as advocate for the minister of national revenue in appeals of the minister's charitable registration decisions, while the provincial attorneys general do not appear at all. Third, appeals to the Federal Court of Appeal are prohibitively expensive for many charities, discouraging them from bringing their issues before the court.[18]

Fourth, registered charity appeals are often decided on a very thin evidentiary record. Subsection 180(3) of the Act continues to provide that the Federal Court of Appeal must hear and determine registered charity appeals "in a summary way." Among other things, this means that the evidentiary record in registered charity appeals stops with the issuance of the initial Charities Directorate decision or Appeals Branch confirmation,[19] and is limited to the documents in the CRA's file. As the Canadian Bar Association noted in a 2014 submission to the minister of justice, the inability of appellants to adduce viva voce or affidavit evidence tested by cross-examination significantly limits their ability to present a complete record on which all relevant factual and legal issues may be raised.[20] Finally, registered charity appeals are governed by administrative-law review principles. As we shall see in the next section, these principles continue to require the Federal Court of Appeal to accord significant deference to decisions over entitlement to registered charity status.

16 Canada Revenue Agency, "Canada Registered Charities Newsletter No. 25—Fall 2005" (https://perma.cc/7PUS-UREM).

17 These arguments are explored at greater length in Kathryn Bromley Chan, "The Function (or Malfunction) of Equity in the Charity Law of Canada's Federal Courts" (2016) 2:1 *Canadian Journal of Comparative and Contemporary Law* 33-63. See also "Written Submission to the Senate Special Committee on the Charitable Sector Submitted by Kathryn Chan on 22 October 2018" (https://sencanada.ca/content/sen/committee/421/CSSB/Briefs/CSSB_KathrynChan_e.pdf).

18 Paragraph 168(2)(b), which authorizes the minister to revoke a charity's registration 30 days after the mailing of the notice of the intention to revoke, even where the charity has appealed, creates a further financial disincentive.

19 In cases where a charity filed a notice of objection, but then appealed to the Federal Court of Appeal on the basis that the Appeals Branch failed to provide a timely response, the court has excluded all documents filed during the internal appeals process from the appeal record: *Opportunities for the Disabled Foundation v. Canada (National Revenue)*, 2016 FCA 94 (Appeal Book Order of Stratas JA).

20 Letter from Margaret H. Mason to Minister of Justice Peter MacKay, "Re: Proposed Changes to Jurisdiction in the Federal Courts Act," March 4, 2014 (https://perma.cc/BK3V-3HFY).

THE IMPACT OF VAVILOV

The interaction between the registered charity provisions in the Act and Canada's judicial review framework has been perhaps the most underrated impediment to the development of case law for charities. Deference is an important animating principle of Canadian administrative law. Where the legislature has delegated a decision-making task to an administrative body, Canadian courts seek to avoid "undue interference" with the delegated task.[21] Historically, the challenge that Canada's judicial review framework posed to registered charities was that it required them to establish that the minister had acted "unreasonably" in respect of each ground for revocation or denial of registration. Reasonableness was a notoriously amorphous standard pre-*Vavilov*, which experts described as requiring "an outcome somewhere between 'good enough' and 'not quite wrong.'"[22] Today, the case law offers much clearer guidance on what it means for a decision maker such as the Charities Directorate to act reasonably. Unfortunately, in order to succeed in a registered charity appeal, charities must now generally show that the directorate made a palpable and overriding error.

Prior to the Supreme Court of Canada's decision in *Vavilov*, appeals over entitlement to registered charity status were governed by administrative-law review, not (judicial) appellate review, principles.[23] "Extricable questions of law," including questions regarding the proper interpretation of the Act, were determined on a standard of correctness.[24] If the Federal Court of Appeal determined that the Charities Directorate had not correctly interpreted a term such as "charitable purposes," for example, it could quash the decision on that basis. On the other hand, "questions of fact or of mixed fact and law, including the exercise of the Minister's discretion based on those facts and the law as correctly interpreted,"[25] were reviewable on a standard of reasonableness. In a series of cases between 2004 and 2016, the Federal Court of Appeal held that reasonableness was the appropriate standard when the question was "whether activities are charitable,"[26] whether a registered charity had made a gift to a non-qualified donee,[27] and whether a registered charity had failed to devote

21 *Vavilov*, supra note 5, at paragraph 8.

22 Ibid., at paragraph 11.

23 *Mouvement laïque québécois v. Saguenay (City)*, 2015 SCC 16; *Edmonton (City) v. Edmonton East (Capilano) Shopping Centres Ltd.*, 2016 SCC 47 (compare *Housen v. Nikolaisen*, 2002 SCC 33).

24 *Prescient Foundation v. Canada (National Revenue)*, 2013 FCA 120, at paragraph 12. See, for example, *Public Television Association of Quebec v. Canada (National Revenue)*, 2015 FCA 170; *Jaamiah Al Uloom Al Islamiyyah Ontario v. Canada (National Revenue)*, 2016 FCA 49; and *Ark Angel Foundation v. Canada (National Revenue)*, 2019 FCA 21. It is arguable that *Prescient Foundation* was inconsistent with the Supreme Court of Canada's decision in *Dunsmuir v. New Brunswick*, 2008 SCC 9, but I will not pursue that argument here.

25 *Prescient Foundation*, supra note 24, at paragraph 12.

26 *Fuaran Foundation v. Canada (Customs and Revenue Agency)*, 2004 FCA 181, at paragraph 10.

27 *Opportunities for the Disabled Foundation*, supra note 19.

its resources to its own charitable activities.[28] Where an organization's charitable registration was refused or revoked for multiple reasons (the usual case), the Federal Court of Appeal consistently held that the appellant had to demonstrate that the minister had acted unreasonably in respect of each ground.[29] If just one of the bases for revocation was maintained, the appeal would be dismissed.[30]

In *Vavilov*, the Supreme Court of Canada articulated a new standard-of-review framework and provided additional guidance for reviewing courts to follow when conducting a reasonableness review.[31] The latter development seemed to hold out hope for those who believe that the Charities Directorate's charitable registration processes should be more transparent and accountable. *Vavilov* is widely seen as having "strengthen[ed] a culture of justification in administrative decision making" by defining reasonable decisions as decisions that are based on a rational chain of analysis and that meaningfully account for the central issues and concerns raised by the parties.[32] The more robust version of reasonableness review that courts apply to administrative decisions post-*Vavilov* could assist organizations that consider that officers at the Charities Directorate have not responded to their arguments or taken all of the relevant facts into account.

Any benefits that the new reasonableness standard might have produced for charities have been scuttled, however, by the amended framework for determining standards of review. While *Vavilov* establishes a presumption of reasonableness review for administrative decisions, it also establishes several exceptions to this presumption. Where a legislature has provided for appeal of an administrative decision to a court, *Vavilov* directs the reviewing court to apply appellate standards of review.[33] For charities, this means that the Federal Court of Appeal will continue to apply a correctness standard to extricable questions of law arising from registration and revocation decisions. However, where the scope of a registered charity appeal includes questions of fact, questions of fact and law, or an exercise of the minister's discretion, the standard of review applicable to those questions is palpable and overriding error.[34] Palpable and overriding error is an exacting standard, requiring an appellant to convince the court that there has been "obvious, calamitous error" in respect of each basis for

28 *Public Television Association*, supra note 22. But see *Action by Christians for the Abolition of Torture v. Canada*, 2002 FCA 499, at paragraphs 23-24, where the court held that the characterization of a registered charity's activities as "political" was a conclusion of law that was subject to a correctness standard.

29 *World Job and Food Bank Inc v. Canada*, 2013 FCA 65, at paragraph 5.

30 *Colel Chabad Lubavitch Foundation of Israel v. Canada (National Revenue)*, 2022 FCA 108, at paragraph 49.

31 *Vavilov*, supra note 5.

32 Ibid., at paragraphs 2, 85, and 127.

33 Ibid., at paragraph 37.

34 Ibid., and *Mahjoub v. Canada (Citizenship and Immigration)*, 2017 FCA 157, at paragraph 73.

revocation or refusal to register.[35] It is animated not by the principle of responsive justification, but rather the principle of judicial economy.[36] Absent an obvious error that affects the outcome of the case, a court considering a registration or revocation decision under this standard will not revisit the sufficiency of the evidence before the minister or the minister's weighing of that evidence.[37] Logic and recent case law suggest that this change will make successful registered charity appeals even more rare.[38]

THE IMPACT OF PUBLIC-LAW CHALLENGES

A second development that should reduce the government's seeming comfort with the existing registered charity appeals process is the trend toward charities bringing public-law challenges to registration decisions in the superior courts. Faced with bleak chances of success at the Federal Court of Appeal, registered charities that wish to challenge the results of CRA audits are increasingly seeking an alternative judicial audience and framing their arguments in public-law terms. From the perspective of the charitable sector, these challenges represent an important response to alleged excesses of government power. However, because the resultant decisions rely on principles external to the common law of charities, they are unlikely to contribute much to a case law that has its own internal logic. Because constitutional challenges require government to amend legislation quickly, in accordance with the directions of a court, the trend toward public-law litigation will also limit government's ability to control the boundaries and design of the registered charity regime.

In 2016, a registered charity finally broke the logjam of failed challenges to the decisions of Canada's charities regulator. *Canada Without Poverty v. AG Canada*[39] involved a registered charity ("CWP") that, at the time of the litigation, had operated to relieve poverty in Canada for 45 years.[40] In 2014, CWP became a subject of Prime Minister Stephen Harper's enhanced political activities audits. In 2015, the Charities Directorate gave the charity notice that it intended to revoke its charitable registration on the basis that most of CWP's activities directed toward the alleviation of poverty were restricted "political activities" under subsection 149.1(6.2) of the Act.[41] The conventional response to this notice would have been to file a notice of objection with the CRA's Appeals Branch, and then to appeal the Appeals Branch deci-

35 *Ark Angel Fund v. Canada (National Revenue)*, 2020 FCA 99, at paragraph 6; see also *Mahjoub*, supra note 34, at paragraph 61.

36 Paul Daly, "The Vavilov Framework and the Future of Canadian Administrative Law" (2020) 33:2 *Canadian Journal of Administration Law and Practice* 111-44, at 119.

37 *Ark Angel Fund*, supra note 35, at paragraph 6.

38 *Colel Chabad Lubavitch Foundation*, supra note 30, at paragraph 49.

39 2018 ONSC 4147.

40 Ibid., affidavit of Leilani Farha, at paragraph 4 (www.cwp-csp.ca/wp-content/uploads/2016/09/CWP-v.-AG-Farha-Affidavit.pdf).

41 Ibid., factum, applicant, at paragraphs 36 and 19.

sion to the Federal Court of Appeal. Instead, CWP filed a notice of application in the Ontario Superior Court of Justice, seeking a declaration that subsection 149.1(6.2) violated sections 2(b) and (d) of the Canadian Charter of Rights and Freedoms.[42] The Charities Directorate agreed not to proceed with revocation until a court had ruled on the constitutional challenge.[43]

Three months after a hearing in which the court received affidavit evidence,[44] the Ontario Superior Court of Justice held that paragraphs 149.1(6.2)(a) and (b) of the Act, which functioned to prohibit charitable organizations from devoting more than 10 percent of their resources to non-partisan political activities, unjustifiably violated CWP's freedom of expression, and must therefore be struck down.[45] The court's constitutional analysis was unconventional at best.[46] However, facing pressure from the charitable sector, the attorney general of Canada chose not to appeal, instead amending the Act in the manner required by the decision.[47]

The statutory amendments to which *Canada Without Poverty* gave rise have improved the registered charity regime in material ways. The revised statutory definition of a "charitable organization" is better aligned with the common-law tradition on which it is based, and registered charities may now participate robustly in public policy dialogue, free from the oppressive ambiguity of former subsection 149.1(6.2).[48] However, the court's decision itself has several drawbacks, the gravity of which depends on one's position within the field. For government, the major drawback of the decision is that it narrows the available options for regulating and taxing charities. The decision imposes significant constitutional limitations on Parliament in its regulation of non-partisan political activity, and arguably also renders existing limits on *partisan* political activity vulnerable to constitutional challenge.[49] For the charitable sector, the major drawback of the decision is that it makes little contribution to the development of case law on charities. Presented with mostly

42 Canadian Charter of Rights and Freedoms, part I of the Constitution Act, 1982, being schedule B to the Canada Act 1982 (UK), 1982, c. 11 (herein referred to as "the Charter").

43 *Canada Without Poverty*, supra note 39, factum, applicant, at paragraph 34.

44 Rules of Civil Procedure, RRO 1990, reg. 194, r 14.05(3)(g.1) and 39.01(1).

45 *Canada Without Poverty*, supra note 39.

46 For an analysis of the decision, see Kathryn Chan, "Constitutionalizing the Registered Charity Regime: Reflections on Canada Without Poverty" (2020) 6:1 *Canadian Journal of Comparative and Contemporary Law* 151-90.

47 Subsection 149.1(1). The new definition states that "'charitable activities' includes public policy dialogue and development activities carried on in furtherance of a charitable purpose (*activités de bienfaisance*)."

48 Adam Parachin's work canvasses problems with the former subsection: see, for example, Adam Parachin, *Charity Versus Politics: Reforming the Judicial, Legislative and Administrative Treatment of the Charity-Politics Distinction* (Edmonton, AB: Pemsel Case Foundation, 2018) (www.pemselfoundation.org/wp-content/uploads/2018/06/Parachin-Charity-Politics-OP-June-20-2018.pdf).

49 See Chan, supra note 46, at 183-84.

constitutional-law arguments, the court did not address the substantial body of trust and tax-law cases on the relationship between charity and politics, nor did it consider whether the common-law prohibition in respect of political purposes was consistent with Canada's constitutional structure.[50] In the specific context of *Canada Without Poverty*, it seems safe to say that the sector was willing to accept this drawback as the price of what was won. However, the long-term effects of constitutionalizing the law of charities may be more concerning.[51] In the most recent public-law challenge to the registered charity regime, for example, the Ontario Superior Court of Justice made obiter comments that could influence the legal definition of "charity," even though it did not consider a single charity-law authority.[52] If the charity appeals process is not reformed to make it a viable option for charities, Canadian charity law may increasingly develop according to public-law logic, rather than the internal logic of its own field.

Irrespective of its drawbacks, *Canada Without Poverty* has done more to change the landscape of Canadian charity law than all the Federal Court of Appeal's decisions combined. The success of the litigation strategy has been the subject of sector-wide conversation and has spurred further public-law challenges to the operation and boundaries of the registered charity regime. In *Muslim Association of Canada v. Attorney General of Canada*,[53] the nation's largest grassroots Muslim charity sought review of its CRA audit, arguing that both the audit and the administrative fairness letter recommending suspension violated the charity's fundamental freedoms and equality rights. Like CWP, the charity sought to avoid the registered charity appeal procedure, seeking relief from the Ontario Superior Court of Justice under section 24 of the Charter. In a decision issued in September 2023, Koehnen J expressed sympathy with many of the applicant's arguments but dismissed the application on the grounds of prematurity.

The reasons for judgment suggest that the trial judge recognized, and sought to resist, the charity's efforts to shift the resolution of its dispute with the Charities Directorate away from the Federal Court of Appeal. In his decision, Koehnen J outlined two things that courts had to consider before entertaining judicial review of an "incomplete" administrative action such as an administrative fairness letter:

50 Compare *Aid/Watch Inc. v. Commissioner of Taxation*, [2010] HCA 42, at 44, where a majority of the High Court held that agitating for political change was an "indispensable incident" of Australia's system of representative government, and that an association's participation in those processes was "for the public benefit" within the meaning of the law of charities, irrespective of the merits of the legislative policy being pursued.

51 Chan, supra note 46. Parachin has also expressed concerns with overly state-focused analyses of charity law: Adam Parachin, "A Charity Law Perspective on a Liberal Perspective on Charity Law," in Matthew Harding, ed., *Research Handbook on Not-for-Profit Law* (London, UK: Edward Elgar, 2018), 82-107.

52 See *Muslim Association of Canada v. Attorney General of Canada*, 2023 ONSC 5171, at paragraphs 53 and 61.

53 Ibid.

first, whether there was an adequate alternative remedy;[54] and second, whether the alternative remedy should lead the court to decline jurisdiction. Koehnen J decided that, on the facts before him, those considerations should lead him to dismiss the Muslim Association of Canada's application.[55] However, it is not difficult to imagine a registered charity marshalling evidence in support of a contrary decision on point. Several factors relevant to the second determination—including the convenience and the remedial capacity of the alternative forum—line up with common criticisms of registered charity appeals.

Irrespective of whether the registered charity appeals process meets the legal standard for an adequate alternative remedy, the lengths to which charities are going to avoid the process are themselves of great concern. Recent allegations of systemic bias in the Charities Directorate's decision-making processes only heighten these concerns. In the context of the *Muslim Association of Canada* litigation, the CRA is facing credible claims that it systematically targets Muslim charities in its audit selection process, that it relies on conjectural and Islamophobic sources, and that it applies different standards to Muslim and Christian charities in assessing charitable purposes and activities.[56] Recent academic and Senate reports have concluded that CRA audits of Muslim charities demonstrate structural bias,[57] and are conducted with "little oversight or accountability and require no proof."[58] Despite the devastating reputational and financial impacts of a negative audit review, however, Muslim charities do not appeal the CRA's decisions, because "everyone knows in the charity sector" that the official appeal mechanism does not work.[59] These are grave and widespread allegations of abuses of government power. They have made it even more crucial that there be a transparent and accessible registered charity appeal mechanism that restores public confidence in the registered charity regime and in the administration of justice.

54 Ibid., at paragraph 78, citing *Strickland v. Canada (Attorney General)*, 2015 SCC 37.

55 *Muslim Association of Canada*, supra note 52, at paragraph 80.

56 Ibid., at paragraphs 29 and 54. See also Abdul Nakua, "Opinion: Reflecting on the CRA Audits of Muslim Charities," *Philanthropist Journal*, December 18, 2023 (https://thephilanthropist.ca/2023/12/reflecting-on-the-cra-audits-of-muslim-charities).

57 Anver M. Emon and Nadia Z Hasan, *Under Layered Suspicion: A Review of CRA Audits of Muslim-Led Charities* (Toronto: Institute of Islamic Studies, University of Toronto and National Council of Canadian Muslims, 2021); and Standing Senate Committee on Human Rights, *Combating Hate: Islamophobia and Its Impact on Muslims in Canada* (Ottawa: Standing Senate Committee on Human Rights, 2023), at 51 (herein referred to as "the Senate report on Islamophobia").

58 The Senate report on Islamophobia, supra note 57, at 53, citing the evidence of Terrance S. Carter, a leading Canadian charities lawyer.

59 The Senate report on Islamophobia, supra note 57, at 52, citing the evidence of Khaled Al-Qazzaz, senior adviser, Muslim Public Affairs Council.

PROPOSALS FOR REFORM

There are a variety of possible options for reform of the registered charity appeals process. The most ambitious of these involve the creation of a new independent body vested with authority to make decisions on registered charity status, or the creation of a new administrative tribunal to hear registered charity appeals.[60] These are proposals of merit, but also complexity, and are beyond my capacity to assess here. Instead, I consider four more modest reforms that could improve transparency and accountability in the process of federal charity registration and facilitate the development of new case law for charities.

Option 1: Transfer jurisdiction over registered charity appeals to the Tax Court of Canada

The most common proposal for reform of the charity appeals process is that appeals of decisions of the Charities Directorate proceed to the Tax Court of Canada for a hearing de novo, rather than the Federal Court of Appeal. Any number of advisory groups and sector members and scholars have made this recommendation, bookended by the Ontario Law Reform Commission in 1996 and the Special Senate Committee on the Charitable Sector in 2019. In 2018, the Muttart Foundation described the transfer of jurisdiction to the Tax Court as the single most important legislative change that could be made regarding charities.[61]

The arguments made in support of transferring jurisdiction over registered charity appeals to the Tax Court centre around three general themes:[62] first, the change would create consistency with other appeal processes under the Income Tax Act; second, the Tax Court process would be cheaper; and third, the Tax Court is likely to generate higher-quality decisions on entitlement to registered charity status, owing to its ability to hold de novo hearings and the parties' opportunity to present evidence. Only the last of these, in my view, is a compelling argument for transferring jurisdiction over registered charity appeals to the Tax Court of Canada. However, there is equally no compelling argument for maintaining the status quo. Indeed, it is arguable that the sector is so profoundly disillusioned with the registered charity jurisprudence of the Federal Court of Appeal that only a change in the identity of the decision maker will restore its confidence in the charity appeals process.

60 The Senate report on Islamophobia, supra note 57, at 13, recommended that Parliament establish an "independent civilian body" to review decisions of the Charities Directorate and provide timely decisions on appeals.

61 Muttart Foundation, *Submission to the Special Committee of the Senate on the Charitable Sector* (Edmonton, AB: Muttart Foundation, October 2018), at 32.

62 See Special Senate Committee on the Charitable Sector, *Catalyst for Change*, supra note 2, at 18, offering a similar characterization.

Option 2: Articulate statutory standards of review applicable to the minister's revocation and registration decisions

If Parliament chooses not to transfer jurisdiction over registered charity appeals to the Tax Court of Canada, an alternative proposal for reform is that the Income Tax Act be amended to articulate standards of review applicable to the minister's charitable registration and revocation decisions. Questions of law should continue to be reviewed on a standard of correctness. Courts do not defer to ministerial interpretations of the Act in the normal course of tax litigation, and there is no evident rationale for changing this approach in registered charity appeals.[63] However, Parliament could amend the Act to provide that, in decisions involving entitlement to registered charity status, conclusions of mixed fact and law, and the exercise of ministerial discretion, are subject to a standard of reasonableness, rather than palpable and overriding error.[64] This modest change would improve the culture of justification and transparency at the Charities Directorate, and improve public confidence in its processes.

Option 3: Amend the Act to allow the publication of Appeals Branch decisions

A third proposal for reform of the charity appeals process is that the confidentiality provisions of the Income Tax Act be amended to allow the publication of Appeals Branch decisions on notices of objection. Section 241 generally prevents the CRA from providing taxpayer information to any person, and from producing evidence relating to any taxpayer information in connection with a legal proceeding.[65] However, subsection 241(3.2) sets out a number of exceptions that apply where the taxpayer is a registered charity.[66] These exceptions could be expanded to include Appeals Branch decisions concerning the registration of a charity or the revocation of its registration under the Act.

The privacy implications of expanding the list in subsection 241(3.2) would have to be considered. However, it is noteworthy that, where the minister has revoked, annulled, or suspended the registration of a charity, the Act already permits the minister to publish a copy of the letter setting out the grounds for the charity's sanction.[67]

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63 *Prescient Foundation*, supra note 24, at paragraph 14. It is also arguable that since many key terms in the registered charity provisions fall to be interpreted in accordance with equitable principles, and the CRA has no equitable jurisdiction, the court is better suited to undertake the interpretation.

64 The Act could simply be amended to provide that the Federal Court of Appeal must not set aside a discretionary decision of the minister unless it is reasonable. For an example of similar statutory language, see the Administrative Tribunals Act, SBC 2004, c. 45, section 59.

65 Subsections 241(1) and (2).

66 For example, the minister may publish a copy of the charity's governing documents, a list of the charity's directors, and a copy of the notification of the charity's registration.

67 Paragraph 241(3.2)(e).

The effect is to provide the public with access to the CRA's allegations regarding a registered charity's misconduct, while the charity's response to the allegations and the Appeals Branch's judgment of the allegations remain sheltered from public view. Arguably, disclosing the Appeals Branch's written reasons for vacating, confirming, or varying the directorate's decision to revoke would be fairer to the charity. Publishing internal appeal decisions on entitlement to registered charity status would also foster better decision making on the part of the Appeals Branch and reinforce public confidence in the fairness of the process.[68]

Option 4: Create a reference procedure

A final reform proposal that is worth considering, in my view, is that the Income Tax Act be amended to establish a reference procedure for matters relating to the legal definition of "charity." This idea, to my knowledge, has never been explored. However, Canada has a tradition of courts issuing advisory opinions on difficult questions, and legislation authorizing reference proceedings in every jurisdiction.[69] In this context, the charity-law reference procedure set out in the Charities Act 2011 (UK)[70] offers an intriguing model.

In 2008, the UK Parliament created an administrative tribunal to hear appeals from decisions of the Charity Commission for England and Wales. The tribunal and its processes replaced the longstanding practice whereby charities appealed decisions of their regulator directly to the High Court. The creation of the Charity Tribunal had two stated objectives: to provide charities with "swift, low-cost access to justice" and to provide a forum for the development of new case law for charities.[71] Today, persons that wish to challenge a formal charitable registration decision of the Charity Commission may seek an internal review of the decision, or appeal it directly to the First-Tier Tribunal (General Regulatory Chamber) (Charity) or the Upper Tribunal (Tax and Chancery Chamber).[72] Unlike in Canada, appeals of registration decisions are de novo proceedings. The tribunal must consider the decision afresh and may

68 See *Baker v. Canada (Minister of Citizenship and Immigration)*, [1999] 2 SCR 817, at paragraphs 38 to 39.

69 Leah McDaniel, "The Reference Procedure: The Government's Ability To Ask the Court's Opinion," *Centre for Constitutional Studies*, August 9, 2012 (www.constitutionalstudies.ca/2012/08/the-reference-procedure-the-governments-ability-to-ask-the-courts-opinion/).

70 Charities Act 2011, c. 25.

71 Alison McKenna, "Appealing the Regulator: Experience from the Charity Tribunal for England and Wales," in Matthew Harding, Ann O'Connell, and Miranda Stewart, eds., *Not-for-Profit Law: Theoretical and Comparative Perspectives* (Cambridge, UK: Cambridge University Press, 2014), 336-57, at 340.

72 Charities Act 2011, supra note 70, section 319. The Upper Tribunal, which is constituted as a superior court of record, hears appeals from the First-Tier Tribunal. It also has the jurisdiction to hear important cases at first instance, where precedent may be set for the benefit of the sector as a whole: Transfer of Functions of the Charity Tribunal Order 2009 (UK) SI 2009/1834, cited in McKenna, supra note 71, at 341.

take into account evidence that was not available to the commission.[73] The tribunal has the power to quash the decision and either remit the matter to the commission or direct the commission to rectify the register.[74]

The Charities Act 2011 (UK) also establishes a reference process, which authorizes the First-Tier Tribunal and the Upper Tribunal to issue advisory opinions on questions regarding the operation or application of charity law. Only the Charity Commission or the attorney general may initiate a reference.[75] Once a question has been referred to the Charity Tribunal, however, the tribunal may make any charity or person who is "likely to be affected" by the tribunal's reference decision a party to the proceedings.[76] According to the former principal judge of the tribunal, these standing rules make the charity reference a "very democratic and inclusive process," in which affected charities present arguments in a manner similar to public-interest intervenors.[77] While reference opinions are technically non-binding in the common-law tradition,[78] the Charities Act specifies that the Charity Commission must give effect to the tribunal's reference decisions in its work.[79] To date, the Upper Tribunal has decided two charity-law references brought by the attorney general. The first addressed various hypothetical questions on the charitable status of independent schools,[80] while the second addressed the charitable status of benevolent funds for persons connected by family relationship or employment.[81]

Any proposal to introduce a reference procedure into Canada's registered charity regime would require close consideration. The English Charity Tribunal has received mixed reviews since its inception,[82] and the arguments for and against its reference power would need to be reviewed. This work falls outside the scope of the present article. I conclude simply with some preliminary reflections on why the proposal may merit further thought.

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73 Charities Act 2011, supra note 70, section 319(4).

74 Ibid., section 323; schedule 6.

75 Ibid., sections 325 and 326.

76 Ibid., sections 325(4) and 326(3).

77 McKenna, supra note 71, at 353, noting that the tribunal heard from 40 charities in the benevolent funds reference.

78 *Reference re References by the Governor in Council*, [1912] AC 571 (JCPC), at paragraph 14.

79 Charities Act 2011, supra note 70, section 327.

80 *Independent Schools Council v. The Charity Commission*, [2011] UKUT 421 (TCC).

81 *Attorney General v. Charity Commission for England and Wales*, [2012] UKUT 420 (TCC) (20 February 2012).

82 See, for example, Mary Synge, "Independent Schools Council v. Charity Commission for England and Wales [2011] UKUT 421 (TCC)" (2012) 75:4 *Modern Law Review* 624-39 (criticizing the Charity Tribunal for venturing into the realm of policy); and Alison McKenna, "Should the Charity Tribunal Be Reformed?" (2012) 14:1 *Charity Law and Practice Review* 1-16 (noting that the Charity Commission has taken a defensive approach to the tribunal).

First, a reference procedure could provide a forum for the development of case law on registered charities that would not compromise the commitment in the Income Tax Act to the confidentiality of taxpayer information. The parties could agree to a statement of facts, as they did in the UK *Independent Schools* reference,[83] or the court could direct the parties to file written evidence for the court's consideration.[84] Second, a reference procedure would allow registered charities to participate in debates about the proper boundaries of the charitable sector without threatening their own registration status or risking punitive sanctions. It would also facilitate the participation of provincial authorities and third parties in charity-law proceedings, as the Ontario Law Reform Commission urged some 30 years ago.[85]

Finally, if embraced by both the government and the charitable sector, a reference procedure could play an important role in filling some of the longstanding gaps in Canadian charity law. There are a substantial number of these gaps, ranging from the meaning of the public benefit requirement, to the limits on permitted business activities for registered charities, to the scope of the "advancement of religion" as a category of charitable purpose. Because only government actors can initiate reference proceedings, a reference process would not remove the need for a functional appeals process for charities. However, a reference procedure might produce higher-quality case law, allowing the Tax Court or the Federal Court of Appeal to consider the informed views of a range of registered charities, as well as provincial and federal actors, before opining on the charitable status of purposes such as investigative journalism or poverty relief. The charitable sector might not like all of the court's answers to reference questions posed. However, the introduction of an inclusive adjudication process, even if used infrequently, might revive the Canadian case law on charities, and improve public and sector confidence in the registered charity regime.

83 Supra note 80.

84 McDaniel, supra note 69.

85 Monahan and Roth, supra note 7, at 30, citing the report of the Ontario Law Reform Commission (supra note 8).

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https://doi.org/10.32721/ctj.2024.72.2.fn

Finances of the Nation

THE PAST, PRESENT, AND FUTURE OF FUEL TAXATION IN CANADA

*Joel Wood**

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 examines the fiscal landscape of gasoline and diesel fuel taxes in Canada at the federal and provincial/territorial levels. After describing the taxes and the current carbon-pricing system, the author discusses the various rationales put forward to justify the taxation of fuels. He notes that the revenues from these taxes have declined as a share of total government revenue, and explains why this decline is expected to continue into the future, especially as electric vehicles become more widely adopted. The article then considers the advantages and disadvantages of replacing fuel taxes with a tax on vehicle kilometres travelled (VKT). Finally, the article provides initial estimates of VKT tax rates that would replace the revenue from current federal and provincial/territorial excise taxes on gasoline and diesel fuels.

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: GASOLINE TAX ■ OPTIMAL ■ PUBLIC FINANCE ■ VEHICLE KILOMETRES TRAVELLED ■ MILEAGE TAX ■ ELECTRIC VEHICLES

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* Department of Economics, Bob Gaglardi School of Business and Economics, Thompson Rivers University, Kamloops, British Columbia (e-mail: jwood@tru.ca).

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When the carriages which pass over a highway or a bridge . . . pay toll in proportion to their weight or their tunnage, they pay for the maintenance of those public works exactly in proportion to the wear and tear which they occasion of them. It seems scarce possible to invent a more equitable way of maintaining such works.

Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Hartford, CT: Cooke, 1811), at 174

INTRODUCTION

The federal government and all provincial and territorial governments in Canada levy per-unit taxes (excise taxes) on gasoline and diesel fuels. The current federal excise tax is 10 cents per litre (¢/L) on gasoline and 4 ¢/L on diesel; these rates are not indexed to inflation and have not increased in more than 25 years. The rates charged on these fuels differ across provinces and territories, and some provinces (British Columbia and Quebec) have implemented rates that vary by region within the province. More recently, some provinces (Alberta, Manitoba, and Ontario) have introduced "tax holidays" to temporarily reduce their fuel tax rates. Fuel tax revenues have been declining as a share of total revenue for all governments in Canada.

In addition to excise taxes, governments in Canada have implemented carbon prices on the sale of gasoline and diesel fuels. In British Columbia this measure comes in the form of the carbon tax, in Quebec in the form of a tradable permit system, and in the rest of Canada in the form of the federal fuel charge. The federal government plans to increase carbon prices over time in an effort to meet its 2030 greenhouse gas (GHG) emissions reduction target and 2050 net zero emissions target.

Gasoline taxes are often justified on the basis of the benefit principle of taxation, according to which taxes on a good or service are levied in proportion to the benefits received (for example, the gasoline tax paid increases with a driver's use of transportation infrastructure). However, as electric vehicles (EVs) become a larger share of Canada's vehicle fleet, the link between gasoline tax paid and extent of road use becomes weaker; and if road transportation becomes completely decarbonized, the link will be fully severed. Furthermore, as EVs become a greater share of the vehicle fleet, government gasoline and diesel tax revenues will decline. In response to this expected outcome, the Saskatchewan government has already implemented a vehicle registration charge that is higher for EVs than it is for traditional vehicles, on the ground that EVs do not pay fuel taxes.[1]

1 Government of Saskatchewan, *Information Bulletin* FT-12, "The Fuel Tax and Road Use Charge Act: Road-Use Charge on Electric Vehicles," October 2021.

Given these future challenges for gasoline taxes, it may be time for the federal and provincial/territorial governments to replace their gasoline and diesel excise taxes (though not their carbon prices) with a tax on vehicle kilometres travelled (VKT). Economic research suggests that a tax on vehicle kilometres travelled would be more efficient at raising revenue and would address more directly the various distance-based external costs of driving.[2]

Calculations in this article suggest that the federal excise taxes on gasoline and diesel fuels could be replaced with a VKT tax of 1.32 cents per kilometre (¢/km). Replacement VKT taxes are also calculated for each province and most territories for the year 2021.

The article proceeds as follows. I first provide an overview of the taxation of gasoline and diesel fuels across Canada, and of the current carbon-pricing system. I then discuss the various rationales in support of the taxation of gasoline. The next section considers the possibility of replacing the current fuel excise taxes with VKT taxes, and evaluates potential challenges of this transition. The final section provides a brief conclusion to the article. An appendix presents the technical details behind the calculations for estimating replacement VKT taxes.

TAXES LEVIED ON GASOLINE AND DIESEL FUELS IN CANADA

This section provides an overview of the taxes currently levied on gasoline and diesel fuels in Canadian provinces and territories. I first consider taxes that are levied with the purpose of raising revenue, and then discuss the various carbon prices imposed on fuels in Canada.

Excise Taxes and Sales Taxes

The federal government levies excise taxes of 10 ¢/L on gasoline and 4 ¢/L on diesel. In addition to the federal excise tax, all provinces and territories levy their own taxes on these fuels. The federal excise taxes on gasoline and diesel have remained unchanged since 1995 and 1987, respectively.[3]

Most provinces and territories apply these taxes uniformly on fuels sold within the jurisdiction; however, British Columbia and Quebec have implemented gasoline taxes that vary by region within the province. British Columbia charges a tax of 27 ¢/L in Metro Vancouver, 20 ¢/L in Metro Victoria, and 14.5 ¢/L in the rest of the province. Quebec has a more complicated system. The base rate of the gasoline tax is 19.2 ¢/L, but this rate is increased for Metro Montreal to 22.2 ¢/L, and is reduced for regions according to their distance from the border with other jurisdictions

2 Ian W.H. Parry and Kenneth A. Small, "Does Britain or the United States Have the Right Gasoline Tax?" (2005) 95:4 *American Economic Review* 1276-89.

3 Natural Resources Canada, "Fuel Consumption Levies in Canada" (https://natural-resources.canada.ca/our-natural-resources/domestic-and-international-markets/transportation-fuel-prices/fuel-consumption-taxes-canada/18885).

(Ontario, New Brunswick, and the United States). Federal and provincial/territorial taxes on gasoline in Canada as of December 2023 and January 2024 are shown in figure 1, and taxes on diesel are shown in figure 2.

In the past few years, some provincial governments have implemented "gas tax holidays" during which provincial taxes on gasoline and diesel are temporarily reduced to zero. In April 2022, Alberta reduced its gasoline tax from 13 ¢/L to zero, with a plan to re-evaluate the tax rate with reference to average values of oil prices; on January 1, 2024, it raised the tax to 9 ¢/L. Effective July 1, 2022, Ontario reduced its gasoline tax by 5.7 ¢/L and its fuel tax by 5.3 ¢/L; the reductions are scheduled to expire on December 31, 2024.[4] And on January 1, 2024, Manitoba reduced its 14 ¢/L tax on both gasoline and diesel to zero for a six-month period. As Tombe notes, gas tax holidays lower prices.[5] In Alberta's case, his estimate of the short-run response to the holiday indicates that between 87 percent and 93 percent of the tax savings were passed on to consumers.

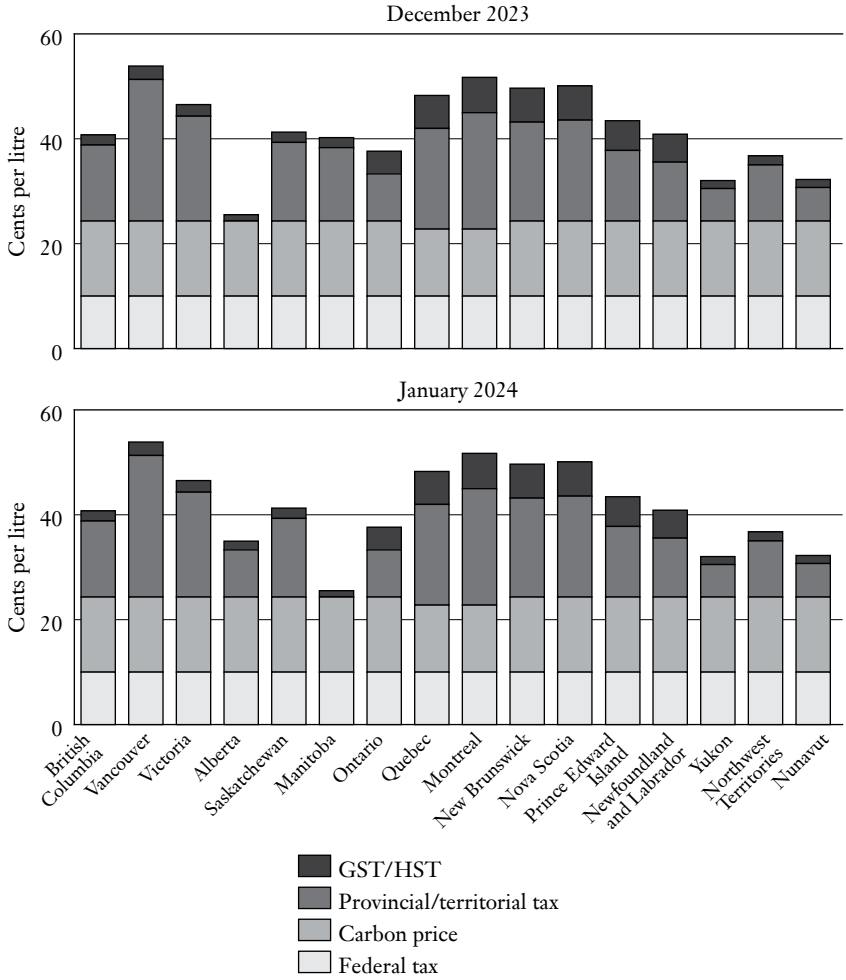
As with fuel tax rates, the sales tax treatment of gasoline and diesel varies across provinces and territories. Not all provincial/territorial sales taxes apply to gasoline and diesel, so in some provinces and territories the only sales tax on these fuels is the federal goods and services tax (GST). In Alberta, British Columbia, Manitoba, Saskatchewan, and the territories, the 5 percent federal GST is the only sales tax that applies to gasoline and diesel. A higher rate is applied in Ontario (13 percent) and the Atlantic provinces (15 percent), where the harmonized sales tax (HST) has been implemented. In Quebec, GST and the Quebec sales tax (QST) apply, for a combined sales tax of 14.98 percent. Figures 1 and 2 show the GST/HST/QST amounts charged per litre in excess of the sales tax paid on the pre-tax fuel price across provinces and territories—that is, the GST/HST/QST paid on only the excise and carbon taxes.

Figure 3 shows that nominal federal and provincial/territorial revenues from gasoline and motive fuel taxes increased between 1965 and 2021. However, revenues from these taxes decreased in 2020-21 and 2021-22 as a result of reduced driving activity during the COVID-19 pandemic. In addition, 2022-23 revenues in Alberta and Ontario dropped further as a result of gas tax holidays. Provincial and territorial governments, and to a lesser extent the federal government, were much more reliant on fuel tax revenue in the past than they are now. As is clear from the second panel of figure 3, fuel tax revenue as a percentage of total government revenue has declined for the federal government since the gasoline tax increase in 1995, and in 2022-23 fuel tax revenue made up only 1.35 percent of total federal revenue (less than half

4 Ontario, Ministry of Finance, "Gasoline Tax," May 21, 2024 (www.ontario.ca/document/gasoline-tax); and Ontario, Ministry of Finance, "Fuel Tax," May 21, 2024 (www.ontario.ca/document/fuel-tax).

5 Trevor Tombe, @TrevorTombe, *X.com*, May 6, 2022 (https://x.com/trevortombe/status/1522665476983181313?s=20): "With gas prices on the rise, some have asked me if this means Alberta's gas tax holiday failed. No. It's not prices today vs March 31 that matters. It's prices vs what they would have been. Agree or not with the policy, evidence is clear: the tax holiday lowers prices."

FIGURE 1 Gasoline Taxes in Canada as of December 2023 and January 2024

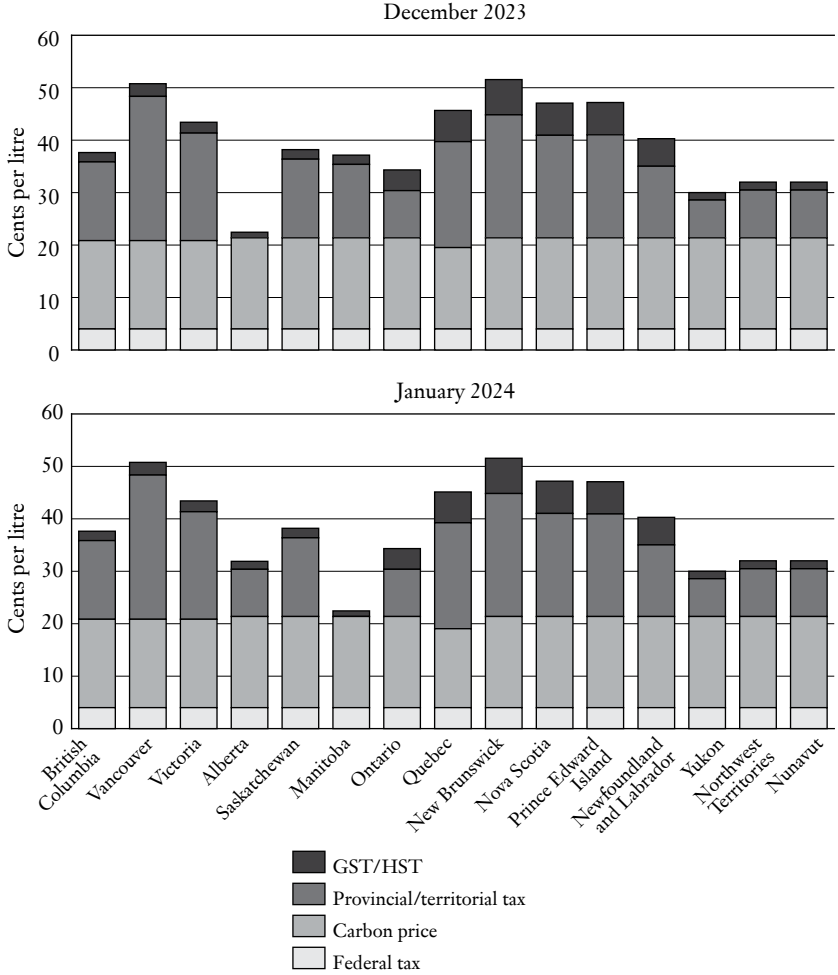


GST = goods and services tax; HST = harmonized sales tax.

Notes: The carbon tax rates for gasoline were taken post-April 1 for all jurisdictions except Quebec. For Quebec, the average settlement price of the four 2023 permit auctions was converted from dollars per ton of CO_2 emissions to cents per litre of gasoline; it is assumed that the cost of permits is fully passed on to gasoline consumers. In Quebec, the Quebec sales tax (QST) rate is the base fuel tax rate on gasoline, but there are many regions in the province where the rate is reduced. The GST/HST/QST amount shown in the graphs is the amount of GST/HST/QST paid in excess of the GST/HST/QST paid on the pre-tax fuel price.

Sources: Natural Resources Canada, "Fuel Consumption Levies in Canada" (https://natural-resources.canada.ca/our-natural-resources/domestic-and-international-markets/transportation-fuel-prices/fuel-consumption-taxes-canada/18885); Revenu Québec, "Table of Fuel Tax Rates in Québec, by Region, in force as of April 1, 2015" (2017) (www.revenuquebec.ca/documents/en/formulaires/ca/ca-1-v%28 2017-06%29.pdf); Ministère de l'Environnement, de la Lutte contre les changements climatiques, de la Faune et des Parcs (www.environnement.gouv.qc.ca) (2023); and author's calculations.

FIGURE 2 Diesel Taxes in Canada as of December 2023 and January 2024



GST = goods and services tax; HST = harmonized sales tax.

Notes: The carbon tax rates for gasoline were taken post-April 1 for all jurisdictions except Quebec. For Quebec, the average settlement price of the four 2023 permit auctions was converted from dollars per ton of CO_2 emissions to cents per litre of gasoline; it is assumed that the cost of permits is fully passed on to gasoline consumers. In Quebec, the Quebec sales tax (QST) rate is the base fuel tax rate on gasoline, but there are many regions in the province where the rate is reduced. The GST/HST/QST amount shown in the graphs is the amount of GST/HST/QST paid in excess of the GST/HST/QST paid on the pre-tax fuel price.

Sources: Natural Resources Canada, "Fuel Consumption Levies in Canada" (https://natural-resources.canada.ca/our-natural-resources/domestic-and-international-markets/transportation-fuel-prices/fuel-consumption-taxes-canada/18885); Revenu Québec, "Table of Fuel Tax Rates in Québec, by Region, in force as of April 1, 2015" (2017) (www.revenuquebec.ca/documents/en/formulaires/ca/ca-1-v%28 2017-06%29.pdf); Ministère de l'Environnement, de la Lutte contre les changements climatiques, de la Faune et des Parcs (www.environnement.gouv.qc.ca) (2023); and author's calculations.

the 1995-96 share). When revenues across all provinces and territories are aggregated, the percentage of total revenue coming from fuel taxes can be seen to have steadily declined over time, from between 3.5 percent and 4 percent in the 1980s and 1990s, to the current level of only 1.34 percent. One reason for the declining share is that the fuel taxes at the federal and provincial/territorial levels are not adjusted in response to inflation. For example, unlike the federal excise taxes on goods such as alcohol, which are adjusted annually for changes in the consumer price index, the federal excise tax on gasoline has remained at 10 ¢/L in nominal terms since 1995. Another reason for the decline in the percentage of total revenue is changing technology. In the coming years, as the share of EVs and more fuel-efficient vehicles in the Canadian vehicle fleet increases, taxes on gasoline and diesel fuels are expected to continue to decline in importance as a share of the revenue of federal and provincial/territorial governments in Canada.

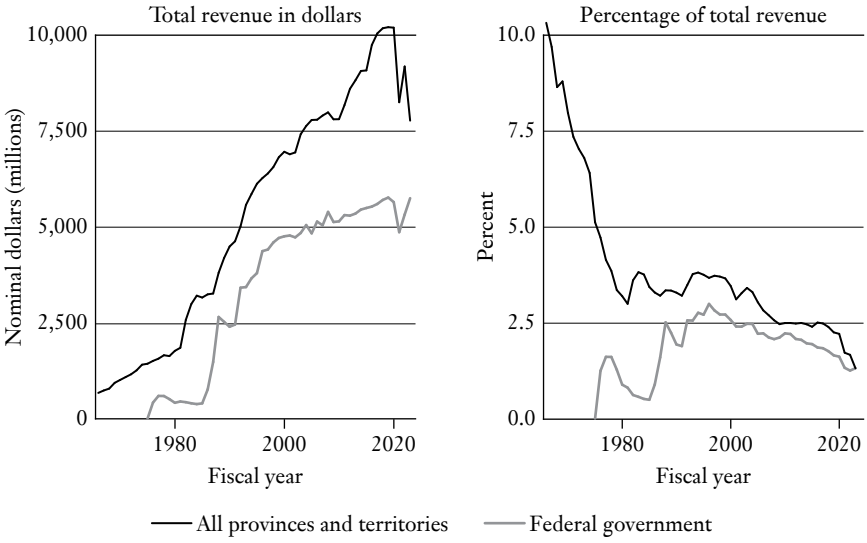
Carbon Pricing on Gasoline and Diesel Fuels in Canada

Canada has agreed under the Paris Agreement[6] to reduce its national GHG emissions by 40 to 45 percent of 2005 levels by 2030, and has committed to net zero emissions by 2050. A major part of Canada's efforts to achieve the 2030 target is its pan-Canadian carbon-pricing policy. Under this policy, the federal government sets benchmarks with regard to stringency (price per ton [$/t]) and coverage (percentage of emissions covered by the policy). If a province or territory does not have a carbon-pricing policy that meets those benchmarks, the federal government imposes its own carbon price on fuel sales in the province or territory. Since 2019, the federal government has imposed the federal fuel charge on the sale of fuels such as gasoline and diesel, and imposed the output-based pricing system on large industrial emitters of GHGs. As of March 2024, the federal carbon price is $65/t, which corresponds to a federal fuel charge of 14.31 ¢/L on gasoline and 17.38 ¢/L on diesel (as shown in figures 1 and 2). The federal government plans to increase the carbon price annually until the price reaches $170/t in April 2030, which corresponds to a federal fuel charge of 37.43 ¢/L on gasoline and 45.45 ¢/L on diesel. The federal fuel charge is currently collected in all provinces and territories except British Columbia and Quebec. The revenue collected from the federal fuel charge is restricted in use by the Greenhouse Gas Pollution Pricing Act.[7] Approximately 90 percent of the revenue is returned to households in the province or territory of collection through Canada carbon rebate payments (formerly the climate action incentive refundable tax credit); the remaining 10 percent is returned to farming businesses (through a refundable tax credit), small and medium enterprises (through the fuel charge

6 United Nations, Paris Agreement, signed by 196 parties at Paris, France on December 12, 2015 (https://unfccc.int/sites/default/files/english_paris_agreement.pdf).

7 SC 2018, c. 12, section 186.

FIGURE 3 Gasoline Tax Revenue in Canada, Fiscal Years 1966-67 to 2022-23



Source: Finances of the Nation, "Government Revenue and Expenditure" (REAL) data (https://financesofthenation.ca) (2024).

proceeds return program), and Indigenous communities (through top-up funding to existing programming).[8]

British Columbia has had a carbon tax on gasoline and diesel since 2008. The current rate is the same as the federal fuel charge and, owing to the federal backstop, is expected to increase to 2030 in lockstep with the federal fuel charge. When the BC carbon tax was introduced, it was marketed as being "revenue-neutral" and was combined with cuts to personal and corporate income taxes and a low-income tax credit; however, it is unclear whether the tax has been revenue-neutral over time.[9] The province ended its commitment to revenue neutrality in 2017, and it now provides an expanded income-based refundable tax credit to households. However, there is no direct link to carbon tax revenues in the BC program, as there is in the federal program.

Quebec has had a tradable emission permit system for GHG emissions jointly with California since 2013 (and with Ontario for 2018). Fuel distributors are required to buy permits for the emissions that those fuels will release when combusted. Therefore,

8 Environment and Climate Change Canada, "Carbon Pollution Pricing Proceeds Programming" (www.canada.ca/en/environment-climate-change/services/climate-change/carbon-pollution-pricing-proceeds-programming.html).

9 Rory Gillis, "Carbon Tax Shifts and the Revenue-Neutrality Dilemma" (2019) 23:1 *Florida Tax Review* 293-348; and Joel Wood, "Is Revenue Neutrality in Carbon Taxation Possible in Practice? Lessons from the Canadian Experience" (2022) 70:3 *Canadian Tax Journal* 563-93.

the carbon price in Quebec is embedded in the retail price of gasoline. The average price in the four permit auctions that were held in 2023 was $44.65/t, which corresponds to 12.78 ¢/L for gasoline and 15.52 ¢/L for diesel, based on the conversion factors used for the federal fuel charge. Revenue from the permit auctions goes into the province's Green Fund, which government ministries can access to fund projects that reduce emissions; however, the 2020-21 report to Quebec's National Assembly by the commissioner for sustainable development raises questions about whether the projects accessing Green Fund money were actually focused on the fund's intended purpose.[10]

GST and HST apply to the carbon pricing imposed on gasoline and diesel fuels. Federal Bill C-358 proposes to exempt the federal fuel charge from the GST.[11] From an economics perspective, GST should apply to the sale of all final goods and services; since carbon pricing places a price on a final service—in this case, the disposal of greenhouse gases into the atmosphere—it therefore should bear GST.

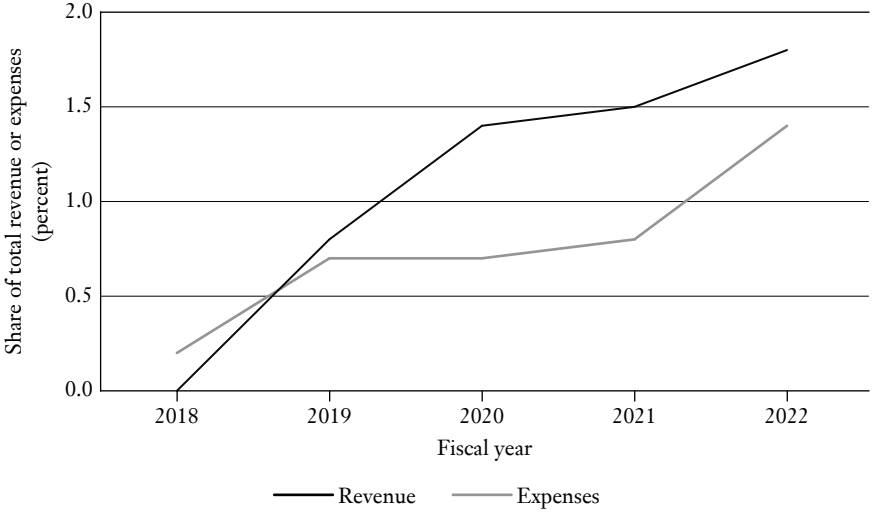
Unlike revenue from gasoline and diesel excise taxes, revenue from carbon pricing is increasing as a share of government revenue at the federal level (see figure 4). This is because the carbon price is being increased annually, and some jurisdictions are leaving and rejoining the federal policy. In 2022-23, the revenue from federal carbon-pricing policies (the majority of which is derived from the fuel charge) was 1.8 percent of federal revenue.[12] This percentage can be expected to continue to increase over the next few years if sales of fuels (and thus emissions) covered under the fuel charge do not decline at a faster rate than the fuel charge increases. In the longer term, successfully meeting the goal of net zero emissions by 2050 means that eventually carbon-pricing revenue will fall to low levels and will cease to be a significant source of government revenue. Furthermore, the legislated link between federal carbon-pricing revenues and programs for returning the proceeds to consumers does not suggest that carbon pricing will become a source of revenue for the funding of regular government services. The legislation could be amended, of course, but currently, as seen in figure 4, the programs for returning the revenue from carbon pricing represent an increasing share of federal government expenses. The way the programs are linked, both shares are expected to continue to increase together, barring a change in the legislation.

10 Vérificateur général du Québec, *Rapport du vérificateur général du Québec à l'assemblée nationale, rapport du commissaire au développement durable, 2020-2021* (Québec: Vérificateur général du Québec, Novembre 2020) (www.vgq.qc.ca/Fichiers/Publications/rapport-cdd/167/cdd_tome-novembre2020_web.pdf).

11 Nasreddine Ammar and Marianne Laurin, "Legislative Costing Note Bill C-358 (44-1), Eliminating the Goods and Services Tax in Respect of Carbon Pricing," January 23, 2024 (www.pbo-dpb.ca/en/publications/LEG-2324-019-S--eliminating-goods-services-tax-in-respect-carbon-pricing--elimination-taxe-produits-services-relativement-tarification-carbone).

12 Canada, Department of Finance, "Fiscal Reference Tables October 2023" (www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables/2023.html).

FIGURE 4 Revenue and Expenses of the Federal Pollution Pricing Framework, 2018-2022



Source: Canada, Department of Finance, "Fiscal Reference Tables October 2023" (www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables/2023.html).

RATIONALES FOR FUEL TAXES

Given that Canadian governments levy taxes on gasoline and diesel fuels for motor vehicle transport, it is worth discussing some of the rationales that economists and others put forward to justify taxing these commodities. This section first reviews the literature on the optimal taxation of commodities in the presence of constraints on the methods of taxation available. It then discusses the benefit principle of taxation, how it applies to gasoline taxes, and how it may begin to break down.

Optimal Gasoline Taxes

There are two dimensions to optimal gasoline taxes: first, they raise revenue; second, gasoline use causes external costs on others (including congestion, air pollution, climate change, and accidents). The first dimension is related to optimal commodity taxation and the original contribution of Ramsey.[13] Ramsey argued that in an economy that relies solely on commodity taxation as its source of revenue, the excess burden of taxation can be minimized by levying higher taxes on goods with relatively more inelastic demand and more elastic supply. From an economic efficiency

13 F.P. Ramsey, "A Contribution to the Theory of Taxation" (1927) 37:145 *Economic Journal* 47-61.

perspective, the fact that gasoline is a product with relatively inelastic demand[14] justifies a higher excise tax if there are constraints preventing higher rates on more efficient taxes (for example, a higher rate on a uniform sales tax applied to final consumption of all goods and services). The basic idea of the Ramsey rule is that goods with inelastic demand are more difficult for consumers to substitute, and this difficulty discourages consumers from switching to a less ideal bundle of goods and services.

Borjesson, Asplund, and Hamilton argue,[15] citing Atkinson and Stiglitz,[16] that the Ramsey justification for differential commodity taxes does not hold when distributional considerations are included in the analysis and when a uniform consumption tax and progressive income tax are available. However, higher commodity taxes on some goods can be justified if leisure is weakly separable in utility.[17]

As argued by Pigou[18] and formalized by Baumol,[19] when the production or consumption of a good imposes external costs or a negative externality on others, there is a specific per-unit tax that will reduce production or consumption of the good to the level that maximizes economic welfare inclusive of the external costs. This argument is regularly used by economists to promote carbon taxation as a policy instrument, as Mankiw and the Climate Leadership Council have done,[20] and would justify a carbon tax on gasoline and diesel fuels. The basic idea of a Pigouvian tax is that it makes consumers of a good internalize the external effects of their action (by paying a higher price for the good), and thus changes behaviour to reduce consumption of that good.

14 Phil Goodwin, Joyce Dargay, and Mark Hanly, "Elasticities of Road Traffic and Fuel Consumption with Respect to Price and Income: A Review" (2004) 24:3 *Transport Reviews* 275-92 (https://doi.org/10.1080/0144164042000181725); Philippe Barla, Bernard Lamonde, Luis F. Miranda-Moreno, and Nathalie Boucher, "Traveled Distance, Stock and Fuel Efficiency of Private Vehicles in Canada: Price Elasticities and Rebound Effect" (2009) 36 *Transportation* 389-402; and Dongfeng Chang and Apostolos Serletis, "The Demand for Gasoline: Evidence from Household Survey Data" (2014) 29:2 *Journal of Applied Econometrics* 291-313 (https://doi.org/10.1002/jae.2312).

15 Maria Borjesson, Disa Asplund, and Carl Hamilton, "Optimal Kilometre Tax for Electric Vehicles" (2023) 134 *Transport Policy* 52-64 (https://doi.org/10.1016/j.tranpol.2023.01.019).

16 A.B. Atkinson and J.E. Stiglitz, "The Design of Tax Structure: Direct vs. Indirect Taxation" (1976) 6 *Journal of Public Economics* 55-75.

17 Angus Deaton, "Optimal Taxes and the Structure of Preferences" (1981) 49:5 *Econometrica* 1245-60; Parry and Small, supra note 2; and Robin Boadway and Firouz Gahvari, "Optimal Taxation with Consumption Time as a Leisure or Labor Substitute" (2006) 90:10-11 *Journal of Public Economics* 1851-78 (https://doi.org/10.1016/j.jpubeco.2006.05.002).

18 Arthur Cecil Pigou, *The Economics of Welfare* (London: Macmillan, 1920).

19 William J. Baumol, "On Taxation and the Control of Externalities" (1972) 62:3 *American Economic Review* 307-22.

20 N. Gregory Mankiw, "Smart Taxes: An Open Invitation To Join the Pigou Club" (2009) 35 *Eastern Economic Journal* 14-23; and Climate Leadership Council, "Economists' Statement on Carbon Dividends" (https://clcouncil.org/economists-statement), which appeared in the *Wall Street Journal* on January 17, 2019.

Sandmo[21] was the first to consider the situation where an economy requires commodity taxation to raise revenue (as a result of some unspecified external constraint on other types of taxes that can be levied), but one of the goods causes a negative externality. In this case, Sandmo works out that the tax on the externality-causing good should be a weighted average of the normal Ramsey rule based on relative elasticities and the marginal external cost of the externality. Building on Sandmo's calculations, Parry and Small[22] develop a representative agent general equilibrium model of motor vehicle use and the labour market, and derive the optimal gasoline tax as a weighted average of two components: the Ramsey component, owing to the efficiency of the tax for raising revenue, and a Pigouvian component, consisting of the marginal external costs of all the vehicle-related externalities (climate change, local air pollution, accidents, and congestion). Using this model, Parry and Small estimate that US gasoline taxes are too low and that UK gasoline taxes are too high. From an economic efficiency perspective, the Ramsey component should not be applied to intermediate inputs in the production process, such as fuel used by transport trucks, work trucks, and the like.[23] (The Parry and Small model does not account for intermediate inputs.)

Wood[24] applies the Parry and Small model to Ontario and finds that the optimal gasoline tax for the Greater Toronto-Hamilton Area is around 53 ¢/L in 2021 Canadian dollars, of which 14 cents are from the Ramsey component and 39 cents are from external costs. The traffic congestion externality alone is responsible for 22 cents of the tax. For Ontario as a whole, Wood finds that the optimal tax is 37.5 ¢/L (in 2021 Canadian dollars), thanks mainly to lower marginal congestion costs. However, these estimates are now almost a decade old and deserve to be revisited. The Wood model was calibrated with statistics from 2006, the year for which traffic congestion cost estimates were available. Given increased incomes and population growth without substantial increases in transportation infrastructure, the marginal cost of congestion is possibly much higher now. On the other hand, developments in remote work technology, as well as changes in employment policies supporting remote work, may have helped to reduce congestion costs. In addition, the climate change externality was valued using the Obama-era estimate of the social cost of carbon of $25/t (in 2021 US dollars), while more recent estimates value this externality at more than $185/t.[25]

21 Agnar Sandmo, "Optimal Taxation in the Presence of Externalities" (1975) 77:1 *Swedish Journal of Economics* 86-98.

22 Supra note 2.

23 P.A. Diamond and J.A. Mirlees, "Optimal Taxation and Public Production 1: Production Efficiency" (1971) 61 *American Economic Review* 8-27; and ". . . 2: Tax Rules" (1971) 61 *American Economic Review* 261-78; and Borjesson et al., supra note 15.

24 Joel Wood, "Is It Time To Raise the Gas Tax? Optimal Gasoline Taxes for Ontario and Toronto" (2015) 41:3 *Canadian Public Policy* 179-90.

25 Rennert et al., "Comprehensive Evidence Implies a Higher Social Cost of CO_2" (2022) 610 *Nature* 687-92 (https://doi.org/10.1038/s41586-022-05224-9).

Dorval and Barla[26] consider optimal gasoline taxes for Montreal, Quebec City, and the rest of Quebec. They ignore the Ramsey component of an optimal tax, since they deem it to be small in other studies, and focus only on the Pigouvian component. Their analysis suggests optimal Pigouvian gasoline taxes of 84.5 ¢/L for Greater Montreal, 76 ¢/L for Greater Quebec, and 33 ¢/L for the rest of Quebec (in 2021 Canadian dollars). The higher amounts for Greater Montreal and Greater Quebec are overwhelmingly due to congestion costs. This leads Dorval and Barla to conclude that taxes in 2017 were too low in Montreal and Quebec City, and about right or perhaps a little too high in the rest of Quebec.

The Benefit Principle of Taxation

Gasoline taxes are often justified from a user-benefit perspective. The normative statement, "Motorists should pay gasoline taxes to fund the public infrastructure that they use," is an example of the application of the benefit principle. The principle is often manifested in taxation policy through the earmarking of gasoline tax revenue for the funding of transportation infrastructure. In the United States, revenue from the federal excise tax on gasoline and diesel fuels is earmarked for the Highway Trust Fund. In British Columbia, the majority of gasoline tax revenue is dedicated to funding the BC Transportation Financing Authority (a Crown corporation that manages the province's transportation infrastructure), Translink (the transportation authority for Metro Vancouver), and BC Transit (which manages transportation infrastructure in the Victoria regional transit area).

At the federal level in Canada, revenue from the gasoline excise tax goes into general revenue. In 2005, the government created the Gas Tax Fund as a program to fund infrastructure projects in provinces/territories and municipalities. The name of the fund and the rationale given in the budget are rooted in the benefit principle; however, despite the link through the name and rationale provided, the program was not directly funded by federal gasoline tax revenues. The Gas Tax Fund has since been renamed the Canada Community-Building Fund to more accurately reflect this.

An environmental equivalent of the benefit principle is the polluter-pays principle, in which the source of the pollution (the beneficiary of the polluting activity) should be required to pay both to remedy the damage caused by the pollution and to minimize further damage. When applied to gasoline taxes, the polluter-pays principle is equivalent to the Pigouvian component of the optimal gasoline tax, which requires drivers to pay for the environmental, health, and congestion costs that they impose on others.

A VKT TAX FOR CANADA?

Canadian excise taxes levied on gasoline and diesel fuels to raise revenue at the federal and provincial/territorial levels are currently not indexed to inflation, unlike

26 Jérémie Dorval and Philippe Barla, "Does Quebec Have the Right Gasoline Tax? An Empirical Investigation" (2017) 43:4 *Canadian Public Policy* 350-62.

other excise taxes, and therefore fuel tax revenues have been declining as a share of total government revenue. Furthermore, as shown in figure 5, EVs as a share of new vehicle registrations are increasing in Canada, especially in British Columbia and Quebec. As EVs increase as a share of the total vehicle fleet, the nominal revenue from fuel taxes will likely decline over time. As the share of EVs in the passenger vehicle fleet increases, the benefit principle link between excise taxes on fuel and the use of transportation infrastructure weakens. This has led some jurisdictions, such as Saskatchewan, to implement a higher vehicle registration charge on EVs on the ground that EV drivers do not contribute to the maintenance of traffic infrastructure because they do not pay fuel taxes. However, a differential registration charge does not adjust to the use of traffic infrastructure in the same way that a fuel tax does.

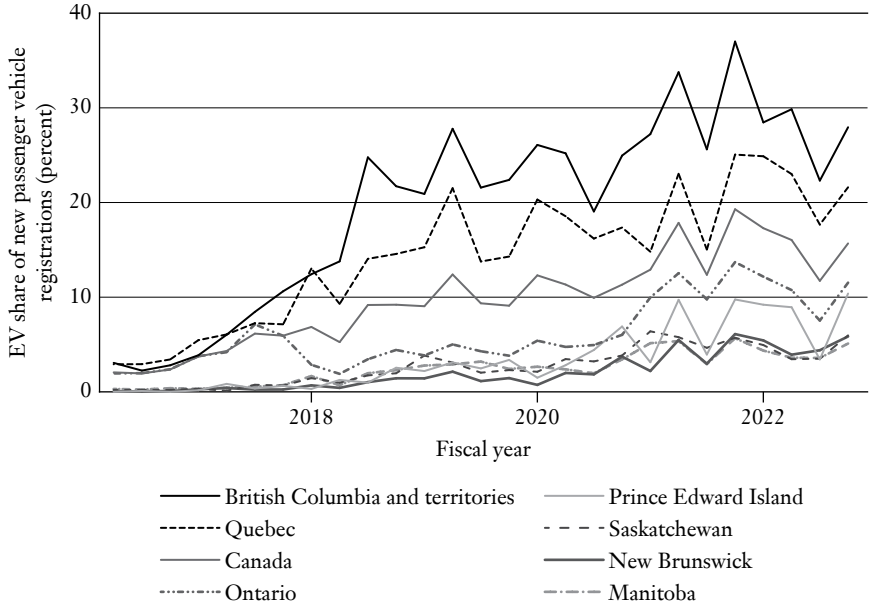
Furthermore, the Pigouvian justification for gasoline taxes was always indirect with respect to some of the external effects of driving. The negative externality of carbon dioxide (CO_2) emissions and climate change is directly related to the use of gasoline; however, traffic congestion and accidents are related to gasoline only to the extent that gasoline is used to travel vehicle kilometres. In the Parry and Small model, it is not the consumption of gasoline itself that consumers are after, it is vehicle kilometres travelled; and a gasoline tax is indirect because consumers respond to the tax both by reducing the number of kilometres they drive (which reduces traffic externalities) and by buying more fuel-efficient vehicles (which does not reduce traffic externalities). As EVs become more prevalent in the vehicle fleet, the effectiveness of a gasoline tax in addressing traffic externalities becomes weaker.

One potential solution to both of these problems is to replace federal and provincial/territorial excise taxes—but not carbon prices—on gasoline and diesel fuels with distance-based taxation (a tax on vehicle kilometres travelled). Economists have considered distance-based policies for a long time.[27] A tax on vehicle kilometres travelled would fit more closely with the benefit principle than would an EV registration charge, since a driver's total tax paid would vary with how much the driver uses traffic infrastructure. Furthermore, a VKT tax would have advantages with regard to economic efficiency. Parry and Small[28] also use their model to calculate various VKT tax rates for the United States and the United Kingdom. In their calculations, a VKT tax is welfare-improving over a gasoline tax with similar outcomes, and they provide two reasons for this. First, the VKT tax is more direct in targeting the distance-based externalities, which are larger than the fuel-use externalities. Second, the VKT tax has a lower excess burden because it can be avoided only by reducing distance travelled, whereas the gasoline tax can be avoided by driving fewer kilometres or by improving fuel efficiency—that is, buying a more fuel-efficient vehicle.

27 For a comprehensive review of economic thought surrounding road pricing, see Robin Lindsey, "Do Economists Reach a Conclusion on Highway Pricing? The Intellectual History of an Idea" (2006) 3:2 *Econ Journal Watch* 292-379.

28 Supra note 2; and Ian W.H. Parry and Kenneth A. Small, *Does Britain or the United States Have the Right Gasoline Tax?* Discussion Paper 02-12 (Washington, DC: Resources for the Future, 2004).

FIGURE 5 Electric Vehicle Registrations as Share of New Passenger Vehicle Registrations, 2017-2023



EV = electric vehicle.

Note: The graph shows the total new registrations of battery electric and plug-in hybrid electric passenger vehicles as a percentage of total passenger vehicle registrations.

Source: Statistics Canada table 20-10-0024-02, "New Motor Vehicle Registrations, Annual Sum"; and author's calculations.

Calculating a VKT Tax To Replace Gasoline and Diesel Taxes

The goal of this section is to consider a replacement of the federal and provincial/territorial excise taxes on gasoline and diesel fuels with a VKT tax that raises the same revenue. Parry and Small outline two approaches to calculating a replacement VKT tax. I use both of these approaches to provide preliminary estimates of replacement VKT taxes for the federal and provincial/territorial excise taxes on gasoline and diesel fuels, using 2021 data.

The first approach in Parry and Small[29] is what they call a "naïve" replacement VKT tax, which does not account for drivers responding to the tax shift.[30] It assumes that vehicle kilometres travelled remain the same under a VKT tax as they would have

29 Supra note 28, *Does Britain or the United States Have the Right Gasoline Tax?*

30 Ibid.

been under the gasoline tax. However, since a VKT tax is more direct, it will likely lead to a reduction in distance travelled compared to the distance travelled under the fuel tax it is replacing. Basically, fuel taxes and VKT taxes both reduce distance travelled compared to the distance travelled in the absence of a tax, but a VKT tax of an equivalent value reduces the distance travelled more. This is because, in response to a fuel tax, drivers reduce fuel use and distance travelled, but also reduce their tax bill by buying more fuel-efficient vehicles; in contrast, in response to a VKT tax, drivers can reduce their tax bill only by reducing their distance travelled. Given that the VKT tax will likely lead to a net decrease in vehicle kilometres travelled, the revenue from the naïve replacement VKT tax may not fully replace current fuel tax revenues. The second method of calculating a replacement VKT tax predicts the behavioural effect of the tax switch on distance travelled and calculates a higher tax rate to fully replace fuel tax revenues. Parry and Small[31] derive an equation from their model that allows us to calculate a replacement VKT tax that accounts for the net reduction in vehicle kilometres travelled that results from replacing the fuel tax with the VKT tax. These two approaches can be easily applied to calculate VKT tax rates for replacing the federal and provincial/territorial excise taxes on gasoline and diesel fuels in Canada. See the appendix to this article for details of these calculations, and Parry and Small[32] for details of the economic model underlying the calculations.

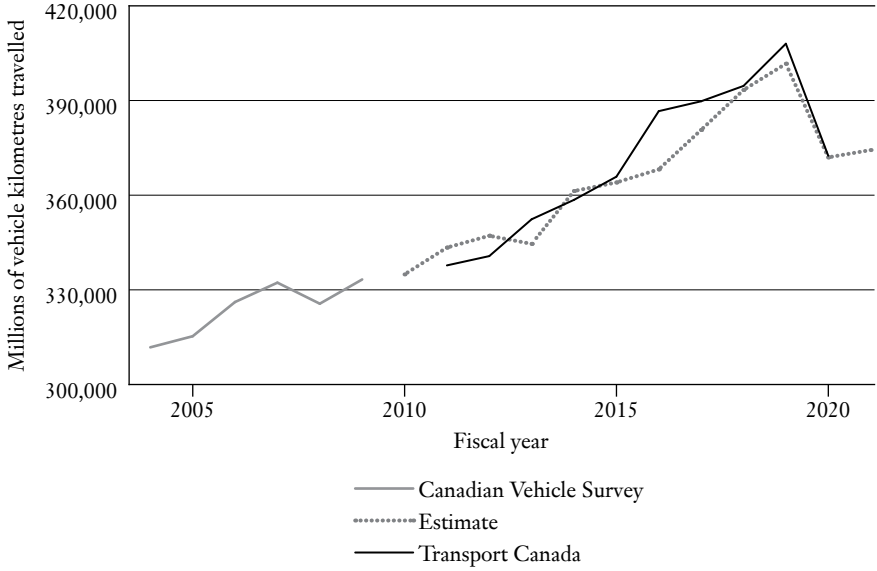
The availability of data regarding vehicle kilometres travelled in Canada limits the analysis to 2021. It also constrains consideration of a VKT tax as a replacement for a composite of vehicle fuel excise taxes (weighted by share of 2021 net sales) rather than as a replacement for separate gasoline and diesel taxes. Ultimately, VKT data for Canada and the provinces and territories had to be separated out from fatality rates reported in the Canadian motor vehicle traffic collision statistics for 2021 published by Transport Canada (see the appendix for details). Figure 6 displays the estimate for national vehicle kilometres travelled separated out from the Canadian motor vehicle traffic collision statistics for 2010 to 2021, compared to Transport Canada's estimate for 2011 to 2020 and the total from the Canadian vehicle survey for 2004 to 2009. Details on all of the data used and the methods used to do the calculations are reported in the appendix.

Table 1 lists the replacement VKT taxes at the federal and provincial/territorial levels for 2021. If the federal excise taxes for gasoline and diesel were eliminated (and if the carbon prices on these fuels remained in place), a VKT tax of 1.22 ¢/km (without a behavioural response) or 1.32 ¢/km (with a behavioural response) would replace the federal fuel tax revenue. At the provincial/territorial level, naïve VKT taxes range from 1.17 ¢/km in Yukon to 3.64 ¢/L in New Brunswick. For a replacement VKT tax that includes the behavioural response, the taxes increase, ranging from 1.22 ¢/km in Yukon to 4.04 ¢/L in New Brunswick. It is notable that New Brunswick has the

31 Supra note 2.

32 Supra note 28, *Does Britain or the United States Have the Right Gasoline Tax?*

FIGURE 6 Canadian Vehicle Kilometres Travelled, 2004-2021



Notes: The series labelled "Estimate" was calculated by combining fatality rates per 100,000 persons, Statistics Canada population estimates, and fatality rates per million vehicle kilometres travelled. The series labelled "Transport Canada" is the department's own estimate of vehicle kilometres travelled as reported in its "Statistics on the Social Costs of Collisions in Canada" reports for 2011 to 2020.

Sources: Transport Canada, "Canadian Motor Vehicle Traffic Collision Statistics" (https://tc.canada.ca/en/road-transportation/statistics-data), for 2010 to 2021; Transport Canada, "Statistics on the Social Costs of Collisions in Canada" (https://tc.canada.ca/en/road-transportation/statistics-data/statistics-data-road-safety/2020-statistics-social-costs-collisions-canada), for 2011 to 2020; Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1, by Age and Gender"; and author's calculations.

highest replacement VKT tax, but does not have the highest composite fuel tax (British Columbia and Quebec both have slightly higher fuel taxes). This is because New Brunswick has much poorer fuel efficiency (18 L/100 km) than British Columbia and Quebec (15 L/100 km and 16 L/100 km, respectively). Similar effects are observed for other jurisdictions with relatively poorer fuel efficiency (Saskatchewan, Newfoundland and Labrador, and Northwest Territories).

Initial estimates of replacement VKT taxes for British Columbia's regional fuel taxes can be calculated under the assumption that these areas have similar levels of initial fuel efficiency. For Metro Vancouver, the rate would be 4.5 ¢/L; for Metro Victoria, it would be 3.3 ¢/L; and for the rest of the province, the rate would be 2.4 ¢/L. These areas likely have different levels of fuel efficiency, so these estimates should be regarded as even rougher than those in table 1.

TABLE 1 VKT Taxes To Replace the Revenue from Federal and Provincial Excise Taxes on Gasoline and Diesel Fuels for 2021

	Composite fuel tax (¢/L)	Naïve VKT tax (¢/km)	Replacement VKT tax (¢/km)
Canada	8.10	1.22	1.32
British Columbia	21.70	3.33	3.62
Alberta	13.00	1.73	1.86
Saskatchewan	15.00	3.37	3.63
Manitoba	14.00	1.53	1.65
Ontario	14.30	2.08	2.24
Quebec	20.89	3.42	3.79
New Brunswick	20.14	3.64	4.04
Nova Scotia	14.67	2.72	2.96
Prince Edward Island	19.32	3.01	3.34
Newfoundland and Labrador	11.97	2.41	2.57
Yukon	6.68	1.17	1.22
Northwest Territories	9.52	3.47	3.63

VKT = vehicle kilometres travelled.

Notes: All values are in 2021 Canadian dollars. The composite fuel tax is a combination of the gasoline excise tax rate and the diesel excise tax rate, weighted by each fuel's share of 2021 net sales in the particular jurisdiction. The British Columbia and Quebec taxes also involve population-weighted composites of their regional fuel taxes. The naïve VKT tax is the VKT tax that replaces the revenue of the current excise taxes if there is no behavioural response by vehicle owners. The replacement VKT tax is the tax per kilometre that replaces the revenue of the current excise taxes accounting for the behavioural response of vehicle owners. Nunavut is omitted owing to a lack of fuel price data. Further details about the calculations and data used are included in the appendix to this article.

Sources: Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1, by Age and Gender"; Statistics Canada table 23-10-0066-01 (formerly CANSIM table 405-0002), "Sales of Fuel Used for Road Motor Vehicles, Annual (x 1,000)"; Statistics Canada table 25-10-0044-01 (formerly CANSIM table 134-0004), "Supply and Disposition of Refined Petroleum Products, monthly"; Transport Canada, "Canadian Motor Vehicle Traffic Collision Statistics" (https://tc.canada.ca/en/road-transportation/statistics-data), for 2011 to 2021; Natural Resources Canada, "Daily Average Retail Prices for Regular Gasoline in 2024" (www2.nrcan-rncan.gc.ca/eneene/sources/pripri/prices_bycity_e.cfm); and author's calculations.

The Optimal VKT Tax for Canada

The rationales in the optimal gasoline tax literature discussed above can be applied to an optimal VKT tax as well.[33] As noted earlier, the VKT tax is more difficult to avoid than a gasoline tax, which may justify a higher rate of tax based on a Ramsey argument. In addition, a VKT tax is more direct in targeting the negative externalities related to distance. These distance-based external costs include local air pollution

33 Supra note 2.

costs related to fine particulate matter from tire and brake use,[34] costs arising from traffic accidents, and costs associated with traffic congestion. Parry and Small[35] show that the optimal gasoline taxes for the United States and the United Kingdom, when converted to VKT taxes, are lower than the optimal VKT taxes. In their estimate of a Pigouvian VKT tax for Sweden,[36] Borjesson et al. include external costs from road infrastructure wear and tear, accidents, particulate matter emissions from brakes and tires, traffic noise, and traffic congestion, based on data gathered from various sources. The sum of these external costs for Sweden for 2019, excluding congestion costs, is reported as 0.009 euros per kilometre (€/km) for light vehicles, 0.007 €/km for trucks without trailers, and 0.18 €/km for trucks with trailers. In 2021 Canadian dollars, converted using the annual euro-Canadian dollar exchange rate reported by the Bank of Canada and adjusted using the Bank of Canada's inflation calculator, these costs are equivalent to 1.4 ¢/km for light vehicles, 1.1 ¢/km for trucks without trailers, and 28.19 ¢/km for trucks with trailers. Transport Canada produces annual statistics on the social costs of collisions in Canada, and the most recent reports (for 2019 and 2020) provide an estimate for the external costs of traffic accidents of 10 ¢/km. From a purely Pigouvian perspective, the Transport Canada estimate of the accident externality on its own would justify higher VKT taxes than the purely replacement ones proposed in table 1. Calculating the optimal VKT tax for Canada, the provinces and territories, and metro regions is important, but it is beyond the scope of the present article and is left for future research.

Potential Issues with Implementing a VKT Tax

There are significant potential issues with implementing a VKT tax. First, any new tax must overcome status quo bias. In Sweden, opposition to congestion pricing was higher initially than it was after the charge had been piloted.[37] In contrast, it is politically easier to increase an existing tax or to rely on existing taxes for which revenue grows automatically with economic activity (as it does with personal income taxes and consumption taxes). Surveys have shown that the public is not in favour of distance-based taxation,[38] and Translink in Metro Vancouver has considered "mobility

34 In addition, Parry and Small, supra note 2, Wood, supra note 24, and Dorval and Barla, supra note 26, treat the external costs related to all local air pollution from driving, even those that are contained in vehicle exhaust, as distance-based. Parry and Small argue that local air pollutants in vehicle exhaust (such as nitrogen oxides and carbon monoxide) are regulated through gram-per-distance emission standards.

35 Supra note 2.

36 Borjesson et al., supra note 15.

37 Jonas Eliasson, Lars Hultkrantz, Lena Nerhagen, and Lena Smidfelt Rosqvist, "The Stockholm Congestion-Charging Trial 2006: Overview of Effects" (2009) 43:3 *Transportation Research Part A: Policy and Practice* 240-50.

38 John Axsen and Michael Wolinetz, "Taxes, Tolls and ZEV Zones for Climate: Synthesizing Insights on Effectiveness, Efficiency, Equity, Acceptability and Implementation" (2021) 156 *Energy Policy* (https://doi.org/10.1016/j.enpol.2021.112457).

pricing" to reduce reliance on the gasoline tax, but there has been insufficient political support to move forward with implementation. However, the public does tend to support auto insurance rates based on distance travelled, and many provinces do allow insurance companies to give discounts to low-distance drivers.[39]

Second, in regard to the implementation of a VKT tax, if the tax were implemented through the use of camera technology, experiences with congestion pricing in London, Norway, and Sweden suggest that this type of system would have high administrative costs.[40] In contrast, gasoline excise taxes have very low administrative costs, which are estimated to be 1 percent or less of revenue collected.[41] An alternative to camera technology is a system that uses global positioning system (GPS) technology. According to Borjesson et al., however, the cost of such a system is unknown because it has not been implemented on a wide scale. In addition, GPS tracking systems may suffer from consumer opposition related to misplaced perceptions of privacy invasion.

Third, a VKT tax itself still targets the congestion externality indirectly, since congestion occurs overwhelmingly on key routes in major metropolitan centres only at peak times of the day. Much of the traffic at a provincial/territorial or national level would be relatively uncongested and occur outside peak periods. Modelling of a Pigouvian VKT tax in Sweden suggests that a congestion charge in metro centres combined with a flat vehicle registration fee would address the congestion externality more directly and be easier to implement.[42]

Despite these challenges, the US state of Oregon implemented a distance-based charge in 2015 alongside its pre-existing gasoline tax.[43] Currently, the distance-based charge is 2 cents per mile and the state gasoline tax is 40 cents per gallon (in US dollars). The road usage charge program is voluntary. Drivers who sign up for it face a 2 cent per mile charge, and can choose different options for recording their usage (through GPS or non-GPS mileage reporting devices) offered by three different providers. Each quarter, drivers' accounts are debited for their mileage tax paid and credited for the state gasoline tax it is estimated they paid based on their vehicle's fuel economy rating. The formula is such that drivers of vehicles with fuel efficiency of 20 miles per gallon (mpg) pay zero—that is, their mileage tax debit is equal to their gasoline tax credit. Vehicles with fuel efficiency of less than 20 mpg are not eligible for the program, and drivers of vehicles with better fuel efficiency end up with a positive net tax bill in their account because their mileage tax debit is higher than their gasoline tax credit. Driving a more fuel-efficient vehicle thus creates a

39 Ibid.

40 Borjesson et al., supra note 15.

41 Robert S. Kirk and Marc Levinson, *Mileage-Based Road User Charges*, CRS Report no. R44540 (Washington, DC: Congressional Research Service, 2016).

42 Borjesson et al., supra note 15.

43 OreGo (www.oregon.gov/odot/programs/pages/orego.aspx).

perverse incentive that discourages voluntary participation in the program. Oregon addresses this problem by offering a discount on its annual vehicle registration fee to program participants who own an EV or a vehicle that gets more than 40 mpg. Unfortunately, the voluntary program has had low enrolment, with only around 700 vehicles participating as of January 2023.[44] Despite its voluntary nature and the design barriers discouraging participation, Oregon's system does demonstrate that this type of system is possible and probably not excessively costly in administrative terms, and its gasoline tax credit offers a model that can be improved upon for a phased implementation of a switch from fuel taxes to a VKT tax.

CONCLUSIONS

The federal government and all provincial and territorial governments in Canada levy excise taxes on gasoline and diesel fuels, but revenue from these taxes has become a smaller share of total government revenue. At the same time, carbon prices levied on gasoline and diesel are increasing and becoming a larger share of government revenue; however, the revenue raised by some carbon-pricing schemes applied in Canada (such as the federal fuel charge) are required by legislation to be returned to households through direct transfers. Furthermore, the increasing share of EVs in the Canadian vehicle fleet suggests that government revenue from gasoline and diesel excise taxes will eventually decline in nominal terms. In addition, as the share of EVs increases, the link between the benefits that road users receive and what they pay in fuel tax is weakened. This potential decline in fuel tax revenue and the weakening of the benefit principle can justify a replacement of excise taxes on fuels with a tax on vehicle kilometres travelled.

In this article I calculated preliminary estimates of VKT tax rates per kilometre travelled to replace the federal and provincial/territorial excise taxes on gasoline and diesel fuels, using data for 2021. It is estimated that a federal VKT tax of 1.32 ¢/km is required to replace these two fuel excise taxes. The replacement VKT rates in each province and territory differ on the basis of differences in 2021 provincial/territorial fuel tax rates and differences in fuel efficiency. More research is needed to identify how sensitive these rates are to changes in parameter values and the year of analysis.

How these replacement VKT tax rates would compare with optimal VKT tax rates was considered. Further research is needed to estimate the congestion costs in Canadian cities to facilitate a calculation of the optimal VKT taxes for Canada, provinces and territories, and key metropolitan regions. Furthermore, although this article has considered the fiscal and economic efficiency ramifications of fuel taxes and VKT taxes, a focus on the distributional implications of a switch from fuel taxes to a distance-based tax is needed. Lindsey notes that road pricing is not necessarily regressive in impact, since lower-income households tend to rely on public transportation more

44 Pat Dooris and Jamie Parfitt, "Here's How Oregon Plans To Replace the Gas Tax as Cars Go Electric," *KGW8*, January 4, 2023 (www.kgw.com/article/news/local/the-story/odot-gas-tax-electric-vehicle-pay-per-mile/283-fad1a341-0550-4c70-aa93-bfe5ead3f4c4).

than other households do.[45] In addition, a switch to a VKT tax will increase the tax paid by drivers of relatively fuel-efficient vehicles, and reduce the tax paid by drivers of relatively fuel-inefficient vehicles; therefore, prior to implementation, a full distributional analysis of these impacts would be informative.

APPENDIX

Presenting the entirety of the Parry and Small model is beyond the scope of this article; readers looking for full details of the model should consult their work.[46] However, it is useful to present the technical details behind the calculation of the replacement VKT taxes in table 1. Parry and Small[47] present what they refer to as a "naïve" replacement VKT tax with the formula $t_F^0 \alpha_{FK}^0 = t_K^0$, where t_F^0 is the current gasoline tax, α_{FK}^0 is fuel efficiency expressed as current litres per 100 kilometres, and t_K^0 is the replacement tax per kilometre travelled.[48] Given that $\alpha_{FK}^0 = \frac{F^0}{K^0}$, where F^0 is current fuel consumption and K^0 is current vehicle kilometres travelled, it is more intuitive to view the naïve replacement equation as $t_F^0 F^0 = t_K^0 K^0$, where the left-hand side is current gasoline tax revenue and the right-hand side is the revenue from the replacement VKT tax when it is naïvely assumed that vehicle kilometres travelled remain at current levels—that is, when it is assumed that there is no behavioural response by vehicle drivers. In the Parry and Small model, drivers produce vehicle kilometres travelled (which provides them with utility) using a combination of gasoline and their choice of vehicle characteristics related to fuel efficiency. In response to a gasoline tax, consumers decrease gasoline use and increase expenditures on vehicle characteristics that improve fuel efficiency (better drive train, smaller trunk space, smaller vehicle, etc.), and the net effect is a reduction in distance travelled. With a switch from a gasoline tax to a VKT tax, drivers respond only by directly reducing vehicle kilometres travelled; they cannot avoid the gasoline tax by switching to a more fuel-efficient car. Therefore, over time, there will be a change in α_{FM}; that is, fuel efficiency will be worse under the VKT tax than under the gasoline tax. Parry and Small's model produces the following equation that predicts this change based on assumptions about the price elasticity of demand for gasoline and the cross-price elasticity of demand for vehicle kilometres travelled and gasoline:

$$\alpha_{FK} = \alpha_{FK}^0 \left(\frac{q_F + t_F}{q_F + t_F^0} \right)^{\eta_{KF} - \eta_{FF}},$$

45 Robin Lindsey, *Congestion Relief: Assessing the Case for Road Tolls in Canada*, C.D. Howe Institute Commentary no. 248 (Toronto: C.D. Howe Institute, 2007).

46 Supra notes 2 and 28.

47 Supra note 28, *Does Britain or the United States Have the Right Gasoline Tax?*

48 As American authors, Parry and Small, supra note 2, use $1/\alpha_{MF}$, which is miles per gallon (the US fuel economy metric), whereas for the current article, focused on Canada, it is appropriate to define α_{FK} as litres per 100 km (the Canadian fuel economy metric). These are equivalent mathematically.

where q_F is the gasoline price, t_F^0 is the current gasoline tax, t_F is the new gasoline tax (which in my calculations to consider a replacement VKT tax would be only the carbon tax), η_{KF} is the elasticity of vehicle kilometres travelled with respect to gasoline prices in absolute value, and η_{FF} is the price elasticity of demand for gasoline in absolute value. Parry and Small demonstrate that to calculate the true replacement VKT tax, the current gasoline tax is divided by α_{FK}, instead of α_{FK}^0, as in the naïve case.

Data on vehicle kilometres travelled have not been readily available in Canada since the discontinuation of the Canadian vehicle survey in 2010. Fortunately, Transport Canada produces an annual report that includes fatality rates per population and fatality rates per million vehicle kilometres travelled, at the national and the provincial and territorial levels. When combined with population estimates,[49] it is possible to obtain an estimate of vehicle kilometres travelled for Canada and each province and territory. The estimates are not perfect since the fatality rates are rounded to the nearest tenth. Figure 6 above plots this estimate at the national level alongside Transport Canada's own national-level VKT estimate (from its reports on the social costs of collisions for 2011 to 2020). The latest year for which VKT data could be estimated was 2021; therefore, that is the year used in the analysis.

In the calculations of replacement VKT taxes at the federal and provincial and territorial levels, the unavailability of VKT data by fuel source prevented the consideration of a replacement VKT tax on gasoline and a different replacement VKT tax on diesel. In the face of this data restriction, I instead consider a VKT tax on all vehicle kilometres travelled, regardless of fuel type, that replaces a composite of gasoline and diesel excise taxes. I created the composite tax by weighting the two excise taxes by the share of net fuel sales to motor vehicles.[50] For 2021, the composite federal excise tax is 0.081 $/L. This approach also worked for most provinces and territories, but for provinces with regional gasoline tax rates (British Columbia and Quebec), I first created a population-weighted provincial excise tax for each fuel (using population estimates from the 2021 census), and then created the composite based on the share of fuel net sales. For Quebec, I ignored the large heterogeneity in regional gasoline tax rates and calculated the population-weighted provincial tax using the simplifying assumption that the standard provincial gasoline tax applies everywhere in Quebec except Metro Montreal. At the national level, I created a composite provincial/territorial fuel tax rate by weighting the 2021 tax rate of each province and territory by its share of national net fuel sales.

A composite fuel price that combines the prices for gasoline and diesel is also needed for each province and territory and nationally. Monthly average price data for all grades of gasoline and for diesel were obtained from a Natural Resources

49 Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1, by Age and Gender."

50 Statistics Canada table 23-10-0066-01 (formerly CANSIM 405-0002), "Sales of Fuel Used for Road Motor Vehicles, Annual (x 1,000)."

Canada database including every city that was available.[51] The annual average was then calculated. For provinces and territories with only one city with price data available, that price was taken as the prevailing provincial/territorial price, whereas for provinces and territories with multiple cities with price data, a population-weighted provincial/territorial price was calculated. A composite gasoline price across the three grades was calculated using the 2018 annual share of each grade sold.[52] A gasoline-diesel composite price was then calculated using the same shares that were used to calculate composite excise taxes across the two fuels. Natural Resources Canada produces gasoline and diesel price averages for Canada as a whole, and these were used for national-level analysis in composite form.

To calculate the naïve VKT tax to replace the composite federal excise fuel tax, α_{FK}^{0} is calculated by dividing 2021 Canadian net fuel sales of gasoline and diesel by the total 2021 vehicle kilometres travelled, giving a fuel efficiency of 0.15053 L/km (or, in the more familiar form, 15.05 L/100 km). Multiplying this by the composite federal excise tax rate of 8.0953 ¢/L yields a naïve replacement VKT rate of 1.218588 ¢/km. To calculate the true replacement VKT tax, α_{FK} is calculated using the formula presented earlier and the parameter values in table A1. The values selected for the two elasticity parameters are the central values selected by Dorval and Barla.[53] The resulting value for α_{FK} is 0.1633, and when this is multiplied by the composite federal excise tax rate of 8.0953 ¢/L leads to a federal replacement VKT tax of 1.32 ¢/km and a composite provincial/territorial replacement VKT tax of 2.7 ¢/km. Similar calculations are done at the provincial/territorial level for all provinces and territories except Nunavut (owing to a lack of fuel price data), and the assumed parameter values are reported in table A2.

51 Natural Resources Canada, "Daily Average Retail Prices for Regular Gasoline in 2024" (www2.nrcan-rncan.gc.ca/eneene/sources/pripri/prices_bycity_e.cfm).

52 Statistics Canada table 25-10-0044-01 (formerly CANSIM 134-0004), "Supply and Disposition of Refined Petroleum Products, Monthly."

53 Supra note 26.

TABLE A1 Parameter Values at the National Level

Parameter	Value	Unit
Net fuel sales, F_0	56,343	millions of litres
Vehicle kilometres travelled, K_0	374,301	millions of kilometres
Price elasticity of demand for fuel, η_{FF}	0.6	
Cross-price elasticity of demand, η_{KF}	0.24	
Federal sales tax	0.05	%
Provincial sales tax composite	0.0556	%
Federal tax composite	0.0810	$/L
Provincial tax composite	0.1657	$/L
Combined excise tax, t_F^0	0.2466	$/L
Composite fuel price (including all taxes)[a]	134.62	$/L
Composite fuel price (excluding sales and excise taxes), q_F	121.52	$/L

a The carbon price charged on the fuel is included.

Sources: Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1, by Age and Gender"; Statistics Canada table 23-10-0066-01 (formerly CANSIM table 405-0002), "Sales of Fuel Used for Road Motor Vehicles, Annual (x 1,000)"; Statistics Canada table 25-10-0044-01 (formerly CANSIM table 134-0004), "Supply and Disposition of Refined Petroleum Products, Monthly"; Transport Canada, "Canadian Motor Vehicle Traffic Collision Statistics" (https://tc.canada.ca/en/road-transportation/statistics-data), for 2011 to 2021; Natural Resources Canada, "Daily Average Retail Prices for Regular Gasoline in 2024" (www2.nrcan-rncan.gc.ca/eneene/sources/pripri/prices_bycity_e.cfm); and author's calculations.

TABLE A2 Parameter Values at the Provincial/Territorial Level

Parameter	BC	AB	SK	MB	ON	QC	NB	PE	NS	NL	YT	NT
Net fuel sales, F_0 (millions of litres)	6,786	8,746	2,984	2,247	19,452	11,508	1,447	268	1,606	951	127	159
Vehicle kilometres travelled, K_0 (millions)	44,259	65,599	13,292	20,513	133,989	70,223	7,997	1,442	10,313	4,712	726	436
Sales tax (%)	0.05	0.05	0.05	0.05	0.13	0.15	0.15	0.15	0.15	0.15	0.05	0.05
Federal excise tax composite ($/L)	0.0815	0.0777	0.0736	0.0799	0.0830	0.0811	0.0834	0.0883	0.0851	0.0819	0.0714	0.0558
Provincial excise tax composite ($/L)	0.2170	0.1300	0.1500	0.1400	0.1430	0.2089	0.2014	0.1467	0.1932	0.1197	0.0668	0.0952
Combined excise tax, t_F^0 ($/L)	0.2985	0.2077	0.2236	0.2199	0.2260	0.2900	0.2848	0.2350	0.2784	0.2016	0.1382	0.1510
Composite fuel price (including all taxes) ($/L)	1.51	1.26	1.27	1.27	1.31	1.34	1.32	1.32	1.28	1.47	1.45	1.40
Composite fuel price (excluding sales and excise taxes),[a] q_F ($/L)	1.14	1.00	0.98	0.99	0.94	0.88	0.86	0.91	0.84	1.08	1.24	1.19

BC = British Columbia; AB = Alberta; SK = Saskatchewan; MB = Manitoba; ON = Ontario; QC = Quebec; NB = New Brunswick; NS = Nova Scotia; PE = Prince Edward Island; NL = Newfoundland and Labrador; YT = Yukon; NT = Northwest Territories.

a The carbon price charged on the fuel is included.

Note: Nunavut is omitted owing to a lack of fuel price data.

Sources: Statistics Canada table 17-10-0005-01 (formerly CANSIM table 051-0001), "Population Estimates on July 1, by Age and Gender"; Statistics Canada table 23-10-0066-01 (formerly CANSIM table 405-0002), "Sales of Fuel Used for Road Motor Vehicles, Annual (x 1,000)"; Statistics Canada table 25-10-0044-01 (formerly CANSIM table 134-0004), "Supply and Disposition of Refined Petroleum Products, Monthly"; Transport Canada, "Canadian Motor Vehicle Traffic Collision Statistics" (https://tc.canada.ca/en/road-transportation/statistics-data), for 2011 to 2021; Natural Resources Canada, "Daily Average Retail Prices for Regular Gasoline in 2024" (www2.nrcan-rncan.gc.ca/eneene/sources/pripri/prices_bycity_e.cfm); and author's calculations.

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International Tax Planning

Co-Editors: Ken Buttenham and Ian Bradley*

EIFEL BEYOND CANADA—THE IMPACT OF THE NEW RULES IN THE FOREIGN AFFILIATE CONTEXT

*Tommy Zhu, Alex Cook, and Michael O'Connor***

The introduction of the excessive interest and financing expenses limitation (EIFEL) rules marks a significant change in the interest deductibility landscape for Canadian taxpayers and their foreign affiliates. Interest and financing expenses of controlled foreign affiliates (CFAs) that are relevant in computing a CFA's foreign accrual property income or foreign accrual property loss can be rendered non-deductible by the EIFEL rules, and can also affect the amounts deductible by the Canadian taxpayer under these rules. This article reviews the specific implications of the new rules in the foreign affiliate context, as well as the impact of the rules on Canadian borrowings to invest in foreign affiliates. The authors use examples to demonstrate the complexity of the EIFEL calculations, which involve a combination of mandatory and elective rules, and which make the determination of the impact of CFAs on a taxpayer's EIFEL calculations a multi-step process. The authors also outline some of the key practical challenges in complying with the new rules. The complexity of the examples demonstrates the importance of carrying out detailed modelling calculations in order to achieve optimal results for Canadian taxpayers and their foreign affiliates.

KEYWORDS: CONTROLLED FOREIGN CORPORATIONS ■ DEDUCTIONS ■ FOREIGN ACCRUAL PROPERTY INCOME ■ FOREIGN AFFILIATES ■ INTEREST ■ INTEREST DEDUCTIBILITY

* Of PricewaterhouseCoopers LLP, Toronto (e-mail: ken.buttenham@pwc.com; ian.k.bradley@pwc.com).

** Tommy Zhu and Alex Cook are of PricewaterhouseCoopers LLP, Toronto. Michael O'Connor is of KPMG, Toronto. We would like to thank Dave Beaulne and Jamie Mitchell (both of PricewaterhouseCoopers LLP) for their thoughtful insights, valuable contributions, and dedication of their time to this article.

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Personal Tax Planning

Co-Editors: Chris Watt Bickley,* Sonia Gandhi,** Dino Infanti,*** and Bessy Triantafyllos****

CANADIAN TAXATION OF FOREIGN PENSION DISTRIBUTIONS AND ACCRUALS

*Peter Megoudis*****

This article analyzes the Canadian tax characterization of different types of plans that are colloquially considered "pensions," and outlines the Canadian tax implications of each such characterization. It focuses on Canadian-resident employees who participate in, accrue benefits under, or receive distributions from foreign pension plans. After a general discussion of the relevant tax sources, the article presents a case study to illustrate the application of such tax concepts to the case of a current Canadian resident who will be receiving distributions from a variety of UK pension plans in which she participated when she was residing and working in the United Kingdom.

KEYWORDS: DEFERRED COMPENSATION ■ EMPLOYEE BENEFIT TRUST ■ EMPLOYEE COMPENSATION ■ FOREIGN ■ PENSIONS ■ TRUSTS

* Of Deloitte LLP, Ottawa (e-mail: cwattbickley@deloitte.ca).

** Of KPMG LLP, Toronto (e-mail: soniagandhi@kpmg.ca).

*** Of KPMG LLP, Vancouver (e-mail: dinfanti@kpmg.ca).

**** Of Deloitte LLP, Toronto (e-mail: btriantafyllos@deloitte.ca).

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Planification fiscale personnelle

Corédacteurs de chronique : Chris Watt Bickley*, Sonia Gandhi**, Dino Infanti*** et Bessy Triantafyllos****

IMPOSITION AU CANADA DES DISTRIBUTIONS ET DES PRESTATIONS ACCUMULÉES DES RÉGIMES DE PENSION ÉTRANGERS

*Peter Megoudis*****

Le présent article analyse la caractérisation aux fins de la fiscalité canadienne de différents types de régimes communément considérés comme des « pensions », et décrit les conséquences fiscales canadiennes de chacune de ces caractérisations. Il se concentre sur les employés qui résident au Canada et qui participent à des régimes de pension étrangers, qui accumulent des prestations dans ces régimes ou qui en reçoivent des distributions. Après un exposé général des sources de revenu fiscal pertinentes, l'article présente une étude de cas pour illustrer l'application de ces concepts fiscaux au cas d'une résidente actuelle du Canada qui recevra des prestations de divers régimes de pension britanniques auxquels elle a participé lorsqu'elle résidait et travaillait au Royaume-Uni.

MOTS CLÉS : RÉMUNÉRATION DIFFÉRÉE ■ FIDUCIE AU BÉNÉFICE DES EMPLOYÉS ■ RÉMUNÉRATION DES EMPLOYÉS ■ ÉTRANGER ■ PENSIONS ■ FIDUCIES

* De Deloitte S.E.N.C.R.L., s.r.l., Ottawa (courriel : cwattbickley@deloitte.ca).

** De KPMG S.E.N.C.R.L., s.r.l., Toronto (courriel : soniagandhi@kpmg.ca).

*** De KPMG S.E.N.C.R.L., s.r.l., Vancouver (courriel : dinfanti@kpmg.ca).

**** De Deloitte S.E.N.C.R.L., s.r.l., Toronto (courriel : btriantafyllos@deloitte.ca).

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Corporate Tax Planning

Co-Editors: Mark Brender,* Brian R. Carr,** Michael R. Smith,*** and Christopher J. Steeves****

EIFEL—IT'S HERE

*Michael O'Connor and Alex Cook*****

In new legislation effective for taxation years commencing on or after October 1, 2023, Canada will implement its version of the recommendations of the Organisation for Economic Co-operation and Development set out in its 2015 action 4 report, addressing base erosion through interest deductions and other financial payments. In this article, the authors explore the computational aspects of the proposed excessive interest and financing expenses limitation (EIFEL) rules. The rules will limit the deductibility of interest and other financing expenses incurred by corporations and trusts, and require an adjustment to certain income that those entities derive from partnerships and controlled foreign affiliates. In November 2023, the authors co-presented a workshop at the Canadian Tax Foundation's annual tax conference dealing with the computations required by the rules. This article extends that work in light of the implementing legislation tabled in Parliament within days of that workshop. The authors begin with some background on the consultation journey toward these rules. Then they explore the math underpinning the rules and the variables underpinning the math. The article shows how practitioners can use math to develop an understanding of the rules, by zeroing in on the key variables and interrelationships that are relevant to the limitations. The authors provide readers with a systematic way to approach computations across multiple entities and thus minimize the work effort involved in applying the EIFEL legislation and navigating the transitional rules.

* Of Osler Hoskin & Harcourt LLP, Montreal (e-mail: mbrender@osler.com).

** Of Thorsteinssons LLP, Toronto (e-mail: bcarr@thor.ca).

*** Of Deloitte LLP, Calgary (e-mail: michaesmith@deloitte.ca).

**** Of Fasken Martineau DuMoulin LLP, Toronto (e-mail: csteeves@fasken.com).

***** Michael O'Connor is of KPMG, Toronto; Alex Cook is of PricewaterhouseCoopers LLP, Toronto. This article builds on Michael O'Connor and Alex Cook, "Computing EIFEL," a workshop held at the 2023 Canadian Tax Foundation's annual tax conference. We wish to recognize Elinore Richardson for her invaluable comments, relentless resistance to the math, and ongoing debates on the application of these rules as they have evolved over the past two-plus years. Any errors or omissions are ours alone.

KEYWORDS: EIFEL ■ EXCESSIVE INTEREST ■ TAX CHANGES ■ OECD BEPS ACTION 4 ■ INTEREST AND FINANCING EXPENSES ■ COMPLEXITY

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Selected US Tax Developments

Co-Editors: Peter A. Glicklich* and Michael J. Miller**

PERHAPS FORGIVENESS TRULY IS DIVINE

*Michael J. Miller***

Pursuant to the common law in the United States, a sole shareholder that purports to transfer assets to a corporation for no consideration may be deemed to have received stock of the corporation for US tax purposes. The Internal Revenue Service has taken the view that stock of the corporation similarly should be deemed to have been issued to a sole shareholder that purports to forgive, for no consideration, accrued but unpaid interest owed to it by the corporation. While this approach may avoid abuse in certain circumstances, it may also present an opportunity for Canadian parent corporations that are owed interest by their US subsidiaries.

KEYWORDS: TREATY ■ ARBITRAGE ■ DEBT FORGIVENESS ■ INTEREST

* Of Davies Ward Phillips & Vineberg LLP, New York (e-mail: pglicklich@dwpv.com).

** Of Roberts & Holland LLP, New York and Washington, DC (e-mail: mmiller@rhtax.com).

1 85 TC 824 (1985); aff'd 872 F.2d 519 (2d Cir. 1989).

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Current Tax Reading

Co-Editors: Kim Brooks, Jinyan Li, Alan Macnaughton, and Michael Veall*

Jerome Monsenego, *Introduction to Transfer Pricing*, 2d ed. (Alphen aan den Rijn, the Netherlands: Kluwer Law International, 2022)

The Canadian transfer-pricing rules are found in section 247 of the Act.[1] They were introduced in 1997 in order to make the Canadian law on transfer pricing consistent with the internationally accepted arm's-length principle and with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (1995) ("the OECD guidelines"). Reforms proposed in 2023 will explicitly link section 247 to the OECD guidelines.[2] The inherent nature of transfer-pricing issues and the importance of preventing the double taxation of profits—an issue that arises from inconsistent transfer-pricing adjustments by tax administrations in different countries—make it important for the Canadian rules to be interpreted and applied in general conformity with international standards. However, understanding the international context can be challenging. Transfer pricing is not an exact science. The arm's-length principle is a principle or standard, not a self-enforcing rule. The OECD guidelines are written differently from the Act, have over 600 pages, and are frequently updated. In addition, in some Canadian transfer-pricing cases, multiple experts (mostly economists) offer different views on how to determine the arm's-length price, thus creating the impression that the meaning of transfer-pricing law is settled through a battle of economists. All of this is to say that transfer-pricing law can be confusing. A meaningful textual, contextual, and purposive interpretation of section 247 requires some understanding of the arm's-length principle and transfer pricing in the general context of international tax.

The literature on transfer pricing tends to be written for transfer-pricing experts and can be highly technical. Monsenego's book is written primarily for students and

* Kim Brooks is of the Schulich School of Law, Dalhousie University, Halifax (e-mail: kim.brooks@dal.ca); Jinyan Li is of Osgoode Hall Law School, York University, Toronto (e-mail: jinyanli@osgoode.yorku.ca); Alan Macnaughton is of the School of Accounting and Finance, University of Waterloo (e-mail: amacnaughton@uwaterloo.ca); and Michael Veall is of the Department of Economics, McMaster University, Hamilton, Ontario, and editor of *Canadian Public Policy* (e-mail: veall@mcmaster.ca).

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

2 Canada, Department of Finance, *Consultation on Reforming and Modernizing Canada's Transfer Pricing Rules* (Ottawa: Department of Finance, 2023).

new practitioners. It provides a general introduction to the fundamentals of transfer pricing and draws on concrete examples to illustrate the fundamentals. Canadian readers, especially lawyers, will find the book helpful for understanding the Canadian transfer-pricing rules.

The book has seven chapters:

1. "The Key to Understanding Transfer Pricing: the Arm's Length Principle,"
2. "Transfer Pricing Methods,"
3. "Transfer Pricing Models,"
4. "Cross-Border Business Restructurings,"
5. "The Substance Requirement from a Transfer Pricing Perspective,"
6. "The Attribution of Profits to Permanent Establishments,"
7. "Administrative Aspects: Compliance Issues and Transfer Pricing Disputes."

Readers who are already familiar with the fundamentals of transfer pricing may find chapter 5 particularly relevant to the Canadian context. The "economic substance" requirement is explained as follows:

> In the field of tax law, it is often established as a connection between, on the one hand, the existence of a given reality (which is sometimes described as 'substance') and, on the other hand, the application of certain rules. This link between reality and taxation is sometimes reinforced in order to prevent tax avoidance, through conditioning either the grant of certain tax benefits or the non-application of a tax avoidance mechanism, to the fulfilment of certain requirements. . . . A connection between 'substance' and the application of certain rules for taxation purposes also exists in the field of transfer pricing, where the substance requirement generally has a twofold meaning: the rather traditional substance-over-form principle (whereby legal form can be disregarded to ensure taxation in line with the reality), and the determination of the appropriate functions, risks, and assets necessary to support a given intercompany transaction.[3]

According to the author, the substance-over-form principle enables the tax administration to depart from legal contracts in situations where contracts and conduct do not match. In such situations, the tax administration can "depart from written contracts so as to prioritise the conduct of the parties for the determination of the reality of an intercompany transaction, in such manner that the reality eventually lays the ground for setting the transfer prices."[4] Accordingly, contracts will be the starting point of the transfer-pricing analysis. A thorough analysis of the conduct of the parties will reveal the reality of a transaction and how roles and responsibilities are shared between the parties. When the contract and the conduct do not match, the tax administration can either adjust the transfer prices, so that they match the reality, or disregard the transaction and replace it with what is revealed by the accurate delineation of the transaction. The OECD guidelines accept the non-recognition of

3 At 149.

4 At 150.

transactions only if two conditions are met: (1) no similar transactions exist on the open market, and (2) the behaviour of the taxpayer is not commercially rational. The author notes that "recharacterising transactions to achieve commercial rationality is inevitably a subjective exercise, so the recommendation of the Guidelines is to stick as closely as possible to the facts when replacing one structure by another."[5]

The second implication of the substance requirement in transfer pricing is that the profit (or economic outcome) is connected to the actual substance as established through an analysis of the functions, risks, and assets of the parties. In other words, the transfer price and the resulting profit for each party is supported by the functions, risks, and assets.

The analysis above may clarify the two-pronged Canadian transfer-pricing rules—that is, the repricing rule under paragraphs 247(2)(a) and (c) and the recharacterizing or replacing rule in paragraphs 247(2)(b) and (d). For example, can the substance-over-form principle be adopted in the application of the repricing rule, as part of the process of delineating the actual conduct that directly bears on the pricing of the transaction?

JL

James Alm, J. Sebastian Leguizamon, and Susane Leguizamon, "Race, Ethnicity, and Taxation of the Family: The Many Shades of the Marriage Penalty/Bonus" (2023) 76:3 *National Tax Journal* 525-60

Sometimes a sharp distinction is drawn between the Canadian personal income tax system, which is based on individual filing, and the US system, in which married couples file jointly. However, because of the way that deductions and credits interact in the Canadian system and because our system includes such features as income splitting, the Canadian system is more "joint" than is sometimes acknowledged. The jointness is enhanced by other features of the tax-transfer system—in particular, perhaps, the guaranteed income supplement (GIS) for the older population, which has a clear marriage penalty.

All of this makes the US joint filing system (with its marriage penalties and, sometimes, marriage bonuses) interesting to Canadians. Two US individuals whose incomes are quite unequal may enjoy tax advantages by marrying. (It could be argued that this gives salary earners some of the same tax advantages as a family-owned firm.) This is also possible in Canada, but only in some circumstances and, typically, to a more limited extent. In the United States, however, if the two individuals with similar incomes marry, their total personal income taxes can increase. This is not the case in Canada.

The authors of this article find that in the United States, the two incomes of a black married couple are commonly closer to being equal than are the incomes of a white married couple. On average, the lower earner/higher earner income ratio within black US couples in 2019 was about 0.22 as opposed to about 0.18 for white

5 At 153-54.

US couples. For higher-earning couples (that is, a couple with a joint income that is greater than US$160,000), for whom the marriage bonus effects can be larger, the ratio is 0.28 for black couples as opposed to 0.16 for white couples. Therefore, given the realities of the US socioeconomic context, white couples are more likely than black couples to receive a marriage bonus. The authors are able to estimate the average difference in this regard between white couples and black couples for 2018. On average, white couples received a marriage bonus that was roughly US$800 larger than the bonus received by black couples. For the higher-income couples, defined as above (that is, couples whose joint income is greater than US$160,000), the difference is about US$1,500. For couples in the US$140,000 to US$160,000 joint income range, the difference is about US$800.

The authors do not advocate a race-based system. Indeed, their recommendations are quite restrained; they suggest that consideration should be given to changing the taxation unit back to the individual, but they view the fact that families with equal joint incomes would pay unequal taxes (as they would in Canada) as a negative feature of individual taxation. The authors do not mention what some see as a fairness advantage of individual taxation: lower-income spouses (somewhat more commonly women) do not have their tax rate determined by the incomes of higher-income spouses (more commonly men). Nor do the authors discuss what some see as the efficiency advantage of the Canadian system: the lower-earning spouse faces a lower marginal tax rate, which may encourage earning and may be one factor in the somewhat higher labour-force participation rate for married women in Canada than for married women in the United States. That said, the article provides an interesting perspective on the joint filing of personal income taxes, and it does so in a way that might lessen this system's attractiveness to many Canadians.

MV

Marie Connolly, Marie Mélanie Fontaine, and Catherine Haeck, "Child Penalties in Canada" (2023) 49:4 *Canadian Public Policy* 399-420 (https://doi.org/10.3138/cpp.2023-015)

Distinct from the marriage penalty or bonus that may be embedded in a legislated tax system and that may apply to both members of a couple, there exists what some perceive as a "labour market" penalty for childbearing. This article demonstrates that women who have children have lower incomes in the years after childbearing. (By way of disclosure, I edit the journal in which appeared this article and two others discussed below.)

The authors use the Longitudinal and International Study of Adults (LISA) to follow women and men from 5 years before the birth of their first child to 10 years after the child's birth. The original source of the income data in LISA is anonymized, longitudinal Canada Revenue Agency (CRA) tax data. Note that most of the analysis is not restricted to women who have only one child; some women have very young additional children 10 years after the birth of their first child, a factor in how one interprets the size of the income reduction.

The authors find that fathers' earnings are not affected by the birth of the child while women's earnings, not surprisingly, drop by about one-half in the year of birth. It is rather more surprising that, 10 years after the child's birth, the earnings reduction for women is still more than one-third. That is greater than the one-seventh reduction in employment after 10 years. This indicates that either employment hours per year or average wages, or both, have fallen for women who are employed. (It cannot be determined which has fallen, because the underlying tax data do not include information on hours worked.)

Interestingly, this study compares Quebec with the rest of Canada. It is estimated that Quebec mothers whose first child was born in 2001 or later (after the introduction of a set of family-friendly policies, including heavily subsidized child care) had a long-term reduction in income that was almost one-third less than the income reduction undergone by (1) Quebec mothers whose first child was born before 2001 and (2) mothers in the rest of Canada. However, the relevant LISA sample is not very large, and considerable variation exists: the results are not statistically significant. The authors note that Karademir, Laliberté, and Staubli, in their forthcoming article,[6] use the Canadian Intergenerational Income Database and the Longitudinal Administrative Databank to generate a larger sample and estimate a somewhat smaller but statistically significant "Quebec effect" in the income reduction experienced by mothers. I also note the more recent article by Lightman,[7] who finds evidence that the income reductions experienced in Canada by immigrant mothers after childbearing are even greater than the income reductions experienced by non-immigrants. The authors argue that this is particularly important for women who entered Canada under the caregiver program, because their talents are particularly needed in the labour market.

MV

Tanya Byker, Elena Patel, and Shanthi Ramnath, "Who Cares? Paid Sick Leave Mandates, Caregiving, and Gender" (2023) 76:3 *National Tax Journal* 649-77 (https://doi.org/10.1086/725876)

This article and the one reviewed next are taken from the September 2023 Forum on Gender and Public Policy in the *National Tax Journal*. It considers the effects of sick-leave mandates. From one perspective, perhaps, this is not a leading concern for tax policy. In principle, given the principle of horizontal equity, it could be argued that sick leave should be a taxable benefit, given that some earners have such a benefit while others do not. As a practical matter, it is unclear how the taxation of sick leave

6 Sencer Karademir, Jean-William Laliberté, and Stefan Staubli, "The Multigenerational Impact of Children and Childcare Policies," *Journal of Labor Economics* (forthcoming).

7 Naomi Lightman, "The High Costs of Caring: Measuring the Prevalence and Consequences of Birth-Related Career Interruptions for Immigrant Care Workers in Canada" (2024) 50:1 *Canadian Public Policy* 38-50 (https://doi.org/10.3138/cpp.2023-005).

would work, let alone whether it would be politically acceptable. The broad question is whether governments should try to increase sick-leave coverage among private-sector employees. The narrower tax policy question is whether such an increase would reduce productivity, incomes, and (as a result) tax revenues.

In answer to the broad question, a government's policy toward sick leave is to some extent a litmus test of its attitudes about the economy and thus about taxation and other policies. One view is that there should be no government intervention: employers and employees are best left to sort out their own arrangements. Given that employers cannot easily determine whether an employee is in fact sick, many employers may not provide such a benefit, and thus employees are left without protection. Another view is that at least some level of sick leave should be mandated. Government-mandated sick leave has the potential to reduce contagion both within the firm and within the population more generally. It may also reduce the stress of employees, with beneficial effects for both society and the health system. Some of this stress may be disproportionately borne by female employees who, in their private lives, are in caregiver roles.

This latter possibility is the starting point for the analysis in this paper. The introduction—on the basis of data regarding time use, provided by Valerie A. Ramey—points out that in the United States in 1950, women reported spending, on average, about 40 hours a week on "home production" (on housework, in other words, including child raising). That average had fallen to about 30 hours per week by 2010. This decline was paralleled by an increase in the hours of paid market work reported by women, which rose from an average of a little more than 10 hours per week to about 25 hours per week. Over the same time period, reported home production by men had increased from less than 10 hours a week to about 15 hours a week, while their market work decreased from close to 45 hours per week to less than 35 hours per week. Thus, while women still work longer hours and, even when employed, spend more time on home production than men do, the role of men in home production has increased, and one might expect that "family-friendly" policies, such as sick leave that permits caregiving, might have an important impact on labour force behaviour.

This is precisely what the authors find. Their empirical analysis is somewhat complicated; essentially, it compares the leave-taking behaviour of individuals in certain states (California, Colorado, Connecticut, Maryland, Massachusetts, New Jersey, New York, Oregon, Rhode Island, and Washington, as well as the District of Columbia) before the passing of sick leave mandates with the behaviour of these individuals after the passing of sick leave mandates. The authors use the behaviour of individuals in other states as controls. Using monthly employment data from the Current Population Survey, the authors find that mandates do not increase the likelihood of women or men taking leave for their own sickness, or the likelihood of women taking sick leave for caregiving purposes. But they do increase such leave-taking by men for caregiving purposes by an estimated 10 to 20 percent, with stronger effects for Hispanic men and less educated men. These are quite large estimated effects, given the authors' statement that roughly 60 percent of employees already had paid sick leave before the mandates and thus were presumably unaffected. The authors applaud the paid

sick leave mandates because their findings suggest that paid sick leave, in addition to reducing contagion, may ease the caregiving burden on women while widening their career opportunities by expanding the pool of jobs with paid sick leave. In principle, this may lead to higher productivity and higher incomes.

MV

Margaret E. Brehm and Olga Malkova, "The Child Tax Credit Over Time by Family Type: Benefit Eligibility and Poverty" (2023) 76:3 *National Tax Journal* 707-41 (https://doi.org/10.1086/725889)

This article begins by noting that in 2015, close to one-quarter of all American children under the age of 18 lived with single mothers. Single-mother households were almost twice as likely to live in poverty as married or cohabiting-couple households. The article then demonstrates that the US child tax credit (CTC), when introduced in 1998, had a minimal effect on the poverty of single mothers because it was largely unrefundable—that is, it could only reduce the amount of federal taxes owed and did not provide a refund if the credit exceeded the taxes owed. This made very low-income households ineligible for the credit. As reforms increased the CTC's refundability, its effectiveness in reducing poverty among this group increased. In 2018, the CTC doubled, with the phase-out threshold increased from US$110,000 to US$400,000 for married joint filers. However, although the refundable portion increased, it did not double. The overall effect was to reduce poverty for some people, but its relative effectiveness in reducing poverty among single mothers was not strengthened: refundability became more partial. Strikingly, the number of children lifted out of poverty by the doubled CTC increased by 90 percent for married and cohabiting families, but there was essentially no increase for single-mother families. The authors find that a fully refundable CTC would have almost entirely closed that gap.

The authors' exercise does not involve a balanced-budget criterion, but it seems apparent that if, at the same cost, the CTC headline amount had been increased by less while the refundable portion had been increased by more, the poverty-reducing effect on single-mother households would have been significantly greater. In the United States (and, I would argue, in Canada), the refundability of tax credits can be an important factor in reducing the most severe poverty, even if, as a consequence, the overall size of the credit needs to be reduced.

MV

Lucas Goodman, Katherine Lim, Bruce Sacerdote, and Andrew Whitten, "Automated Tax Filing: Simulating a Prepopulated Form 1040" (2023) 76:4 *National Tax Journal* 805-38 (https://doi.org/10.1086/726592)

In the United States as in Canada, the interest in reducing the burden of personal income tax filing has increased. The starting point of this article is US Internal Revenue Service estimates that average filers in 2019 spent US$210 and 11 hours to file their standard tax form. The article proceeds to explore the idea of automatically prepopulating the tax form with information already possessed by the IRS. This

system is already used in more than 45 countries. In the United Kingdom, about half of all taxpayers accept their prefilled return as accurate and make no alteration.

The authors' simulations are based on a random sample of 2019 tax returns for 358,800 individuals. They take the IRS third-party information returns for those individuals (assuming, effectively, that they would all be available in a timely fashion) and identify, on the basis of a previous return for that individual, the filer's dependants and their ages, the filing status of the individual, and the identity of any second filer. Using this information, the authors simulate a prepopulation of each of the individual tax returns.

They use two methods to score their results as failures or successes. The first involves the use of information returns. A failure may occur if the return is inaccurate because of what the authors call a "failure situation,"[8] where the prepopulation simulation misses credits by more than US$100 or misses income or deductions by more than US$500. This could occur if, for example, a new dependant (for example, a baby), a marriage, or a divorce is not accounted for, or if the taxpayer has income that is not on an information return or does not match the information return. (Missing or inaccurate income reports commonly occur when there is self-employment income.) A failure may also occur if the taxpayer claims a tax credit or deduction that is not covered by information returns. This means a likely failure for almost all itemizers, because there is no information return for state property taxes or charitable contributions. Using this method, the authors estimate a success rate of 48 percent.

The second scoring method uses a modified National Bureau of Economic Research Tax Simulation Model (NBER TAXSIM) tax calculator on each of the prepopulated returns. The return is counted as a success if the estimated tax liability is within US$100 of the tax-reported liability. Using this method, the authors estimate a success rate of 42 percent, although they note that a more sophisticated tax calculator might do better. The success rate of each method also increases by about 5 percent if it is assumed that the IRS had fully accurate information on filing status and dependants. The authors also show that the methods have higher success rates for lower incomes, although success rates are not convincingly more than 50 percent unless incomes are below US$15,000. With respect to non-filers, the authors estimate that there are 7.5 million non-filers who, although not required to file, would be owed refunds of US$390, on average, if they did.

It is not clear how encouraging this 42 to 48 percent estimated success rate is for a prepopulated return approach. A result whereby, say, 45 percent of returns were prepopulated successfully and thereby handled at low compliance and administrative cost, while the remaining 55 percent were handled as before, would indeed be a successful implementation. Quite possibly, however, some of the 55 percent will rely on the prepopulated returns they have been sent, and this may lead, in the case of errors, to messy exchanges between the IRS and individuals. In this regard, the authors consider the possibility of using the previous year's information to categorize tax-filers. They

8 At 811.

also note that, more often or not, the liabilities calculated by their simulation method exceed the liabilities on the actual tax returns. If the IRS instituted prepopulated returns with the same feature, the onus would be on individual filers to ensure that their returns were correct.

MV

Antoine Genest-Grégoire, Jennifer Robson, Saul Schwartz, and Josh Dadjo, "What Proportion of Tax Returns Could the Canada Revenue Agency Complete?" *Canadian Public Policy* (forthcoming)

This article considers the prepopulated-tax-return issue from a Canadian perspective. In Canada, the literature on the topic has considered the issue of non-filing in light of the fact that the Canadian system has many cash-transfer programs that operate through the personal income tax system. Robson and Schwartz[9] estimate that $1.7 billion worth of such benefits, for which the lowest-income Canadians are often eligible, were not distributed in 2015 because the potential beneficiaries did not file. Laurin and Dahir[10] use the Social Policy Simulation Database and Model (SPSD/M) of Statistics in their consideration of automatic filing, and they estimate that it might be a suitable approach for 32 percent of all filers. They conclude that without a simplification of the tax system, an automatic tax-filing system is less likely to reduce compliance costs than is the current system, which does have some auto-fill capability.

The article by Genest-Grégoire et al. uses the Longitudinal Administrative Databank to calculate directly the proportion of personal income tax returns that, in their view, would not be too complex for the CRA to complete for the taxfiler. They envision a system in which the CRA sends a completed tax return to the taxfiler, who either signs it in agreement or makes modifications. They estimate that the CRA's return would be more or less correct for about 29 percent of filers, which essentially confirms the Laurin-Dahir estimate.

But they depart from Laurin and Dahir in emphasizing that for lower-income individuals, including those whom the tax system might make eligible for cash-transfer benefits, the returns are typically less complicated. They estimate that the CRA could successfully complete returns for more than half of all families in the bottom 20 percent of the income distribution and for 60 to 88 percent of families who rely on provincial social assistance programs. They also estimate that up to 4.6 million of the returns submitted to the agency (1) are simple, (2) report income under $25,000, and (3) probably involved the payment of a fee for the preparation of the return or for the software needed to prepare the return. The authors argue that such returns

9 Jennifer Robson and Saul Schwartz, "Who Doesn't File a Tax Return? A Portrait of Non-Filers" (2020) 46:3 *Canadian Public Policy* 323-39 (https://doi.org/10.3138/cpp.2019-063).

10 Alexandre Laurin and Nicholas Dahir, *Automatic Tax Filing: A Challenging Idea for Canada*, C.D. Howe Institute Commentary no. 616 (Toronto: C.D. Howe Institute, 2022).

could be accurately completed by the CRA. I note that the fee itself may not be as important as the evidence that so many individuals find it so challenging to prepare their own returns, even in simple tax situations. This helps explain why some individuals do not file at all, even though, as a consequence, they miss important benefits that might materially improve their lives and the lives of their families.

MV

Youssef Benzarti and Luisa Wallossek, "Rising Income Tax Complexity" (2024) 77:1 *National Tax Journal* 143-73 (https://doi.org/10.1086/728586)

Continuing with the theme of prepopulating tax returns, I turn to an article titled "Administrative Burden in the Tax and Transfer System," from the *National Tax Journal*'s March 2024 Forum feature.

The authors begin with a survey of US taxpayers that is based on the platform Prolific. Thus, the sample is not random: participants were paid to do the survey, in this case US$12 an hour. Given that the average response took 3 minutes, the payment works out to about 60 cents per survey. The survey ran from July 10 to July 11, 2023. Respondents were screened to ensure that they (1) lived in the United States, (2) had English as their first language, (3) were older than 25, and (4) had full- or part-time employment status. The responses of those who did not usually file taxes were dropped. The final sample had 797 individuals, 85 percent of whom reported that they self-filed their tax returns—a process that could include paid-for tax-preparation software but not paid tax preparers. Perhaps surprisingly, this 85 percent appears to include fairly substantial representation from all income levels below US$150,000 and some representation from income levels equal or close to $150,000. The median salary of those in the 85 percent was in the US$60,000 to US$80,000 range, matching the US median household income of approximately US$71,000. The age range was 25 to 86, with an average of 41 years, and the sample was 55 percent male, 79 percent white, 8 percent African-American, and 5 percent Asian-American. According to the respondents' self-reports, the sample was slightly left-leaning.

The majority reported a perception that tax complexity and compliance costs have been increasing over time, with a stronger average response from those with more experience with taxes. More interestingly, perhaps, the majority reported that they would be willing to pay for the simplification of the system and the adoption of prepopulated returns. Respondents were given a scenario of an alternative tax system, with fewer deductions, that would save them 50 percent of their time (if they self-filed) or 50 percent of their money (if they paid tax preparers). The downside involved in the scenario was a higher tax bill. The answers to the survey implied an average willingness to pay US$130 for reduced complexity. An alternative scenario involved prepopulated forms. Here, there was an average willingness to pay US$77 for the advantages of prepopulated forms.

Political preferences did not appear to be a factor: across the political spectrum, tax filing was perceived as equally tedious, and respondents were consistently in

favour of simplification and prepopulation. However, conditional upon income, liberals were prepared to pay more for simplification and were more likely to believe that complexity encourages evasion and decreases fairness.

In the second part of the article, the authors study the changes over time in the word counts of the tax codes of Canada, France, Germany, Morocco, Switzerland, and the United States. Regarding Canada's tax code, the authors write the following: "We use the English version of the Income Tax Act. Historic versions are provided by the Canadian government for years 2004-2023.[11] For 2023, we use the latest available version, enacted in June 2023. We count words on the website."[12] For 2003, the word count for Canada's Act, according to the authors' graph, appears to be about 800,000 words. It rises fairly smoothly to about 1.3 million words by 2023. The authors do not compare word counts across countries, preferring to study changes over time within each country. Word counts rise substantially for all of the countries. It is interesting that the US tax code's word count rose from about 3.6 million to 4.5 million over the same period: many more words were added than were added to Canada's Income Tax Act, but the rate of increase, as a percentage of the whole, is actually slightly lower in the US case.

The authors also provide an interesting discussion of the increase, over the last 30 years, in the IRS administrative costs, which have risen by about US$40 per person in the United States. This cost has increased despite a reduction in the IRS workforce from over 110,000 to about 80,000 over that same period.

Furthermore, the authors provide what they call "suggestive evidence that an increasing tax complexity benefits the tax-preparation industry."[13] They also note that the "Biden administration recently mandated that the IRS implement a free filing option,"[14] and they suggest that "it will be interesting to see how this free filing option is implemented, whether it will compete with the nonfree tax-filing software, and whether it will affect tax filing and tax bills."[15]

MV

Marie Connolly and Catherine Haeck, "Intergenerational Income Mobility Trends in Canada" (2024) 57:1 *Canadian Journal of Economics* 5-26 (https://doi.org/10.1111/caje.12699)

Relatively low-income parents in Canada are more likely to have relatively low-income children, and relatively affluent parents are more likely to have relatively affluent children. This article examines whether this tendency has been changing over

11 Department of Justice Canada, "Income Tax Act (R.S.C., 1985, c. 1 (5th Supp.), Full Documents Available for Previous Versions)," *Justice Laws Website* (https://laws-lois.justice.gc.ca/eng/acts/I-3.3/PITIndex.html).

12 At 362.

13 At 171.

14 Ibid.

15 Ibid.

time. It uses Statistics Canada's Intergenerational Income Database, whose source data (anonymized personal income tax data) is used to match parental incomes with the incomes of their children. Parental income is defined as the average income for both parents (if present) during the period of time when their child is 15 to 19. This income is then converted to a ranking for that period of time in the overall income distribution. This ranking is then compared with the child's income ranking in the overall income distribution when the child is 27 to 31 years old and (where possible, given that the sample ended in 2016) when the child is 32 to 36 years old and, finally, 37 to 41 years old. The degree of persistence in the income status is then estimated by regressing the ranking of the child's income in any age category on the earlier observed parental income. In most analyses, the ranks are national, but provincial rankings are also explored.

The authors studied birth cohorts from 1963 to 1985, and their summary finding is that the degree of intergenerational income persistence (that is, the likelihood that an individual's income rank will be close to their parents') has increased over time. The change over time in the regression coefficients makes this clear, but an easily interpretable result is that over the 1963-1985 period, the estimated probability of someone born to parents with income in the bottom quintile remaining in that same bottom quintile has increased from 0.275 to 0.331. The trend is the same when provincial rankings are used. Manitoba and Saskatchewan stand out as the two provinces where this bottom-quintile persistence is strongest. The authors note that it is too early to observe whether the Quebec child-care reform, which affected children born in the early 2000s along with their parents, may have changed the strength of intergenerational income persistence.

The authors note that their result contrasts somewhat with that of Ostrovsky,[16] who found, using the same data source, that intergenerational income measures were stable over time. The biggest difference between the two studies appears to be that the Ostrovsky article used a measure that required a longer span of years to calculate each value. In consequence, the span of birth cohorts that could be included was shorter. Ostrovsky, therefore, included only birth cohorts from 1970 to 1984. Connolly and Haeck argue that their ability to include cohorts from 1963 to 1985 helped reveal a stronger trend.

MV

Syed M. Hussain and Lin Liu, "Macroeconomic Effects of Discretionary Tax Changes in Canada: Evidence from a New Narrative Measure of Tax Shocks" (2024) 57:1 *Canadian Journal of Economics* 78-107 (https://doi.org/10.1111/caje.12689)

This article combines time series econometrics with what is called the "narrative approach" to analyze the macroeconomic effects of "exogenous" tax changes in

16 Yuri Ostrovsky, *Doing as Well as One's Parents? Tracking Recent Changes in Absolute Income Mobility in Canada* (Ottawa: Statistics Canada, 2017).

Canada from 1960 to 2014. The problem with studying the macroeconomic effects of tax changes in general is that, although tax changes may influence GDP, it is also the case that GDP can affect measured variables that are used to measure tax revenues. For example, most increases in GDP cause incomes—and thus personal income tax revenue—to rise. For policy purposes, the authors want to study the effects of tax changes that originate in government decisions to change the system because of long-term goals. They call such proactive changes "exogenous." They give the example of a change made in the year 2000, when the government accelerated a plan to lower the corporate tax rates with a view to increasing investment, the capital stock, and (accordingly) the long-run performance of the economy. The authors distinguish such changes from what they call "endogenous" changes, which are reactions to short-run economic developments. An example that they provide is the cut in personal income taxes after the 1973 recession, which was intended to stimulate demand.

The narrative approach tries to identify these exogenous tax changes by studying government decisions and legislation directly. Federal budget documents are the authors' main narrative source, although economic and fiscal updates and economic statement and budget updates are also used. The authors argue that this approach is particularly appropriate for Canada because most of the fiscal changes occur during budget speeches, and thus the review exercise is somewhat contained. In Canada, budgets are also kept secret, which may reduce the amount of anticipatory change in economic activity that can occur in advance of the actual announcement. Tax changes are classified as exogenous if the budget states that they are motivated by (1) long-term considerations regarding debt, economic performance, or the fiscal health of the economy; or (2) political or philosophical reasons. The size of tax changes is taken from budget estimates.

This is painstaking work. I expect scholars in the area will analyze the authors' classifications carefully, but the step that comes after the classification step is fairly straightforward, at least conceptually. Regressions are run whereby the left-hand-side dependent variable is a current outcome variable—for example, tax revenues, government spending, interest rates, and output. The right-hand-side independent variables are lagged values of the exogenous tax variables along with other lagged variables that may affect the outcome variable. The authors estimate that an exogenous tax reduction reduces tax revenues (as one would expect), increases government spending (somewhat surprisingly), and increases interest rates. Their most important finding is that a tax cut in an amount equal to 1 percent of GDP leads to an immediate increase in GDP of over 2 percent, which builds to a total increase of 2.7 percent after three quarters before beginning to fade slowly. The GDP changes are driven by consumption and investment. Cuts in personal income taxes are found to have particularly strong effects. It is important, however, that the estimated expansionary effects from exogenous tax cuts were not statistically significant after 1991. The authors argue that this was caused by the interaction of these cuts with the contractionary spending policies adopted by governments concerned about long-term debt.

MV

Adam M. Lavecchia, "Family-Level Responses to the Introduction of Tax-Free Savings Accounts" (2024) 57:1 *Canadian Journal of Economics* 108-39 (https://doi.org/10.1111/caje.12690)

By way of disclosure, Adam Lavecchia is my colleague at McMaster University. He begins this article by noting that 13.5 million tax-free savings accounts (TFSAs) existed in Canada in 2016, only eight years after the introduction of TFSAs. The main research question is the extent to which TFSAs increase saving as opposed to providing an outlet for saving that would have occurred in any case but would have occurred through other savings vehicles.

The article takes advantage of an important institutional feature of TFSAs: an individual cannot have one before the age of 18. Using data on savings from the Survey of Financial Security for the years 1999, 2005, 2012, and 2016, the author examines the differences in savings between families whose youngest child is 18 to 20 and families whose oldest child is 15 to 17. Controlling for other variables, TFSAs would be judged to have had a demonstrable saving-increasing effect if (1) the savings of the former families are greater than the savings of the latter families and (2) that difference between child-old-enough families and child-too-young families was greater in 2012 and 2016, when TFSAs existed, than it was in 1999 and 2005, when TFSAs did not exist. This analysis is complemented with an additional analysis that uses the Longitudinal Administrative Databank (which provides anonymized personal income tax data) to examine changes in holdings in TFSAs and other registered savings accounts when a child turns 18.

The overall finding is that a $1 increase in family TFSA balances lowers other financial asset holdings by only 25 to 45 cents, which indicates that TFSAs increase overall saving. There is no statistically significant effect on other tax-deferred accounts, such as registered retirement savings plans. The article concludes that having an additional family member eligible to open a TFSA increases family savings.

MV

Trevor Tombe, "The Alberta Pension Advantage? A Quantitative Analysis of a Separate Provincial Plan" (2024) 50:1 *Canadian Public Policy* 1-19 (https://doi.org/10.3138/cpp.2023-044)

This article is a response to recent investigations by the government of Alberta into the possibility of Alberta seceding from the Canada Pension Plan (CPP) and operating its own pension plan. In particular, a report by the private provider LifeWorks[17] suggested that an Alberta pension plan (APP) could have a contribution rate of 5.9 percent, much lower than the CPP contribution rate of 9.9 percent. Tombe finds instead that an APP rate for a plan comparable to the CPP would probably require a higher contribution rate of 8.6 percent. He also points out various risks. Besides

17 LifeWorks, *Alberta Pension Plan—Analysis of Costs, Benefits, Risks and Considerations: Report from LifeWorks* (Edmonton: Alberta Treasury Board and Finance, 2023).

possibly increased investment risks, about two-thirds of the differential depends on the in-migration to Alberta of younger workers.

As the author points out, the essential difference between his analysis and that of LifeWorks is how one interprets language in the Canada Pension Plan Act regarding how to distribute the surplus in the case of a province leaving the CPP. LifeWorks finds that Alberta would be entitled to over one-half of the CPP assets, or about $300 billion. The author argues that a more reasonable interpretation of the Act reduces that amount to $110 billion. (I commend to the interested reader the article's detailed discussion of these issues on pages 10 to 11.) While the Act does not appear to be clear, one notable point is that it makes the federal minister of finance responsible for making the calculation (with the courts, presumably, responsible for judging the reasonableness of the calculation). A second notable point is that the method of division was much clearer when the plan held only provincial (and, potentially, some federal) bonds. At that time, the returns to a separating province amounted to merely the returning of the amount that the province had paid in. But the rules were not re-clarified with the reforms in the 1990s, which expanded the range of eligible assets and, as a consequence, increased returns, and it is, in part, the division of the returns that complicates the dispute. Also noteworthy is Professor Tombe's finding that if the LifeWorks approach gives Alberta 50 percent of the assets used, and British Columbia and Ontario decide to leave on the same terms, more than all of the assets (specifically, 128 percent) would need to be paid out by the plan. It could be argued that the courts—given the imprecision in the Act, which Tombe's article discusses—would be unlikely to choose an interpretation with that implication.

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