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CANADIAN TAX JOURNAL
REVUE FISCALE CANADIENNE

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Transparency, Trust, Transnationality, and Tax Compliance: Lessons from Google's Financial Reporting Practices in New Zealand — *Victoria Plekhanova*

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Current Tax Reading — *Jinyan Li and Michael Veall*

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Thomas Schneider Community Impact Research Award

The Canadian Tax Foundation congratulates Alan Macnaughton—along with his co-author, Amin Mawani (Professor of Taxation at York University's Schulich School of Business)—on being awarded the inaugural Thomas Schneider Community Impact Research Award by the Canadian Academic Accounting Association, at its annual conference in Toronto on June 14, 2025. This very impressive award (their research was selected from among all Canadian accounting research published in the last 25 years) was for the following article:

- Alan Macnaughton and Amin Mawani, "Contributions of Employee Stock Options to RRSPs and TFSAs: Valuation Issues and Policy Anomalies" (2008) 56:4 *Canadian Tax Journal* 893-922.

The article's importance for the Canadian community was shown by the government's response to its publication. When TFSAs were first introduced in 2009, the CRA's statements on the new savings tool were interpreted as allowing unlimited contributions of employee stock options—potentially enabling the tax-free sheltering of millions of dollars of investments. This outcome was widely viewed as inappropriate and unfair. The CRA, recognizing the unfairness, notified the authors that this interpretation of its past public statements was inconsistent with Canadian income tax law, and it invited the authors to publish a clarifying addendum: "Addendum—CRA: Employee Stock Options and TFSAs" (2009) 17:5 *Canadian Tax Highlights* 10. Together, the two publications alerted both government and public to a loophole in the TFSA rules and likely prevented its exploitation before such arrangements became widespread.

Prix Thomas Schneider pour la recherche avec impacts communautaires

La Fondation canadienne de fiscalité félicite Alan Macnaughton et son coauteur, Amin Mawani, professeur de fiscalité à la Schulich School of Business de l'Université York, d'avoir remporté le tout premier Prix Thomas Schneider pour la recherche avec impacts communautaires, décerné par l'Association canadienne des professeurs de comptabilité lors de sa conférence annuelle à Toronto le 14 juin 2025. Ce prix impressionnant (leur article de recherche a été choisi parmi toutes celles qui ont été publiées au Canada au cours des 25 dernières années) s'adressait à leur article intitulé :

- Alan Macnaughton et Amin Mawani, « Contributions of Employee Stock Options to RRSPs and TFSAs: Valuation Issues and Policy Anomalies » (2008) 56:4 *Revue fiscale canadienne* 893-922.

L'importance de cet article pour la communauté canadienne a été démontrée par la réponse du gouvernement à sa publication. En effet, lors de l'introduction du CELI en 2009, les énoncés de l'ARC sur ce nouveau véhicule de placement ont été perçus comme permettant des contributions illimitées pour les options d'achat d'actions des employés. Cette interprétation aurait pu entraîner l'exonération fiscale de millions de dollars d'investissements. Les auteurs ont jugé ce résultat comme étant inapproprié et inéquitable. L'ARC a reconnu l'injustice et a informé les auteurs que son interprétation de ses déclarations précédentes ne correspondait pas à la législation fiscale canadienne. Elle leur a demandé de publier un addendum pour clarifier la situation : « Addendum : L'ARC et l'évaluation des Options d'achat d'actions versées dans les CELI des employés » (2009) 17:5 *Faits saillants en fiscalité canadienne* 12. Grâce à leurs efforts combinés, ces deux publications ont alerté le gouvernement et le grand public sur un moyen de contourner les règles du CELI. Elles ont donc probablement évité que cette pratique ne se répande davantage.

Call for Book Proposals

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:

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

Michael Lubetsky
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 :

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

Michael Lubetsky
a/s Canadian Tax Foundation / Fondation canadienne de fiscalité

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

JOURNÉE D'ÉTUDES FISCALES
Montreal and via webcast, May 29, 2025

WOMEN IN TAX TORONTO NETWORKING EVENT
Toronto, June 24, 2025

PRAIRIE PROVINCES TAX CONFERENCE & LIVE WEBCAST
Calgary and via webcast, June 2-3, 2025

YOUNG PRACTITIONER FOCUS CONFERENCE
Virtual, September 3, 2025

BRITISH COLUMBIA TAX CONFERENCE & LIVE WEBCAST
Vancouver and via webcast, September 15-16, 2025

TAX POLICY SYMPOSIUM AND WEBCAST
October 3, 2025

ONTARIO TAX CONFERENCE & LIVE WEBCAST
Toronto and via webcast, October 27-28, 2025

ATLANTIC PROVINCES TAX CONFERENCE
Halifax, November 7-8, 2025

77TH ANNUAL TAX CONFERENCE
Calgary, November 30-December 2, 2025

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

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■ Canadian Tax Journal

INVITATION TO SUBMIT

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

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

PEER REVIEW

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

SUBMISSION DETAILS

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

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

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

POLICY FORUM CONTRIBUTIONS

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

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

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

ACCESSING THE JOURNAL

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

The *Canadian Tax Journal* is also indexed in 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.

MEMBERSHIP

Membership in the Foundation is open to all who are interested in its work. Membership fees are $468.00 a year, except that special member rates apply as follows: (a) $229.00 for members of the accounting and legal professions in the first three years following date of qualification to practise; (b) $229.00 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) $197.00 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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Toute personne intéressée aux travaux de la FCF peut en devenir membre. Les droits d'adhésion sont de 468,00 $ par année, à l'exception des tarifs spéciaux suivants : a) 229,00 $ pour les personnes faisant carrière en comptabilité ou en droit pendant les trois premières années suivant leur admission à la profession; b) 229,00 $ pour le personnel enseignant à temps plein dans un collège, une université ou une autre maison d'enseignement; c) gratuite pour les étudiants fréquentant à temps plein une maison d'enseignement reconnue; et d) 197,00 $ pour les personnes qui ont 65 ans et plus et qui ne travaillent plus activement en fiscalité. La période d'adhésion est de 12 mois, à compter de la réception de la demande accompagnée du paiement approprié.

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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Transparency, Trust, Transnationality, and Tax Compliance: Lessons from Google's Financial Reporting Practices in New Zealand

Victoria Plekhanova*

PRÉCIS

En prenant pour exemple la Nouvelle-Zélande, cet article discute de l'influence de la transparence fiscale sur la confiance du public dans les institutions gouvernementales, la confiance dans le secteur privé et la confiance sociale entre contribuables; il met tout particulièrement l'accent sur les défis de l'imposition du revenu des multinationales et son incidence sur l'observation fiscale volontaire des particuliers dans un État providence où l'économie est ouverte. À partir des théories du choix rationnel et de l'action collective, ainsi que des résultats d'études empiriques sur la psychologie de la coopération, l'article montre que l'observation fiscale, bien qu'elle semble être un choix individuel, est fondamentalement une action collective basée sur la confiance envers les autres contribuables et les institutions gouvernementales. L'article avance que pour avoir confiance, un contribuable raisonnable doit avoir accès à de l'information comparable sur les contributions des autres contribuables et à de l'information sur les réponses du gouvernement à la non-observation fiscale. Si la confiance sociale peut encourager l'observance des personnes résidentes d'une juridiction fiscale définie, cette confiance ne s'étend pas aux non-résidents et aux sociétés. Qui plus est, par défaut, les contribuables perçoivent ces non-membres avec méfiance et exigent donc davantage d'information à propos du comportement fiscal des non-membres et de réponses du gouvernement à l'égard des comportements répréhensibles.

L'article analyse deux structures institutionnelles nationales de la Nouvelle-Zélande — le régime fiscal et le régime de communication de l'information financière — ainsi qu'une étude de cas des pratiques de communication de l'information financière de Google au pays. L'analyse révèle comment trois facteurs clés créent et perpétuent un déficit d'information fiscale et sapent l'intégrité du régime fiscal et l'observation fiscale volontaire des particuliers : le manque de coordination entre le régime fiscal et le régime de communication de l'information financière; le manque de transparence quant au rendement institutionnel des administrateurs fiscaux;

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et l'insuffisance des mécanismes devant dissiper la méfiance du public à l'égard des multinationales. Les conclusions soulignent la nécessité de réviser le cadre de réglementation de la Nouvelle-Zélande relativement à la gestion et à la divulgation d'information fiscale, en particulier au regard des multinationales qui exercent des activités au pays. Ces conclusions peuvent s'appliquer à d'autres pays, comme le Canada, qui protègent la confidentialité de l'information fiscale des sociétés.

ABSTRACT

Using New Zealand as an example, this article discusses how tax transparency influences public trust in governing institutions, trust in the private sector, and social trust among taxpayers, with a particular emphasis on the challenges of the corporate income taxation of multinational enterprises and its impact on the voluntary tax compliance of individuals in an open-economy welfare state. Drawing on rational choice and collective action theories, along with the results of empirical research on the psychology of cooperation, the article demonstrates that tax compliance, while appearing to be an individual choice, is fundamentally a collective action dependent on trust in fellow taxpayers and in governing institutions. The article argues that to develop trust, a rational taxpayer requires access to comparable information about other taxpayers' contributions and to information about the government's responses to tax non-compliance. While social trust may drive compliance of people residing within a defined tax jurisdiction, this trust does not extend to non-residents and corporate entities. Furthermore, the default perception of these non-members is rooted in distrust, which increases the demand for information about non-members' tax behaviour and the government's responses to any misbehaviour.

The article analyzes two domestic institutional structures in New Zealand—the tax system and the financial reporting regime—alongside a case study of Google's financial reporting practices in the country. The analysis reveals how three key factors create and perpetuate a tax information deficit and undermine the tax system's integrity and the voluntary tax compliance of individuals: insufficient coordination between the tax system and the financial reporting regime, limited transparency in the institutional performance of tax administrators, and inadequate mechanisms for addressing the public distrust of multinational enterprises. The findings emphasize the need to revise New Zealand's regulatory framework for managing and disclosing tax-related information, particularly regarding multinationals operating within the country. These findings are relevant to other countries, including Canada, that protect the confidentiality of corporate tax information.

KEYWORDS: TRANSPARENCY ■ PUBLIC TRUST ■ SOCIAL TRUST ■ COMPLIANCE ■ FINANCIAL REPORTING ■ GOOGLE

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Neither theory nor evidence provides much support for the hypothesis that fuller and more timely disclosure and discussion would have adverse effects.

Joseph E. Stiglitz, 1999[1]

INTRODUCTION

Canada and New Zealand have a long tradition of protecting the tax information of individuals and corporate taxpayers, where only court proceedings and decisions are made public while tax returns, assessments, and tax audits remain confidential.[2] Tax policy in both countries views the non-disclosure of taxpayers' information to the public as a necessary condition of voluntary tax compliance, on the assumption that taxpayers will be unwilling not only to disclose their tax information to tax authorities, but also to comply with their tax obligations, if the disclosed information is made public. These views prevail worldwide, despite the fact that the United States and many Scandinavian countries, for example, require some type of public disclosure of tax information.[3]

1 Joseph E. Stiglitz, "On Liberty, the Right To Know, and Public Discourse: The Role of Transparency in Public Life," January 27, 1999, at 20 (http://documents.worldbank.org/curated/en/436941546609601734).

2 For New Zealand's approach and its evolution, see Georgia Bellett, "A New Approach to Tax Secrecy: Does a Move Toward Taxpayer Confidentiality Pose a Threat to the Integrity of the Tax System?" (bachelor dissertation, University of Otago, Faculty of Law, 2017). For a detailed overview of Canada's approach, see Allison Christians, "Country Report: Canada," in Eleonor Kristofferson, Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer, and Alfred Storck, eds., *Tax Secrecy and Tax Transparency: The Relevance of Confidentiality in Tax Law*, part 1 (Frankfurt: PL Academic Research, 2014), 209-40.

3 Eleonor Kristofferson and Pasquale Pistone, "General Report," in Kristofferson et al., supra note 2, at 22. See also Miranda Stewart, "Transparency, Tax, and Human Rights," in Philip G. Alston, and Nikki R. Reisch, eds., *Tax, Inequality, and Human Rights* (Oxford, UK: Oxford University Press 2019), 237-58, at 246-47 (https://doi.org/10.1093/oso/9780190882228.003.0011); and Makoto Hasegawa, Jeffrey L. Hoopes, Ryo Ishida, and Joel Slemrod, "The Effect of Public Disclosure on Reported Taxable Income: Evidence from Individuals and Corporations in Japan" (2013) 66:3 *National Tax Journal* 571-607, at 571 (https://doi.org/10.17310/ntj.2013.3.03).

The reasons for protecting the tax information of individuals[4] are very different from the reasons that are usually marshalled against the mandatory disclosure of corporate income tax returns.[5] When it comes to multinational enterprises, support for keeping the details of corporate income tax returns secret is at odds with the growing demand for the tax transparency of multinationals, the rise of international tax disclosure regimes,[6] and domestic initiatives toward transparency in some countries.[7] Advocacy is increasing for both the transparency of governing entities in their responses to corporate tax avoidance and the public disclosure of country-by-country reports.[8] Disclosure of the tax information of multinationals is viewed as "part of a well-functioning democratic process" that "enables media, civil society organisations and the public to hold large multinational corporations to account."[9] A tradition of protecting the tax information of corporate taxpayers is also at odds with a general-purpose financial reporting regime, as exists in New Zealand, Canada, and many other countries, that requires the public disclosure of certain tax information by some companies. At a more general level, this article also argues that a taxpayer's right to confidentiality of their tax information conflicts with their need to know whether or not other taxpayers are paying their taxes.

Scholarly discussions tend to ignore these tensions and instead focus on the effects of the public disclosure of tax information on the tax compliance of multinationals,

4 For a detailed discussion of the benefits and detriments of public disclosure of individual taxpayer information, see Ken Devos and Marcus Zackrisson, "Tax Compliance and the Public Disclosure of Tax Information: An Australia/Norway Comparison" (2015) 13:1 *eJournal of Tax Research* 108-29.

5 See, for example, David Lenter, Joel Slemrod, and Douglas Shackelford, "Public Disclosure of Corporate Tax Return Information: Accounting, Economics, and Legal Perspectives" (2003) 56:4 *National Tax Journal* 803-30, at 803 (https://doi.org/10.17310/ntj.2003.4.06).

6 Diane M. Ring, "Corporate Migrations and Tax Transparency and Disclosure" (2017) 62:1 *Saint Louis University Law Journal* 175-92.

7 For example, Australia has been a strong supporter of tax transparency of large companies for many years and, as of July 1, 2024, it has a public country-by-country tax transparency regime. See Parliament of Australia, "Treasury Laws Amendment (Responsible Buy Now Pay Later and Other Measures) Bill 2024," schedule 4 (www.aph.gov.au/Parliamentary_Business/Bills_LEGislation/Bills_Search_Results/Result?bId=r7199). See also Australian Government, Department of Treasury, "Taxation Administration (Country by Country Reporting Jurisdictions) Determination 2024" (www.legislation.gov.au/F2024L01713/asmade/text).

8 Ring, supra note 6, at 188. For advocacy in New Zealand, see Oxfam Aotearoa, "Four Crucial Benefits of Tax Transparency in New Zealand," October 25, 2018 (www.oxfam.org.nz/news-media/blog/benefits-of-tax-transparency-in-nz). For dissatisfaction of the Canadian public with Canada's international tax policy and its willingness to "name and shame" companies avoiding tax, see Allison Christians, *Taxing Transnationals: Canada and the World*, Canada in International Law at 150 and Beyond Paper no. 15 (Waterloo, ON: Centre for International Governance Innovation, March 2018), at 8.

9 Oxfam Aotearoa, supra note 8.

and therefore overlook the impact of disclosure (or non-disclosure) on the tax compliance of individuals. As a result, the reasons behind a tax gap—that is, "a difference between the potential tax revenue and actual tax revenue"[10]—are not fully understood. While New Zealand does not report its tax gap,[11] recent research suggests that the self-employed in New Zealand underreport their income on average by about 20 percent.[12] According to Australian tax authorities, not-in-business individuals and non-corporate small businesses are the main contributors to the tax gap in Australia.[13]

This article lays theoretical grounds for future empirical research on the effects of transparency on individuals' voluntary tax compliance—specifically, transparency about the tax paid by multinational enterprises and the government's responses to any real or perceived non-compliant behaviour of multinationals. The article establishes the link between transparency and tax compliance, and explains the extent to which this link is mediated by the concept of "trust" in situations in which some taxpayers are members of the same social group but others are not. It focuses on a particular type of outgroup member—multinational enterprises—and argues that the presence of multinationals puts more pressure on governments to be transparent about their dealings with them and to demand that multinationals be more transparent about the taxes they pay. This transparency is a condition for building the trust that motivates individual taxpayers' voluntary tax compliance.

The discussion proceeds as follows. After establishing the link between transparency and tax compliance, the article looks at institutional settings in New Zealand to explain how they contribute to the tax information deficit and limit the visibility of the tax affairs of multinationals. It then illustrates how these settings were used by Google in its financial reporting in New Zealand, prior to suggested changes to New Zealand's regulatory framework for managing and disclosing corporate tax information regarding multinationals operating in the country. The article's theoretical argument is informed by analyses of documents and literature selected for their relevance to the purpose of the inquiry.

10 Organisation for Economic Co-operation and Development, *Tax Administration 2024: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris: OECD, 2024), at 182.

11 Asian Development Bank, *A Comparative Analysis of Tax Administration in Asia and the Pacific*, 7th ed. (Metro Manila, Philippines: ADB, 2024), chapter 3. See also OECD, supra note 10, chapter 11.

12 Ana Cinta G. Cabral and Norman Gemmell, *Estimating Self-Employment Income-Gaps from Register and Survey Data: Evidence for New Zealand*, Working Papers in Public Finance 07/2018 (Wellington, NZ: Victoria University of Wellington, 2018), at 2.

13 Australian Taxation Office, "Tax Gap Program Summary Findings" (www.ato.gov.au/about-ato/research-and-statistics/in-detail/tax-gap/australian-tax-gaps-overview/tax-gap-program-summary-findings).

TAX TRANSPARENCY, VOLUNTARY TAX COMPLIANCE, AND TRUST

Transparency and Voluntary Tax Compliance

The concept of transparency is used in many tax contexts and generally means transparency of information. However, as Stewart has observed, "*who* is transparent, concerning *what* data, process, or outcomes, for what *purpose* transparency is advocated, *how* transparency is achieved, and how it is *intended to achieve* the stated purpose, differ depending on the context."[14]

Discourses about tax transparency focus on either *transparency of the people to governments* (and to the public by some form of media or broad disclosure), or "*transparency of governments to the people*."[15] Discussions of the disclosure of corporate income tax information usually appear in discussions of transparency of the people to governments, but, as this article argues, the issue of disclosure of tax information is related to both types of transparency, and in some tax contexts we can even talk about *transparency of the people or corporate structures to the people*. Both are linked to the collective nature of taxation, but *transparency of the people to the people* is related to social trust, whereas *transparency of corporate structures to the people* is premised on the idea of social responsibility.

While the link between tax transparency and voluntary tax compliance is recognized in policy and scholarly debates, it has not been thoroughly analyzed. As explained below, under the heading "Trust in a Tax Policy Context," this link is established through the notion of trust, but the type of trust depends on the circumstances.

There is no consensus on the benefits of tax transparency generally, or in relation to tax compliance specifically. This lack of consensus often arises from empirical findings that tax compliance correlates with, among other things, people's perception of the rate of compliance by other people (so-called conditional cooperation).[16] On the one hand, making tax non-compliance more visible might create a norm of non-compliance.[17] On the other hand, making tax compliance more visible should encourage more compliance. The latter view enjoys much better empirical support. In Norway, for example, a combination of the public disclosure of tax filings and their online availability to anyone who has access to the Internet resulted in an increase in reported business income.[18]

14 Stewart, supra note 3, at 248 (emphasis added).

15 Ibid., at 238-39 (emphasis added).

16 Bruno S. Frey and Benno Torgler, "Tax Morale and Conditional Cooperation" (2007) 35:1 *Journal of Comparative Economics* 136-59 (https://doi.org/10.1016/j.jce.2006.10.006).

17 For more detail, see Eyal Zamir and Doron Teichman, *Behavioral Law and Economics* (New York: Oxford University Press, 2018), at 448.

18 Erlend E. Bø, Joel Slemrod, and Thor O. Thoresen, "Taxes on the Internet: Deterrence Effects of Public Disclosure" (2015) 7:1 *American Economic Journal: Economic Policy* 36-62.

Another reason for disagreement about the effects of tax transparency on voluntary tax compliance arises from the narrow approach taken to tax transparency. When tax transparency is viewed only as *transparency of the people to governments*, discussions tend to revolve around the effects of the public disclosure of tax information on the behaviour of the taxpayer whose information is disclosed. The difficulty of measuring these effects adds to the disagreement. The disagreement is broad, but for the purposes of this article, only the issue of the disclosure of corporate income tax information generally, or in relation to multinationals, is relevant to the discussion. This issue has been the subject of scholarly and tax policy debates in many countries. Empirical studies of the effects of this disclosure, including its impact on tax compliance, are rare and come to different conclusions.[19] The main reason for this is that tax compliance (or non-compliance) is influenced by many factors; this diversity and the interplay between factors make it difficult to establish a direct link between the public disclosure of tax information and its effects on tax compliance.[20]

Some scholars argue against full mandatory disclosure of corporate income tax information because it may "cause companies to dilute the information content of these returns, hampering tax enforcement, and might, even in diluted form, reveal proprietary information that could provide a competitive advantage to those companies that are not required to make such a disclosure."[21] However, limited mandatory disclosure is supported—in particular, because it will "contribute to the transparency of the tax system by clarifying the tax payments of corporations in and of themselves, relative to other corporations, and relative to the income they report on their financial statements."[22] Increased transparency could "put pressure on legislators to improve the tax system," "induce corporations to resist aggressive tax reduction strategies," and "contribute to better functioning of financial markets if it sheds new light on the information presented in financial statements."[23] Greater transparency could also increase the motivation of the particular revenue agency to collect revenue; lead to better compliance behaviour by tax-reporting taxpayers; educate the public about corporate tax compliance, including why some companies might legitimately pay no tax in a particular year; and operate as an indirect accountability check on the government.[24] This article argues that such transparency is also

19 See, for example, Jeffrey L. Hoopes, Leslie Robinson, and Joel Slemrod, "Public Tax-Return Disclosure" (2018) 66:1 *Journal of Accounting and Economics* 142-62 (https://doi.org/10.1016/j.jacceco.2018.04.001).

20 For a detailed summary of these factors, see James Alm, "Devising Administrative Policies for Improving Tax Compliance" (2022) 70, supplement *Canadian Tax Journal* S43-67, at S46-54. See also Erzo F.P. Luttmer and Monica Singhal, "Tax Morale" (2014) 28:4 *Journal of Economic Perspectives* 149-68.

21 Lenter et al., supra note 5.

22 Ibid.

23 Ibid.

24 Stewart, supra note 3, at 248.

important for improving the tax compliance of individual taxpayers and reducing the tax gap.

Voluntary Tax Compliance and Its Drivers

Voluntary tax compliance is a behaviour with social and legal implications. It is a response, in the form of conformity, to legal regulations and social influence. This response is usually motivated by a desire to gain a reward or avoid a punishment.[25] Both the rewards and the punishments can be social or legal. Accordingly, for a taxpayer, the social implications of their behaviour can be internal (in this case, coming from members of the same social group) or external. The internal social implications of tax compliance operate only among members of a social group. Non-members, it can be argued, can be motivated only by external social or legal rewards and punishments, and only if the probability of these rewards and punishments is high enough.[26] External social rewards and punishments can come from customers or current or potential investors, if these customers or investors are humans and are interrelated. While the rewards and punishments are social in nature because they come from a group of people, they are external in their form because their target is not a member of a social group. The probability of external social rewards and punishments may be subject to many factors and therefore can be difficult to predict. The probability of legal rewards and punishments, in turn, depends on the quality of laws that define these rewards and punishments, and on the functionality of the institutions that apply these laws. The socio-legal nature of voluntary tax compliance, and the role that social groups can play in it, explain a complex relationship between such compliance and its drivers. This article focuses on one of these drivers—trust.

Trust in a Tax Policy Context

Voluntary tax compliance is not only "a crucial component of both the fairness and the integrity of the tax system,"[27] but also an outcome of such fairness and integrity. A perception that a tax system is unfair is a common reason for tax non-compliance.[28]

25 Elliot Aronson, *The Social Animal*, 11th ed. (New York: Worth, 2012), at 35.

26 In particular, empirical findings support the correlation between the probability of being caught and tax evasion. See Jonathan Shaw, Joel Slemrod, and John Whiting, "Administration and Compliance," in James A. Mirrlees, Stuart Adam, Timothy Besley, Richard Blundell, Stephen Bond, Robert Chote, Malcolm Gammie, Paul Johnson, Gareth Myles, and James Poterba, eds., *Dimensions of Tax Design: The Mirrlees Review* (Oxford, UK: Oxford University Press, 2010), 1100-162, at 1116.

27 Lisa Marriott, "Tax and Transparency: Why Is There No Tax Gap Estimation in Aotearoa New Zealand?" (2023) 29:4 *New Zealand Journal of Taxation Law and Policy* 367, at 368-69.

28 Chris Evans and Sally-Ann Joseph, "General Report," in Chris Evans et al., ed., *Improving Tax Compliance in a Globalized World* (Amsterdam: IBFD, 2018), chapter 1, at 1.7.2.

This perception, it can be argued, fundamentally depends on the existence or non-existence of taxpayers' trust, which in turn depends on transparency. Like transparency, trust has many meanings.[29] It is a context- and object-specific concept,[30] which makes it at times appear "ambiguous and fuzzy."[31]

In a policy context, trust is often analyzed through the lens of rational choice theory, and is viewed as an instrument for facilitating good governance and institutional trustworthiness and enabling citizens' cooperative behaviour and compliance with governmental decisions.[32] Empirical research also suggests that "investment and growth improve with trust."[33] Trust can play a cost-saving role as well. When most tax revenues are collected voluntarily, any efforts to build and maintain trust have very strong economic implications, because the deterioration of trust may increase the cost of enforcing tax obligations.

Trust, as a condition of voluntary tax compliance, is usually discussed from the single-state and single-taxpayer perspectives. A state appears to exist in isolation from other states, and the collective nature of domestic taxation tends to be ignored. Such discussions tend not to distinguish residents from non-residents, and individuals from corporate taxpayers, and usually regard the tax system as being independent from other domestic regulatory institutions and regimes. As a result, the role of trust in tax compliance and the conditions for its formation are often misunderstood.

Three types of trust are important for voluntary tax compliance: social trust, public trust, and trust in the private sector. Social trust is trust between members of a particular community—for example, a state—and is seen as essential for social cohesion, integration, and stability.[34] It is a cultural phenomenon,[35] and is linked to cognitive mechanisms concerning trustworthiness.[36] Social trust is foundational to

29 *American Heritage Dictionary of the English Language* (https://ahdictionary.com), entry "trust."

30 Kenneth Newton, Dietlind Stolle, and Sonja Zmerli, "Social and Political Trust," in Eric M. Uslaner, ed., *The Oxford Handbook of Social and Political Trust* (New York: Oxford University Press, 2018), 37-56, at 39 (https://doi.org/10.1093/oxfordhb/9780190274801.013.20).

31 This comment is related to the use of the concept of "trust" in the public sector literature. See Dorothea Greiling, "Accountability and Trust," in Mark Bovens, Robert Goodin, and Thomas Schillemans, eds., *The Oxford Handbook of Public Accountability* (Oxford, UK: Oxford University Press, 2014), 617-31, at 617.

32 Seok-Eun Kim, "The Role of Trust in the Modern Administrative State: An Integrative Model" (2005) 37:5 *Administration & Society* 611-35, at 612.

33 Paul J. Zak and Stephen Knack, "Trust and Growth" (2001) 111:470 *Economic Journal* 295-321, at 317.

34 Newton et al., supra note 30, at 38.

35 Christian Bjørnskov, "The Political Economy of Trust," in Roger D. Congleton, Bernard Grofman, and Stefan Voigt, eds., *The Oxford Handbook of Public Choice*, vol. 1 (New York: Oxford University Press, 2019), 628-48, at 644 (https://doi.org/10.1093/oxfordhb/9780190469733.013.32).

36 Staffan Kumlin, Isabelle Stadelmann-Steffen, and Atle Haugsgjerd, "Trust and the Welfare State," in *The Oxford Handbook of Social and Political Trust*, supra note 30, 385-408, at 400.

voluntary tax compliance; it is underpinned by the belief that fellow taxpayers will pay their fair share of tax, thereby reducing the risk of free riding.[37]

Trust in others is high in New Zealand.[38] Empirical research suggests that societies where social trust is high have relatively small underground economies, with taxpayers in these societies being less likely to cheat on taxes, and tax authorities being less corrupt and more efficient.[39] Like many other countries, New Zealand is a welfare state. In welfare states, social trust makes the universal welfare system more sustainable and allows equality to coexist with wealth.[40] Social trust also reduces the need for strong formal enforcement institutions. This is why the degree of social trust (or distrust) is often reflected in the enforcement behaviour of such formal institutions.[41] For example, New Zealand promotes the encouragement and education of taxpayers, including at schools,[42] and prioritizes the settling of tax disputes over their formal resolution through the court system.[43]

Strong formal enforcement institutions may not be necessary in a society where social trust is high, because the moral cost of non-compliance in such a society is also high, and can drive the voluntary tax compliance of social group members. As a social phenomenon, however, social trust exists only between members of a social group.[44] Moreover, trust is a feeling and hence can motivate only people. It can therefore be argued that the idea of social trust is relevant only to those individuals who reside in the state. Time spent in that state allows for the building of connections

37 For a literature overview in support of this assumption, see ibid., at 391.

38 In the 2014 New Zealand general social survey, 68.4 percent of the population aged 15 years and over said that most people can be trusted. See New Zealand, Ministry of Social Development, "The Social Report 2016—Te pūrongo oranga tangata" (https://socialreport.msd.govt.nz/social-connectedness/trust-in-others.html).

39 Bjørnskov, supra note 35, at 638.

40 Ibid.

41 Robert Putnam, Robert Leonardi, and Raffaella Y. Nonetti, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton, NJ: Princeton University Press, 1993), chapter 5.

42 In particular, a topic on income taxation is part of the curriculum of New Zealand schools. See New Zealand, Ministry of Education, "Financial Capability" (https://nzcurriculum.tki.org.nz/Curriculum-resources/Financial-capability/Financial-capability-progressions#collapsible1), under tab "Financial Capability Progressions, Managing Money and Income," see "Theme: Income and taxation."

43 For more details about New Zealand's tax dispute resolution system, see Melinda Jone, "Tax Dispute Systems Design: International Comparisons and the Development of Guidance from a New Zealand Perspective" (PhD dissertation, Department of Accounting and Information Systems, University of Canterbury, 2016).

44 Marilynn B. Brewer, "The Psychology of Prejudice: Ingroup Love and Outgroup Hate?" (2002) 55:3 *Journal of Social Issues* 429-44 (https://doi.org/10.1111/0022-4537.00126). See also Daniel Balliet, Junhui Wu, and Carsten K.W. De Dreu, "Ingroup Favoritism in Cooperation: A Meta-Analysis" (2014) 140:6 *Psychological Bulletin* 1556-81.

with other people living there and the fostering of a sense of belonging, which is an essential component of any social group.

Non-resident individuals are arguably alien to the social group because they lack the sense of belonging that connects the group's members. Corporate structures are legal fictions and cannot be members of a social group, which is, by definition, a "set of human beings who either are, recently have been, or anticipate being in some kind of interrelation."[45] Social trust therefore does not extend to corporate structures or non-residents. This means, first, that the tax behaviour of corporate structures or non-residents is free both of the social pressure that exists within social groups and of social trust. Second, the tax behaviour (or misbehaviour) of these taxpayers can affect only the public trust of other taxpayers in the institutions tasked with governing their behaviour, and, in case of corporate structures, trust in the private sector.

Public trust is, generally speaking, trust in the governing institutions. This trust is "required for collective action in complex societies,"[46] and it is built on, among other things, public transparency and transparent systems of oversight "so that experts are overseeing experts on behalf of the relevant publics."[47] The system of oversight, in turn, is premised on the idea of public accountability. Generally, accountability is "the provision of an account for actions to others who have some right to require the provider [to] make an account."[48] When this right is held by the public, there is "public accountability."[49]

Public trust comprises trust in public services and trust in the public brand and in central government. Trust in public services is measured by satisfaction with recent experiences of public services. This type of trust is very high in New Zealand,[50] which is explained by the high standards of integrity and conduct of public servants.[51] In contrast, trust in the public brand and in central government is measured by surveying

45 See *Encyclopaedia Britannica* (www.britannica.com/topic/social-group), entry "social group."

46 Karen S. Cook and Jessica J. Santana, "Trust and Rational Choice," in *The Oxford Handbook of Social and Political Trust*, supra note 30, 253-78, at 270.

47 Mark Warren, "Trust and Democracy," in *The Oxford Handbook of Social and Political Trust*, supra note 30, 75-94, at 90.

48 Christie Hayne and Steven E. Salterio, "Accounting and Auditing," in *The Oxford Handbook of Public Accountability*, supra note 31, 421-40, at 421.

49 See ibid., at 428. Other types of accountability include political, managerial, professional, and personal accountability.

50 As of December 2024, 82 percent of surveyed New Zealanders said that they trust public services. See New Zealand Government, Public Service Commission, "Rangahau o Kiwis Count/Kiwis Count," April 24, 2025 (www.publicservice.govt.nz/research-and-data/kiwis-count). See also Organisation for Economic Co-operation and Development, *Building Trust in Public Institutions: Drivers of Trust in Public Institutions in New Zealand* (Paris: OECD, 2023), at 1.1.

51 New Zealand, Public Service Commission, "Te Ngākau Pono ki Te Ratonga Tūmatanui/Trust in the Public Service," April 24, 2025 (www.publicservice.govt.nz/research-and-data/trust-in-the-public-service).

people's perceptions. This trust is much lower in New Zealand.[52] While both of these types of public trust are relevant to voluntary tax compliance, this article's argument and discussion are more related to public trust in central government. Therefore, public trust in the context of this article is trust in central government. This trust is linked to the ability of the governing institutions to control the tax-related behaviour of all taxpayers, which in turn is based on effective mechanisms of public accountability that apply to both governing institutions and taxpayers. "A tax system built upon voluntary compliance requires public perception that its common burden is upheld, particularly where some look to escape it."[53]

The effect of public trust on a tax system has been recognized in tax policy discussions in New Zealand. In particular, the Michael Cullen Tax Working Group, which was established in 2017 to examine further improvements in the structure, fairness, and balance of the tax system,[54] has emphasized that "[a] sense of fairness is central to maintaining public trust and confidence in the tax system. This is because a system that distributes the costs of taxation in a way that is perceived to be unfair will generate resentment and undermine social capital."[55] According to the group, perceptions of unfairness can "erode public acceptance of the prevailing levels of taxation, as well as the spirit of voluntary compliance that underpins efficient tax collection."[56] Broadly speaking, these perceptions can feed into taxpayers' concerns about the integrity of the tax system.

Trust in the private sector—which often means institutional trust in corporate entities—is low in New Zealand.[57] In the tax context, trust in the private sector can, first of all, be related to the voluntary tax compliance of corporate taxpayers to the extent that these taxpayers may compare, and when possible copy, each other's tax behaviour or use it as a justification for their own tax behaviour. Whether or not trust

52 As of December 2024, only 59 percent of surveyed New Zealanders trusted the public service generally. See "Kiwis Count," supra note 50, at figure 2, "Trust in Public Services and Public/Private Brand by Quarter." In 2023, "46% of people in New Zealand reported high or moderately high trust in the central government, above the OECD average of 39%": see Organisation for Economic Co-operation and Development, *OECD Survey on Drivers of Trust in Public Institutions—2024 Results—Country Notes: New Zealand* (Paris: OECD, 2024), at 2.

53 Harry Pottinger-Coombes, "Paternalism or a Reasonable Limitation on Privacy? The Inland Revenue Department's Powers To Collect Information" (2024) 30:1 *New Zealand Journal of Taxation Law and Policy* 47-68, at 63-64.

54 New Zealand, Ministry of Finance, *Terms of Reference: Tax Working Group* (Wellington, NZ: Ministry of Finance, 2017).

55 New Zealand, Tax Working Group, *Future of Tax: Final Report—Recommendations*, vol. 1 (Wellington, NZ: Tax Working Group, 2019), at 31.

56 Ibid., at 33.

57 As of December 2024, only 47 percent of surveyed New Zealanders said that they trusted the private sector. See "Kiwis Count," supra note 50, figure 2, "Trust in Public Services and Public/Private Brand by Quarter"; and OECD, supra note 52.

of corporate entities in other corporate entities exists, whether it produces an in-group pressure similar to peer pressure in social groups, and whether it extends to entities of multinational groups are questions that deserve attention, but they lie beyond the scope of this article. For the purpose of this discussion, it can be argued that trust (or distrust) in the private sector can affect individuals' tax compliance because individuals compare their own tax behaviour with the tax behaviour of corporate entities.

Trust in the private sector and social trust need to be distinguished from another driver of tax compliance—social responsibility. Society is foundational to the very existence of companies as economic actors separate from their owners and directors; therefore, it legitimately expects companies to benefit society or at least not to harm it. This expectation is manifested in many forms, including the idea of corporate social responsibility in the voluntary international standard ISO 26000.[58] The idea of social responsibility does not, however, transform companies into quasi-members of society; it only emphasizes the expectations of society that are foundational to the legitimacy of companies.

Social responsibility, as part of a governance strategy, can drive the tax compliance of companies and people, but it will do so by using different forces. Indeed, different policy efforts are required to develop trust and encourage the social responsibility of companies and individuals. In relation to individual taxpayers, social responsibility can be powered by peer pressure, whereas when applied to companies it can rely on pressures from customers, investors, and competitors. A detailed discussion of social responsibility, or other possible drivers of tax compliance (corporate or individual), is beyond the scope of this article. Instead, the article continues with a comprehensive discussion of the role of trust in the voluntary tax compliance of people and its connection to tax transparency, focusing on a specific aspect of such transparency—the availability of tax information about the entities of multinational groups, and the government's responses to these groups' aggressive tax-planning strategies or non-compliance with domestic laws and regulations generally. This article argues that as long as people know little about what taxes are being paid by multinational enterprises in their country and what efforts are being made by domestic institutions to increase multinationals' tax contributions, people will have less trust in these institutions and multinationals, and will use this distrust as a rationale for their own non-compliant tax behaviour.

58 International Organization for Standardization (ISO), *International Standard ISO 26000: Guidance on Social Responsibility*, 1st ed. (Switzerland: ISO, 2010), at 2.18 (emphasis in original): "[S]ocial responsibility: responsibility of an *organization* (2.12) for the *impacts* (2.9) of its decisions and activities on society and the *environment* (2.6), through transparent and *ethical behaviour*."

Integrity and Conflicting Expectations of Taxpayers

Integrity is one of the three criteria of organizational trustworthiness.[59] Generally, trustworthiness implies an assessment of past performance and reputational information, and responds to any incentives offered by an institution or arising from the embeddedness of a truster in a social or professional network.[60] When applied to governing institutions, integrity usually means legal compliance and procedural fairness.[61] The integrity of New Zealand's tax system is presented as a combination of the public perception of the integrity of the tax system (a collective aspect) and a set of rights and responsibilities of taxpayers and corresponding responsibilities of those administering the law.[62]

As indicated, the public's perception of the integrity of the tax system fundamentally depends on public trust. Rationally developed trust stems from observations of the behaviour of others and a comparison of behaviours, which in turn depends on the availability of comparable and sufficient information and the ability of a truster to make comparisons. The outcome of such comparisons, it can be argued, drives collective action (or inaction). From a taxpayer's perspective, tax compliance is a collective action with an overarching goal of funding the provision of public goods. In this context, comparisons allow taxpayers to assess the contribution they make to funding the provision of public goods relative to that of other taxpayers. Underpinning this is the fair treatment of taxpayers, which, in particular, includes an assessment of the response of the governing institutions to any taxpayers who fail to contribute. Some taxpayers may choose tax avoidance and even evasion if they believe that other taxpayers have been avoiding or evading taxes and have not been penalized for doing so. Therefore, from a tax compliance perspective, information about other

59 Two other criteria of organizational trustworthiness discussed in the literature are ability, which comprises competence, financial balance, and outcome, and benevolence, including interactional courtesy and a responsibility to inform. See Cam Caldwell and Stephen E. Clapham, "Organizational Trustworthiness: An International Perspective" (2003) 47:4 *Journal of Business Ethics* 349-64.

60 Cook and Santana, supra note 46, at 259 and 273.

61 Caldwell and Clapham, supra note 59.

62 Tax Administration Act 1994, 1994 No. 166, section 6(2) (emphasis in original):

> Without limiting its meaning, the **integrity of the tax system** includes—
>
> (a) the public perception of that integrity; and
>
> (b) the rights of persons to have their liability determined fairly, impartially, and according to law; and
>
> (c) the rights of persons to have their individual affairs kept confidential and treated with no greater or lesser favour than the tax affairs of other persons; and
>
> (d) the responsibilities of persons to comply with the law; and
>
> (e) the responsibilities of those administering the law to maintain the confidentiality of the affairs of persons; and
>
> (f) the responsibilities of those administering the law to do so fairly, impartially, and according to law.

taxpayers' behaviour and the tax authorities' responses to any taxpayer misbehaviour is critical to informing a taxpayer's comparison-based decision whether to comply with their own tax liability. In other words, when it comes to a collective action such as taxation, the integrity of a tax system is not only about how one taxpayer is treated relative to others, but also about how a failure to respond to one taxpayer's misbehaviour affects other taxpayers.

A taxpayer's right (and the corresponding obligation on tax authorities) to have their individual tax affairs kept confidential[63] complicates the issue of the public perception of the integrity of the tax system. This perception, and the public trust it supports or undermines, is twofold. It comprises not only the belief that tax authorities are doing the right thing, including their response to non-complying taxpayers, but also the presumption that the authorities can and will keep the taxpayer's own information confidential. There is thus an inherent conflict in these two expectations of taxpayers: to know about any official responses to non-complying taxpayers, which implies knowing whether or not other taxpayers are complying with their tax liabilities, and the amount of their tax contribution and tax liability; and the individual taxpayer's right to keep their own tax information confidential. This conflict exists, for example, in Canada,[64] and in many other countries that rely on voluntary tax compliance but that keep taxpayers' tax information confidential.

Distrust by Default

Public trust does not exist in isolation from social trust or distrust and from trust or distrust in the private sector. In fact, this article argues, distrust is a "default setting" in people's perception of both non-residents and corporate entities and their treatment by governing institutions. Alexander, for example, has colourfully illustrated this perception in relation to American companies.[65]

The existence of taxpayers outside the social group does not mean that members of the group will be indifferent to the tax affairs of non-members. Quite the opposite: in-group favouritism[66] and the biases it creates against non-members means it is likely that group members will be watching the tax affairs of non-members much

63 Ibid., sections 6(2)(c) and (e).

64 Allison Christians and Vokhid Urinov, "Canada," in *Improving Tax Compliance in a Globalized World*, supra note 28, chapter 10, at 10.7.2.

65 Raquel Meyer Alexander, "Tax Transparency" (2013) 56:5 *Business Horizons* 543-49, at 549: "While Americans take pride in the success of U.S. companies doing business abroad and rely upon these profits to fund the retirements of American workers, foreigners clearly hold a different opinion: United States-based MNCs are often viewed as predators that steal sales from local businesses, use local services, skirt tax obligations, and hide profits in tax havens to enrich wealthy U.S. shareholders."

66 Aronson, supra note 25, at 143; and Moshe Hirsch, "Regulators' Mindsets, Ingroup Favoritism, and the National Treatment Obligation in World Trade Organization Law" (2022) 23:3 *German Law Journal* 298-313.

more closely, and will be more likely to suspect them of wrongdoing. When the tax information of non-members is unavailable, incomplete, or obscured, it will not affect the social trust among the group members, but it will deepen distrust toward non-members and erode public trust in the governing institutions that are failing to alleviate the concerns of domestic social groups about the possible misbehaviour of non-members.

Findings in research on cooperation support the distrust argument. Building on research from social and biological science on neural and behavioural "markers" of subjective value and top-down control, Hughes, Ambady, and Zaki have found that people find it intuitive and subjectively valuable to cooperate with in-group members, while cooperation with outgroup members requires deliberate efforts to override intuitive distrust.[67] In the tax context, this means that governing institutions should operate on the assumption that the public will more likely be suspicious of the tax behaviour of non-residents and companies, and therefore should employ some instruments to alleviate these negative perceptions. One of the most obvious instruments is transparency about the taxes that these outgroup members pay. Making both the tax compliance of outgroup members (non-residents and companies) and the efforts to collect taxes from non-complying outgroup members more visible should encourage greater tax compliance of people living in a taxing state. Such visibility will allow institutions to build public trust in the integrity of the tax system in relation to outgroup members. Such visibility is also necessary when non-tax regulatory regimes, such as a financial reporting regime, require public disclosure of some tax information.

Performance (Non)Transparency

"Tax administrations are increasingly expected to be accountable, both to the government of the day and to society."[68] Accountability and transparency are viewed as "the central pillars of good governance."[69] Tax transparency, it is suggested, "enables dialogue on the design and implementation of tax policies and practices; promotes trust between government and the governed; and facilitates an understanding of the role of government in advancing social and economic goals."[70] In Canada, a common argument is that maintaining taxpayer trust in public institutions through the transparency of tax administration and fairness is essential for the effective functioning of

67 Brent L. Hughes, Nalini Ambady, and Jamil Zaki, "Trusting Outgroup, But Not Ingroup Members, Requires Control: Neural and Behavioral Evidence" (2017) 12:3 *Social Cognitive and Affective Neuroscience* 372-81, at 379 (https://doi.org/10.1093/scan/nsw139).

68 Marriott, supra note 27, at 368-69.

69 Global Initiative for Fiscal Transparency (GIFT), "Transparency Principles for Tax Policy and Administration" (https://fiscaltransparency.net/tax-transparency-principles).

70 Ibid.

Canada's tax system, because it relies primarily on voluntary compliance rather than enforcement.[71] The same argument prevails in New Zealand.

There is, however, a considerable difference between the tax transparency expected by the stakeholders of the tax system and the transparency actually delivered by the system's administrators. The Global Initiative for Fiscal Transparency (GIFT) has recognized that the stakeholders of a tax system require information that allows them to

1. understand how the tax that people have to pay is determined;
2. understand the administrative procedures that prescribe how taxes are paid;
3. assess whether the taxes they are expected to pay are fair compared to the contribution required of others within the society of which they are a part;
4. determine whether all of those who should pay taxes actually do so;
5. evaluate what alternative options for raising revenues exist within their society;
6. understand how their tax system compares to those of similar jurisdictions; and
7. know how the taxes that are collected are used by government.[72]

However, the tax authorities in many countries tend to focus on performance transparency and view it from a very narrow perspective. The Anglo-Saxon approach to public trust and public accountability, which New Zealand and Canada follow, assumes that performance transparency created by public accountability may enable public trust if the performance is good.[73] Given that taxation is a collective action, performance transparency requires the sharing of meaningful and sufficient information about taxpayers' tax compliance, the sharing of any responses by governing institutions to non-complying taxpayers, and a demonstration of procedural fairness. In reality, performance transparency is often reduced to procedural fairness. Taxpayers are expected to trust that the tax system is fair, and that they can seek a confirmation of such fairness through their own engagement with tax authorities. Little is known about the degree of voluntary tax compliance in New Zealand and of the responses of governing institutions to non-complying taxpayers.[74] This narrow approach to performance transparency feeds into conspiracy theories about governing institutions and about those taxpayers who are required to assess their own tax liability and pay tax.

71 Allison Christians, "Trust in the Tax System: The Problem of Lobbying," in Bruno Peeters, Hans Gribnau, and Jo Badisco, *Building Trust in Taxation* (Cambridge, UK: Intersentia, 2017), 151-72, at 166 (https://doi.org/10.1017/9781780684734.009).

72 GIFT, supra note 69.

73 Greiling, supra note 31, at 624. See also Kim, supra note 32, at 622.

74 New Zealand authorities do not report the tax gap; they also do not disclose the number of taxpayers who negotiated outcomes with the tax authority or the number of taxpayers who paid financial penalties. See Lisa Marriott, "Criminal Prosecutions and Tax Fraud in Australia, New Zealand and the United Kingdom" [2024] no. 5 *British Tax Review* 759-86, at 773.

Many countries monitor taxpayers' satisfaction with their tax authorities. Results vary significantly across jurisdictions, with external surveys often showing less favourable results than those of government surveys.[75] This may suggest that domestic policies dealing with tax transparency fail to satisfy the public demand. One reason for this failure is the inability of the tax administration systems to strike the right balance between protecting tax confidentiality and assuring taxpayers that other taxpayers are complying with their tax obligations.

TAX INFORMATION DEFICIT IN A CROSS-BORDER CONTEXT

The general-purpose financial reporting regime makes some comparable tax information publicly available and can potentially alleviate the tax information deficit in New Zealand and other countries. However, as explained below, this potential remains unrealized. Many factors contribute to the tax information deficit. Some of these are institutional, such as the confidentiality of income tax returns,[76] managers' discretion as to what information is revealed in financial reports, and a separate-entity approach to the taxation of multinational enterprises. Other factors are cultural, such as a weak enforcement culture, as found not only in New Zealand but also in Canada[77] and other countries.[78] This section focuses on the institutional factors that are relevant in a cross-border tax context but that have attracted little or no attention of tax scholars. These factors include the institutionalized independence of the general-purpose financial reporting regime from the country's tax system (a feature that New Zealand shares with Canada and other countries); a narrow approach to the information needs of taxpayers and the users of financial information; high thresholds that apply to for-profit reporting entities in a general-purpose financial reporting regime; and a monitoring approach to the auditing of financial reports. Analysis of these factors leads to the conclusion that New Zealand's tax field exhibits both low transparency of the government to the people and low transparency of multinationals to the people and the government.

75 Evans and Joseph, supra note 28, at 1.7.2.

76 Tax Administration Act 1994, supra note 62, sections 18 and 18D to 18J.

77 Christians and Vokhid argue that public trust requires visible enforcement efforts against tax evasion by wealthy individuals and public officials. See Christians and Urinov, supra note 64, at 10.7.2.

78 For example, a weak enforcement culture in the United Kingdom was discussed in relation to securities regulation, but it is very likely that the same culture can be found in taxation and other regulatory areas. See Luca Enriques, Gerard Hertig, Reinier Kraakman, and Edward Rock, "Corporate Law and Securities Markets," in Reinier Kraakman et al., eds., *The Anatomy of Corporate Law: A Comparative and Functional Approach*, 3d ed. (Oxford, UK: Oxford University Press, 2017), 243-266, at 259, section 9.2.1.

An Independent Financial Reporting Regime

The income tax system and the general-purpose financial reporting regime in New Zealand both require the mandatory disclosure of tax-related information from the same persons, but they are viewed as being independent from each other.[79] In the tax context, "mandatory disclosure of tax-related information" is an umbrella term that covers situations in which taxpayers, their tax agents, or third parties are required by law to provide tax-related information to revenue officers. In the Tax Administration Act 1994, these situations are usually referred to as "reporting."[80] The concept of "disclosure" applies to the sharing of tax-related information by revenue officers,[81] or, in the context of a non-disclosure right of a tax adviser, a legal instrument protecting the confidentiality of communication between some tax advisers and their clients.[82]

Because the tax system, when it is based on voluntary compliance, and the financial reporting regime require the disclosure of tax-related information, they can be viewed through an accountability lens, even though the rationale for and object of the disclosures differ. In this case, the tax system is a system of rules that define the subjects of tax accountability (taxpayers), the objects of accountability (those who are entitled to demand accountability from these subjects, such as tax authorities or the public), a form of tax accountability (tax returns), and the scope of accountability (specific tax information). When the general public is not entitled to demand tax accountability from particular taxpayers, tax accountability (voluntary or involuntary) is owed solely to the tax authorities, or the government generally. This narrow approach treats taxation only as a relationship between a taxpayer and a tax authority or a state, and thus ignores the collective nature of taxation, which, as explained below, undermines voluntary tax compliance generally.

The financial reporting regime requires reporting entities to be accountable for their own financial situation. The regime sets the boundaries of financial accountability by defining the subjects of accountability (reporting entities), the objects of accountability (the primary users of the financial information), a form of accountability (financial statements), and the scope of accountability (specific financial information). The boundaries of financial accountability depend on the particular model that underpins the state's financial reporting regime. Broadly speaking, models are premised on an ideology that focuses on either investors and their interests (the Anglo-American approach) or the interests of creditors and a state (the continental European model).

79 For more detail, see Tax Administration Act 1994, supra note 62, section 15B(e), and various New Zealand equivalents to international financial reporting standards.

80 See, for example, Tax Administration Act 1994, supra note 62, subparts 3B and 3C.

81 Ibid., sections 18C to 18K.

82 See, for example, ibid., sections 20B to 20G.

New Zealand has adopted the international financial reporting standards (IFRS) developed by the International Accounting Standards Board (IASB).[83] The IFRS follow the Anglo-American approach, which is informed by the "concession theory" of company law[84] and ignores the connection between financial reporting and tax compliance. This approach was developed in the United Kingdom in the 19th century "with the goal of enhancing the ability of equity holders to monitor their investments."[85] It is based on the idea that mandatory disclosure is the "price" for limited liability.[86] Under this approach, the financial reporting regime aims to help investors or creditors control the managers of specified entities. Members of the general public become "accidental" rather than primary users of the disclosed financial information. Moreover, even when the IFRS refer to a "publicly accountable entity," the entity does not need to be accountable to the public at large, as the discussion in the next section demonstrates.

In contrast, the continental European approach to financial reporting and accounting, which originated in 17th-century France, is oriented toward the protection of creditors and the facilitation of taxation.[87] This approach is grounded on a theory of citizenship,[88] which, in particular, argues that a company has an essentially social purpose and that stakeholders' rights in relation to the company arise not from their investments in the company but from their general rights as citizens.[89] From this perspective, any reporting entity is directly accountable to the public. Despite the almost universal adoption of the IFRS, many European countries rely on the continental European approach to unconsolidated accounting,[90] which, it can be argued, aligns with the purposes of a welfare state and therefore does not undermine its operation. This, however, is not the case when the Anglo-American approach is followed. This approach is the main reason for the independence of New Zealand's

83 For a justification of full adoption, see New Zealand, Accounting Standards Review Board, *Proposed Application of Accounting and Assurance Standards Under the Proposed New Statutory Framework for Financial Reporting: Discussion Document* (Wellington, NZ: ASRB, 2009), at paragraphs 68-71 (herein referred to as "the discussion document") (www.xrb.govt.nz/dmsdocument/1809/).

84 Vanessa Edwards, *EC Company Law* (Oxford, UK: Clarendon, 1999), at 120-23.

85 Enriques et al., supra note 78, at 252, section 9.1.2.6.

86 Wolfgang Schön, "Corporate Disclosure in a Competitive Environment—The Quest for a European Framework on Mandatory Disclosure" (2006) 6:2 *Journal of Corporate Law Studies* 259-98, at 264 (https://doi.org/10.1080/14735970.2006.11419953).

87 Enriques et al., supra note 78, at 252, section 9.1.2.6.

88 Sheldon Leader, "Accountable Corporate Governance," in *The Oxford Handbook of Public Accountability*, supra note 31, 354-69, at 357. See also Hayne and Salterio, supra note 48, at 427-28.

89 Leader, supra note 88, at 358.

90 Andreas Hellmann, Hector Perera, and Chris Patel, "Continental European Accounting Model and Accounting Modernization in Germany" (2013) 29:1 *Advances in Accounting* 124-33 (https://doi.org/10.1016/j.adiac.2013.02.002).

financial reporting regime from the country's tax system: the former is viewed as a private relationship and therefore as having no impact on the provision of public goods, whereas the latter is a public relationship.[91]

In New Zealand, the independence of the financial reporting regime from the country's tax system is supported by various institutional settings that keep Inland Revenue, the governing entity responsible for the administration of the domestic tax system, separated from the External Reporting Board, an entity that develops and maintains standards for both financial reporting and auditing.[92] Not only do these entities have different functions, but Inland Revenue is a public service department, whereas the External Reporting Board is an independent Crown statutory entity, meaning that it is generally independent of government policies.[93]

A Narrow Approach to Information Needs

When public trust depends on the satisfaction of information needs, policy makers and regulators should be mindful in determining whose needs they want to satisfy and the effects that this satisfaction (or dissatisfaction) will have on public trust. The following discussion highlights the problems arising from the very narrow approach of New Zealand's tax system and financial reporting regime to information needs, and how this contributes to the institutionalization of their independence from each other.

Tax System

Administration of the tax system depends on the availability of information about taxpayers. Most of this information comes from tax returns filed by taxpayers themselves or their tax agents, or by persons who have a legal obligation to withhold taxes from payments that they make to taxpayers. However, when the tax system is based on voluntary compliance, the availability of information *to* taxpayers also becomes important for the system's administration. The question is what information these taxpayers might need to comply with their tax obligations. One view is that taxpayers need to know how to calculate a tax and when to pay it under the existing law. This view underlies the purpose of specific tax legislation[94] and a legal obligation

91 The private nature of a company is disputed in company law scholarship. See, for example, Susan Watson, *The Making of the Modern Company* (Oxford, UK: Hart, 2022). See also Jonathan Hardman, *The Limits and Logic of Agency Theory in Company Law* (Oxford, UK: Routledge, 2025).

92 For more detail, see New Zealand, Financial Reporting Act 2013, 2013 No. 101, section 12.

93 New Zealand, Crown Entities Act 2004, 2004 No. 115, section 7 and schedule 1, part 3.

94 For example, New Zealand, Income Tax Act 2007, 2007, No. 97, section AA 1:

> The main purposes of this Act are—
>
> (a) to define, and impose tax on, a net amount of income:
> (b) to impose obligations concerning tax:
> (c) to set out rules for calculating tax and for satisfying the obligations imposed.

to comply with the law.[95] Taxation is viewed as a simple exchange of taxes for public goods between a taxpayer and the state. Accordingly, if a taxpayer fails to pay taxes, it should concern only the state, not other taxpayers or the recipients of benefits that are funded by the taxes. This narrow approach to information needs reflects the priority given to a taxpayer's right to keep their tax information confidential, over the taxpayer's right to know about other taxpayers' contributions, or over the public interest more generally. The right to know about other taxpayers' tax contributions and liabilities is not legislated because tax legislation does not recognize the fact that taxation is a process of raising money through collective action. However, effective voluntary tax compliance is impossible without this recognition. It means that tax authorities cannot use a very effective instrument for the facilitation of voluntary tax compliance—peer pressure—because such pressure is based on access to comparable information about tax contributions and tax liabilities, which the taxpayer's right to confidentiality makes unavailable through the tax system. In the case of companies, the availability of tax information can create pressure from customers and investors, which in turn may change the companies' tax behaviour. Such change, in turn, could motivate non-corporate taxpayers to comply with their own tax obligations.

The right to confidentiality of tax information[96] balances the taxpayer's legal obligation to "disclose to the Commissioner in a timely and useful way all information (including books and records) that the tax laws require the taxpayer to disclose."[97] The right to confidentiality of tax information applies only to sensitive information, but the scope of sensitive information is so broad that almost any information that could identify a taxpayer is protected in New Zealand.[98] The breach of confidentiality of a taxpayer's information may be considered to be an offence and penalized.[99]

95 Tax Administration Act 1994, supra note 62, section 6(2)(d).

96 Ibid., section 18.

97 Ibid., section 15B(e).

98 Ibid., section 16C(3):

> For the purposes of this subpart and schedule 7, **sensitive revenue information**—
>
> (a) means revenue information—
>
> (i) that identifies, or is reasonably capable of being used to identify, a person or entity, whether directly or indirectly; or
>
> (ii) that might reasonably be regarded as private, commercially sensitive, or otherwise confidential; or
>
> (iii) the release of which could result in loss, harm, or prejudice to a person to whom, or an entity to which, it relates:
>
> (b) does not include aggregate or statistical data that may contain information about the person or entity to the extent to which the information does not meet the requirements of paragraph (a):
>
> (c) does not include information if the only person or entity that it identifies is the Commissioner or chief executive of the Inland Revenue Department, unless it relates to the application of the Inland Revenue Acts to the Inland Revenue Department as a taxpayer.

99 Ibid., section 18(4).

Also, even in some circumstances in which the commissioner of inland revenue can disclose sensitive information,[100] the commissioner "is not required to disclose any item of revenue information if the release of the information would adversely affect the integrity of the tax system or would prejudice the maintenance of the law."[101]

In 2019, the Michael Cullen Tax Working Group reported that it had

> received many submissions about international taxation and the tax practices of multinational companies and digital firms. It is clear from the submissions that many people feel a deep sense of unfairness about the way in which the tax system deals with these firms. This is a worrying phenomenon: perceptions of unfairness have the potential to erode public support for the tax system as a whole.[102]

In the same year, Inland Revenue expressed its concern about multinational enterprises not paying their fair share of taxes in New Zealand; however, it did not mention specific multinationals, despite the political importance of the issue. By the end of November 2024, the Inland Revenue website had 417 media releases;[103] the information in sections "Prosecutions" (91 releases) and "From courts" (57 releases) concerned individuals or small domestic businesses; the section "International tax" (30 releases) was last updated in December 2022.

Inland Revenue tends to refrain from making any comments about foreign multinational enterprises and their entities operating in New Zealand, even though the information it collects from these entities could help to alleviate the public's concern about the taxes that multinationals pay in New Zealand. In addition to typical sources, Inland Revenue uses annual questionnaires to collect tax information from foreign-owned businesses operating in New Zealand. The purpose of this data collection is to "inform New Zealand's approach to meeting our international obligations in respect to the OECD's work on base erosion and profit shifting,"[104] rather than to help with the assessment of the effectiveness of the domestic tax system and put forth proposals for its improvement. Inland Revenue discloses only some tax information about foreign multinationals, and only in a highly aggregated form.[105] This information includes the number of surveyed foreign multinationals (excluding

100 Ibid., sections 18(2), 18D to 18J, and schedule 7.

101 Ibid., section 18(3).

102 Tax Working Group, supra note 55, at paragraph 38.

103 The latest update on international tax matters was made on December 13, 2022; see New Zealand, Inland Revenue, "Tax Evasion Software Prompts Stern Warning," *News Release*, December 13, 2022.

104 New Zealand, Inland Revenue, "International Questionnaire/Uiuitanga Aowhānui" (www.ird.govt.nz/international-tax/business/international-questionnaire).

105 New Zealand, Inland Revenue, "International Questionnaire 2023 Income Year Summary" (www.ird.govt.nz/-/media/project/ir/home/documents/international/international-questionnaire/international-questionnaire-summaries-2014-2023.pdf?modified=20240620011121&modified=20240620011121).

banks and insurers) and their top geographical locations and largest industries; the percentage of those surveyed multinationals who confirmed (1) material structural changes that resulted in a reduction of functions, assets, and risks of New Zealand operations, (2) New Zealand's group aggregate amount of expenditure above a specified threshold on goods and services supplied from low-tax jurisdictions, and (3) cross-border supplies to or from related parties above a specified threshold; a choice of a primary transfer-pricing method; and the thin capitalization percentage of New Zealand's groups. This aggregated information by no means addresses the concern that multinationals operating in New Zealand may not be paying their fair share of taxes.

Changes made in 2018 to New Zealand's tax legislation allow the commissioner to request information from a member of a large multinational group about offshore payments and information relating to it or to the group at large.[106] The commissioner can also disclose this and other information under section 18D of the Tax Administration Act 1994, and can do so proactively. Such disclosure needs to be considered reasonable under the law and its interpretation by the commissioner,[107] but information can be disclosed only to a specified person or entity[108] and only "for the purpose and about the matter described in the provision, [and] subject to any conditions set out in the provision."[109] In other words, disclosures made by the commissioner or revenue officers generally are limited in scope and are not public.

When the confidentiality of tax information is unreasonably prioritized over more general tax information needs, or when such needs are assumed to be related solely to a taxpayer's understanding of how to comply with their own tax liability, public trust in the integrity of the tax system and its administration will inevitably be eroded. There could be good reasons to keep a taxpayer's tax information secret,[110] but these reasons may need to be revisited regularly to ensure that the tax confidentiality rules align with changing economic circumstances and domestic culture. It is plausible to assume that much fewer New Zealanders support the confidentiality of corporate tax information after the global financial crisis, many journalists' investigations into the aggressive tax behaviour of multinationals in New Zealand and abroad, and various global initiatives seeking to combat cross-border profit shifting and increase

106 Taxation (Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters) Act 2019, 2019 No. 5, section 10. See also Tax Administration Act 1994, supra note 62, sections 17F and 17G.

107 New Zealand, Inland Revenue, *Standard Practice Statement* ED0210, "Application of Discretion in Section 18D(2) of the Tax Administration Act 1994—An Exception to Confidentiality," at paragraphs 12 and 15.

108 Tax Administration Act 1994, supra note 62, schedule 7, part A, clauses 3 to 13.

109 Ibid., schedule 7, part A, clause 2(b).

110 For example, to protect the informants. See Ombudsman Peter Boshie, "Exercise of Discretion To Refuse Request for Personal Information Not Unreasonable," Case no. 538720, July 21, 2022 (www.ombudsman.parliament.nz/resources/exercise-discretion-refuse-request-personal-information-not-unreasonable).

the transparency of financial information. The changes in public perceptions of tax confidentiality, if rigorously monitored in New Zealand, could signal the need for changes not only in the legislation but also in Inland Revenue's approach to the disclosure of tax information about multinational groups operating in the country.

Financial Reporting Regime

The IASB conceptual framework that underpins the IFRS,[111] and the IFRS themselves, are based on the idea of "user information needs" and the criteria of information and its presentation that should satisfy such needs in order to be "useful." Generally, information is "useful" when it is "relevant and faithfully represents what it purports to represent."[112] Specific standards elaborate on these requirements.[113] Therefore, the scope of the financial information that is subject to mandatory disclosure depends on the meaning of "user" and the criteria regarding the usefulness of information as defined in the financial standards.

New Zealand's Accounting Standards Review Board, a predecessor of the External Reporting Board, acknowledged that "users and their information needs can be categorised in numerous different ways,"[114] but it adopted an approach developed by the IASB. To define user needs, the board used various indicators and made sectoral

111 International Accounting Standards Board, "Conceptual Framework for Financial Reporting," issued September 2010, revised March 2018 (www.ifrs.org/content/dam/ifrs/publications/pdf-standards/english/2021/issued/part-a/conceptual-framework-for-financial-reporting.pdf).

112 New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework) Issued May 2018 and Incorporates Amendments to 31 January 2019," at paragraph 2.41 (herein referred to as "2018 NZ conceptual framework").

113 For example, New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 3 Business Combinations (NZ IFRS 3) Issued February 2008 and Includes Amendments to 31 January 2022," at 7, paragraph 1; New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 9 Financial Instruments (NZ IFRS 9) Issued September 2014 and Incorporates Amendments to 31 January 2022," at 7, paragraph 1.1; New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 15 Revenue from Contracts with Customers (NZ IFRS 15) Issued July 2014 and Incorporates Amendments to 31 January 2022," at 7, paragraph 1 (herein referred to as "NZ IFRS 15"); New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 16 Leases (NZ IFRS 16) Issued February 2016 and Incorporates Amendments to 23 April 2021," at 7, paragraphs 1 and 2; New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 17 Insurance Contracts (NZ IFRS 17) Issued August 2017 and Incorporates Amendments Up to and Including 31 December 2022," at 7, paragraphs 1 and 2; and New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Accounting Standard 7 Statement of Cash Flows (NZ IAS 7) Issued November 2004 and Incorporates Amendments to 31 March 2025," overview.

114 The discussion document, supra note 83, at 5.

distinctions between for-profit and public benefit entities.[115] Neither of these indicators mentioned taxes or broader regulatory purposes in general as potentially useful information that the users of financial reports might be interested in; nor were entities of multinational groups distinguished from stand-alone for-profit entities.

New Zealand's conceptual framework of general-purpose financial reporting[116] largely replicates the IASB conceptual framework;[117] in particular, it requires for-profit entities to provide some financial information about themselves that is useful to the maximum number of primary users in making decisions about (1) buying, selling, or holding equity and debt instruments; (2) providing or settling loans and other forms of credit; or (3) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.[118] In other words, information should be useful "in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources."[119]

Investors (existing and potential), lenders, and other creditors are considered "the primary users to whom general purpose financial reports are directed."[120] Other potential users are specifically excluded from the target audience of such financial reporting.[121] Therefore, despite the claim that financial reports "are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs,"[122] the reports seek to address only the needs of primary users, and then only to the extent defined in the financial reporting standards.

The irrelevance of the needs of non-primary users is not only institutionalized but also reinforced through expert opinion. When the External Reporting Board revised its framework for financial reporting in 2016, it commissioned a group of accounting academics to conduct an empirical study of financial information needs in New Zealand. The group did not attempt to find out whether, or to what extent, New Zealand's financial reporting regime reflected the demands for accountability

115 Ibid., at paragraph 28 and at 21, table 1.

116 2018 NZ conceptual framework, supra note 112.

117 International Accounting Standards Board, supra note 111.

118 2018 NZ conceptual framework, supra note 112, at paragraphs 1.2, 1.6, and 1.8.

119 Ibid., at paragraph 3.2. Also see ibid., paragraphs 1.4 and 1.12.

120 Ibid., at paragraph 1.5.

121 Ibid., at paragraph 1.10: "Other parties, such as regulators and members of the public other than investors, lenders and other creditors, may also find general purpose financial reports useful. However, those reports are not primarily directed to these other groups."

122 New Zealand External Reporting Board, "External Reporting Board Standard A1 Application of the Accounting Standards Framework Issued December 2015 and Incorporates Amendments to 31 March 2024" (www.xrb.govt.nz/dmsdocument/3573), at paragraph 6.

that had been identified in other empirical studies.[123] Instead, the researchers engaged with investors, lenders, intermediaries, and regulators[124] to find out how the currently reported information is used by selected groups of users, and to learn what other information the surveyed persons would like to see in financial statements. The researchers made no attempt to explain how (or whether) their findings were linked to, and reflected, the indicators that were used in New Zealand's financial reporting regime to define user needs in relation to for-profit entities.

In New Zealand, in the past decade, the pool of users of financial information whose interests the financial regime aims to protect has shrunk significantly, as a consequence of very subtle changes in the reporting standards. A relatively old New Zealand accounting standard, NZ IAS 1, did not refer to primary users, nor did it link user needs to users' expectations about returns on investment. Instead, it said that "[t]he objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is *useful to a wide range of users in making economic decisions*."[125] A new standard, NZ IFRS 18, replicates this definition[126] but explicitly states that only material information should be disclosed[127]—that is, information that satisfies the needs of primary users.[128]

New Zealand's financial reporting regime, as does any regime that closely follows the IFRS, comprises reporting and assurance. These two elements play different roles, but are oriented toward the same goal: seeking to make the reporting entity disclose financial information that is truthful and useful to specified groups of users. However, the auditors' view about the "users of financial statements" is even narrower than the view assumed in the financial reporting requirements. When auditing the financial statements of New Zealand companies, auditors tend to emphasize that their reports

123 Hayne and Salterio, supra note 48, at 429.

124 Fawzi Laswad, Nives Botica Redmayne, Warwick Stent, and Lei Cai, *Information Needs of Users of New Zealand Capital Markets Entity Reports*, An External Reporting Board Research conducted on its behalf by Massey University (Wellington, NZ: Massey University, 2016), at 4.

125 New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Accounting Standard 1 Presentation of Financial Statements (NZ IAS 1) Issued November 2007 and Incorporates Amendments to 31 May 2023" (www.xrb.govt.nz/dmsdocument/4978/), at paragraph 9 (emphasis added). This version is effective for reporting periods beginning on or after January 1, 2024.

126 New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Financial Reporting Standard 18 Presentation and Disclosure in Financial Statements (NZ IFRS 18) Issued May 2024" (mandatory as of January 1, 2027), at paragraph 9 (herein referred to as "the NZ IFRS 18").

127 Ibid., at paragraph 15.

128 Ibid., at 25, appendix A, definition of "material information": "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity."

are made solely to the company's shareholders, as a body,[129] in accordance with section 207B of the Companies Act 1993.[130]

High Thresholds for Reporting For-Profit Entities

The IFRS apply a tiers-based approach to reporting "whereby the reporting—particularly disclosure—requirements are reduced for different groups of entities in a manner commensurate with the reduction in benefit accruing from the information."[131] In relation to for-profit entities, the current two-tier system is compulsory for reporting periods beginning on or after January 1, 2016.[132] Tier 1 for-profit entities are subject to full mandatory disclosure requirements. Tier 2 for-profit entities can opt out of many of the mandatory disclosure requirements, including those that are related to the entity's tax liability,[133] or the relationship between tax expense (income) and accounting profit.[134] Tier 1 for-profit entities include entities that either have public accountability or are large for-profit public sector entities, or entities that are eligible for reduced disclosure treatment (prospective tier 2 entities) but that have not elected to use such treatment.[135] The public accountability criteria

129 See, for example, reports of Ernst and Young accompanying financial statements, infra note 170, at 3 (https://app.companiesoffice.govt.nz/companies/app/service/services/documents/2C7584C190837E10487016636F853FB3): "This report is made solely to the Company's shareholders, as a body. Our audit has been undertaken so that we might state to the Company's shareholders those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's shareholders, as a body, for our audit work, for this report, or for the opinions we have formed."

130 New Zealand Companies Act 1993, 1993 No. 105.

131 The discussion document, supra note 83, at paragraph 46.

132 New Zealand Accounting Standards Board of the External Reporting Board, "External Reporting Board Standard A1: Application of the Accounting Standards Framework, Issued December 2015 and Incorporates Amendments to 31 December 2022)" (www.xrb.govt.nz/dmsdocument/4788), introduction and section B.

133 In particular, a tier 2 for-profit entity is not required to disclose

> the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:
>
> (a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and
>
> (b) the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates.

See New Zealand Accounting Standards Board of the External Reporting Board, "New Zealand Equivalent to International Accounting Standard 12 'Income Taxes' (NZ IAS 12) (Issued November 2004 and Incorporates Amendments to 31 December 2023)," at paragraph 82.

134 Ibid., at paragraph 84.

135 Supra note 122, at paragraph 17.

for tier 1 entities are defined by the Financial Markets Conduct Act 2013 and are applied to issuers of securities, stocks, and shares, including licensed insurers, registered banks, credit unions, and building societies ("FMC reporting entities").[136] The criteria for large for-profit public sector entities were set by the External Reporting Board; currently, there is only one criterion—the total expenses of the reporting public entity should exceed $30 million.[137] In contrast, the criteria for large for-profit non-public entities are defined in the Financial Reporting Act 2013[138] and the Companies Act 1993;[139] these criteria focus on assets and revenue, and set different thresholds for domestic entities and for foreign companies and their New Zealand subsidiaries. The Accounting Standards Review Board was responsible for deciding on the tiers in relation to each class of reporting entities.[140] A tiers-based approach to financial reporting, the in-scope thresholds for reporting entities, and the scope of mandatory disclosure are justified by the so-called cost and benefit principle. Originally, for-profit entities were divided into four tiers, but in 2014 the

136 The External Reporting Board, ibid., at paragraph 9, has interpreted criteria of public accountability as follows:

> An entity is deemed to have public accountability in New Zealand if:
>
> (a) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a "higher level of public accountability" than other FMC reporting entities under section 461K of the Financial Markets Conduct Act 2013; or
>
> (b) it is an FMC reporting entity or a class of FMC reporting entities that is considered to have a "higher level of public accountability" by a notice issued by the Financial Markets Authority (FMA) under section 461L(1)(a) of the Financial Markets Conduct Act 2013.

137 Ibid., at paragraph 18.

138 Supra note 92, section 45, "Meaning of large":

> (1) For the purposes of an enactment that refers to this section, an entity (other than an overseas company or a subsidiary of an overseas company) is **large** in respect of an accounting period if at least 1 of the following paragraphs applies:
>
> (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed $66 million:
>
> (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds $33 million. . . .
>
> (2) For the purposes of an enactment that refers to this section, an overseas company or a subsidiary of an overseas company is large in respect of an accounting period if at least 1 of the following paragraphs applies:
>
> (a) as at the balance date of each of the 2 preceding accounting periods, the total assets of the entity and its subsidiaries (if any) exceed $22 million:
>
> (b) in each of the 2 preceding accounting periods, the total revenue of the entity and its subsidiaries (if any) exceeds $11 million.

139 Supra note 130, section 198, definition of "large company."

140 New Zealand, Ministry of Economic Development, "Regulatory Impact Statement: The Review of the Financial Reporting Framework, Agency Disclosure Statement" (P/008/PR018/006) (www.mbie.govt.nz/dmsdocument/2915-ris-financial-reporting-framework-agency-disclosure-statement-pdf).

number of tiers was reduced to two.[141] This change placed many subsidiaries of non-resident companies outside the scope of the financial reporting regime and out of public view.

In 2009, when the Ministry of Economic Development of New Zealand and the Accounting Standards Review Board were developing frameworks for financial reporting, the ministry suggested weighing the benefits of financial reporting against the associated compliance costs.[142] The idea was to balance the information needs of specific users against the costs of preparing the reports. The benefits of information disclosure therefore were not framed as the user's interest in the disclosure of information as against the reporting entity's interest in protecting the confidentiality of information—the perspective usually applied in a discussion of disclosure in the tax context.

In explaining the cost and benefits principle, the Ministry of Economic Development referred to the compliance costs for reporting entities. However, the Accounting Standards Review Board referred to the cost and benefits principle not only to justify the tiers-based approach to reporting entities and to promote the sectoral approach to financial reporting suggested by the IASB,[143] but also to highlight the cost of assurance[144] and the cost of standard setting.[145] These references have created an impression that the benefits of information to primary users should be weighed not only against the compliance costs for reporting entities, but also against the cost of assurance and the cost of standard setting. However, the cost of standard setting does not fall on the reporting entities, and the cost of assurance is part of a governance legal strategy that aims to reduce the cost of any misinformation or incomplete information provided to primary users. The use of this expansive cost rhetoric to justify full adoption of the IFRS in New Zealand seems to indicate either incompetence or the lobbying of the interests of some reporting entities. The operationalization of the cost and benefit principle by the Accounting Standards Review Board also supports these concerns.

The Accounting Standards Review Board operationalized the cost and benefit principle based on the size of an entity and the global environment.[146] Both factors are questionable. The reliance on the entity's size was based on an assumption that

141 New Zealand External Reporting Board, "External Reporting Board Standard A1: Accounting Standards Framework (For-Profit Entities Plus Public Sector Public Benefit Entities Update) (XRB A1 (FP Entities + PS PBEs Update))," issued May 2013 and incorporating amendments arising from "Amendments to XRB A1 Accounting Standards Framework: Omnibus Amendments (Legislative Update)" issued in February 2014, which amended various paragraphs of the standard to reflect legislative changes (www.xrb.govt.nz/dmsdocument/1179).

142 The discussion document, supra note 83, at paragraph 18.

143 See, for example, 2018 NZ conceptual framework, supra note 112, at paragraph 7.3.

144 The discussion document, supra note 83, at paragraph 21.

145 Ibid., at paragraph 19.

146 Ibid., at paragraphs 23-24.

"the smaller the entity the smaller the number of users there are likely to be, and therefore the fewer the benefits that are likely to accrue from [general-purpose financial reporting]."[147] The fact that small entities can be part of large multinational enterprises, and therefore have many potential "users of reporting information" in New Zealand and abroad, was completely ignored. The views of reporting entities about the costs of general-purpose financial reporting have been assumed rather than established empirically. Therefore, it remains unknown whether and to what extent such reporting is indeed costly for reporting entities. Existing empirical studies provide very little evidence on the direct and indirect costs associated with financial disclosure regulation.[148] The Ministry of Economic Development has also acknowledged significant constraints in identifying the costs and benefits of the changes to the financial reporting framework.[149]

The global environment factor focused largely on New Zealand entities and disregarded their associations with foreign multinational groups. According to the Accounting Standards Review Board, comparability of financial information with that produced in other jurisdictions can be important in raising capital and to overall international competitiveness.[150] These links were neither explained nor supported empirically. The board asserted that standardization reduces the compliance costs for entities operating in many jurisdictions,[151] but in reality such reduction is minimal because full adoption of the IFRS is rare and many countries use the IFRS only for consolidated reporting. Further, the board has emphasized that "[u]sing international standards also strengthens international linkages for New Zealand's accounting profession, and reduces domestic standard setting costs."[152] It is, however, unclear how professional networking and the outsourcing of standard setting to a foreign private entity such as the IASB can benefit the users of financial information in New Zealand and address their information needs.

Monitoring Approach to Auditing

Generally, auditing is "an assurance service which improves the quality of information or its context."[153] Auditing can play an information role, an agency role, an

147 Ibid., at paragraph 23.

148 Christian Leuz and Peter D. Wysocki, "The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research" (2016) 54:2 *Journal of Accounting Research* 525-622, at 575 (https://doi.org/10.1111/1475-679X.12115).

149 Supra note 140.

150 The discussion document, supra note 83, at paragraph 24.

151 Ibid.

152 Ibid.

153 David Hay, W. Robert Knechel, and Marleen Willekens, "The Function of Auditing," in David Hay, W. Robert Knechel, and Marleen Willekens, eds., *The Routledge Companion to Auditing* (Oxford, UK: Routledge, 2014), at 1. See also Hayne and Salterio, supra note 48, at 421; and Bronwen Morgan, "The Economization of Politics: Meta-Regulation as a Form of Nonjudicial Legality" (2003) 12:4 *Social and Legal Studies* 489-523.

insurance role, an organizational control role, a confirmation role, or a risk management role.[154] The emphasis on a specific role, in particular, affects courts' decisions in lawsuits against auditors. A study of such decisions made in the United Kingdom, Canada, Australia, and New Zealand has revealed how, influenced by US law, an insurance approach to auditing became common in the second half of the 20th century, and then was replaced with a contract-based monitoring approach, which narrowed auditors' liability to third parties for negligence.[155]

The 2009 reform of New Zealand's assurance standards, which was triggered by the Enron scandal and subsequent concerns that auditors worldwide were closely aligned with their clients' managers rather than with the users of the financial information being produced,[156] did not result in fundamental changes. The Ministry of Economic Development sought public opinion on the legal enforcement of assurance standards and audit-related offence provisions, and suggested two new audit-related offence provisions.[157] The Accounting Standards Review Board, in contrast, focused on the level of assurance for various general-purpose financial reporting entities, and promoted a view that user assurance requirements should be reduced proportionately with reductions in entity size as user benefits also decrease.[158] Neither of the bodies has questioned the "multinationalization" of the assurance business.

The users of financial information made no submissions on the proposed changes.[159] Most of those who made submissions were either reporting entities, most of which were small businesses, or providers of assurance services.[160] The reporting entities wanted to define the terms of audits themselves and pushed for an "adviser-type" auditing model,[161] while the assurance service providers were strongly against the proposal to give auditing standards the force of law and criminalize breaches of auditing standards.[162] The Auditor Regulation Act 2011[163] and the Financial Reporting Amendment Act 2011[164] accommodated most of these views, allowing the

154 Hay et al., supra note 153, at 2.

155 Carl Pacini, William Hillison, Ratnam Alagiah, and Sally Gunz, "Commonwealth Convergence Toward a Narrower Scope of Auditor Liability to Third Parties for Negligent Misstatements" (2002) 38:3 *Abacus* 425-64 (https://doi.org/10.1111/1467-6281.00116).

156 Hayne and Salterio, supra note 48, at 436.

157 For a brief overview, see Marion Davis and David Hay, "An Analysis of Submissions on Proposed Regulations for Audit and Assurance in New Zealand" (2012) 22:3 *Australian Accounting Review* 303-16, at 306-7 (https://doi.org/10.1111/j.1835-2561.2012.00165.x).

158 Ibid., at 307.

159 Ibid., at 304.

160 Ibid.

161 Ibid., at 314.

162 Ibid.

163 2011 No. 21.

164 2011 No. 22.

assurance of financial reports to remain client-oriented and monitor the accuracy of reporting rather than ensure the accuracy of reported information. Under section 3 of the Auditor Regulation Act 2011, the purpose of the assurance system for general-purpose financial reports is defined as being to "(a) promote, in respect of FMC audits, quality, expertise, and integrity in the profession of auditors"[165] and "(b) promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions."

CASE STUDY: GOOGLE BUSINESS IN NEW ZEALAND

In 2013, the taxation of income of multinational digital service providers such as Google, Amazon, Facebook, and Apple became a central focus of action 1[166] of the base erosion and profit shifting (BEPS) project of the Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20).[167] This attention stemmed from widespread public and political concerns over these companies paying minimal income tax in many countries despite generating substantial profits from their business activities within those jurisdictions.[168] One might assume that in response to the global public outrage, digital tech giants would try to alleviate concerns about the amount of taxes they pay in market jurisdictions. One way of alleviating such concerns would be through clear and informative financial reporting that would allow the public and governing institutions to compare the total sales revenue derived by these multinationals from the business activities of their entities in New Zealand with the amount of income tax they pay there, as well as the amount of their capital investments in New Zealand. However, a case study of Google business in New Zealand demonstrates the opposite.

Revenue Streams

The Alphabet group of companies is a multinational enterprise formerly known as the Google group;[169] it has two entities incorporated in New Zealand. Google New

165 "FMC audits" are audits of reporting entities defined in sections 6(1) and 451 of Financial Markets Conduct Act 2013, 2013, No. 69.

166 Organisation for Economic Co-operation and Development, *Addressing the Tax Challenges of the Digital Economy*, *Action 1: 2015 Final Report* (Paris: OECD, 2015) (herein referred to as "the BEPS action 1").

167 The BEPS project, launched in 2013, aimed to eliminate gaps in tax rules that permitted corporate tax bases to be eroded or artificially shifted to low- or no-tax jurisdictions. The G20 leaders endorsed the final "BEPS package" of 2015, which included minimum standards and amendments to core OECD guidance documents. See Organisation for Economic Co-operation and Development, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013).

168 Chris Noonan and Victoria Plekhanova, "Taxation of Digital Services Under Trade Agreements" (2020) 23:4 *Journal of International Economic Law* 1015-39, at 1015-16 (https://doi.org/10.1093/jiel/jgaa031).

169 Alphabet, "Google Announces Plans for New Operating Structure" (https://abc.xyz/investor/news/2015/0810).

Zealand Ltd. is involved in the provision of the firm's online advertising and cloud computing services to customers in New Zealand, while Google Payment New Zealand Ltd. participates in the selling of apps and the collection of revenue from in-app purchases on the Google Play platform. Both subsidiaries are wholly owned by Google International LLC, a company incorporated in the United States and part of the Google business of the Alphabet group.[170] This group structure is illustrated in figure 1.

As indicated by the consolidated financial statements of the ultimate parent of the Alphabet group, Alphabet Inc., the group derives most of its revenue from Google Services and Google Cloud. All revenues are recognized when control of the promised goods or services is transferred to Alphabet's customers and the collectibility of sales proceeds becomes probable.[171]

Google Services include performance advertising; brand advertising; consumer subscriptions; app platforms; and sales of the Pixel family of phones, tablets, and other devices.[172] In 2023, more than 75 percent of total group revenues came from online advertising.[173] For reporting purposes, the Alphabet group divides advertising revenue into revenues generated on YouTube properties, revenues generated on Google Search and other properties (such as Gmail, Google Maps, and Google Play), and revenues generated on Google Network properties.[174] Most of Google's cloud revenues come from consumption-based fees and subscriptions for access to, and the services of, Google Cloud platform and Google Workspace platform.[175]

Advertising and cloud revenues generated by Google properties are reported on a gross basis, because in providing services for such properties, an entity of the Alphabet group is always a principal. Advertising on Google Network properties

170 Google New Zealand Limited Financial Statements, Financial Year Ended 31 December 2023 (https://app.companiesoffice.govt.nz/companies/app/service/services/documents/2C7584C190837E10487016636F853FB3); and "Google Payment New Zealand Limited (1904436) Registered" (https://app.companiesoffice.govt.nz/companies/app/ui/pages/companies/1904436/shareholdings).

171 For advertising sold on a cost-per-click basis, the revenue is recognized when a user clicks on the ad on properties of Google or Google Network members, or views the ad on YouTube for a specified period of time. For advertising sold on a cost-per-impression basis, the revenue is recognized on the basis of the number of times the advertiser's ads were displayed on properties of Google or Google Network members. Consumption-based cloud revenues are recognized when the customer utilizes the services and are based on the quantity of services consumed; subscription cloud revenues are recognized rateably. See Alphabet Inc., "Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2023" (https://abc.xyz/assets/43/44/675b83d7455885c4615d848d52a4/goog-10-k-2023.pdf), at 56-57.

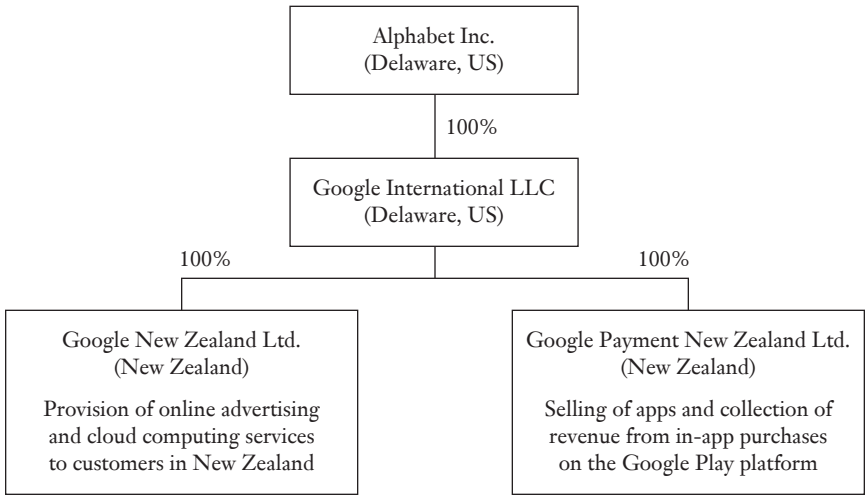
172 Ibid., at 7 and 31.

173 Ibid., at 11.

174 Ibid., at 31.

175 Ibid., at 32.

FIGURE 1 Google Business in New Zealand



involves third parties and their properties. When reporting these revenues, the Alphabet group uses two approaches, depending on whether its entity acts as a principal or an agent in the provision of advertising services. The decision about the role of an entity in the provision of advertising services is based on three facts: the control of the advertising inventory; responsibility to customers (that is, advertisers requesting the services); and the level of discretion exercised in establishing pricing.[176] When the group acts as a principal, advertising revenues for ads placed on Google Network properties are reported on a gross basis—the amounts billed to customers are recorded as revenues, and the amounts paid to Google Network partners are recorded as costs of revenues.[177] When the group acts as an agent, it reports revenues on a net basis.[178] When contracts with customers include multiple performance obligations, the Alphabet group allocates revenues to each performance obligation based on its relative stand-alone selling price, which is the price charged to customers.[179]

The principal-agent distinction in relations between the Alphabet group and the customers of its digital services is relevant only with regard to third parties advertising on Google Network properties. However, the separate-entity approach to the accounting and taxation of multinational groups allows the principal-agent distinction to be used also at the intragroup level, and enables intragroup transactions to

176 Ibid., at 56-57.

177 Ibid.

178 Ibid.

179 Ibid., at 57.

be organized in a way that leaves very little taxable profit in a market jurisdiction. In order to operate as a principal supplier of cloud and advertising services, an entity of the Alphabet group should control web servers where the information can be stored (cloud storage) and control the properties for ad placement. By assigning control over cloud storage and ad placement to the group's entity resident in a low-tax jurisdiction and assigning very few assets, functions, and risks to subsidiaries in market jurisdictions,[180] the Alphabet group shifts most of its sales revenues from these jurisdictions, as the example of Google business in New Zealand illustrates.

Reporting of Revenues and Taxes by Google in New Zealand

No Google entities incorporated in New Zealand are tier 1 for-profit entities under New Zealand's financial reporting regime. In 2014, when the number of tiers for for-profit reporting entities was reduced to two,[181] Google Payment New Zealand Ltd. became a non-reporting entity because it did not meet the new criteria of a "large" company for overseas companies and their subsidiaries.[182] As a result, since 2014, nothing has been publicly known about the revenue generated from the sales of subscriptions, apps, and devices to customers of Google in New Zealand, nor about the amount of income tax paid by Google Payment New Zealand Ltd. in relation to those sales. Only Google New Zealand Ltd. is required to file its financial statements in New Zealand, and even then it is entitled (and has chosen) to be treated as a tier 2 for-profit entity and therefore subject to reduced disclosure requirements.

In its financial statements, Google New Zealand Ltd. refers to Google Asia Pacific Pte. Ltd., a tax resident of Singapore that acts as a sales hub for Google entities in the Asia Pacific (APAC) region. Whether Google Asia Pacific Pte. Ltd. has the degree of control that would allow it to act as a principal supplier of advertising and cloud services of the Alphabet group, or whether it is an agent of another entity of the Alphabet group, is not publicly known. It is, however, plausible to assume that if such control were exercised by New Zealand's Google entities, their reported revenue would be much higher, because they would, at least formally, be performing more functions and incurring more risks, which would be reflected in their share of intra-group revenue.

180 For a range of functions, assets, and risks, see Organisation for Economic Co-operation and Development, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD, 2017), at 51-74, paragraphs 1.51 to 1.109 (herein referred to as "OECD transfer-pricing guidelines").

181 Supra note 141.

182 Financial Reporting Act 2013, supra note 92, section 45(2); and Companies Act 1993, supra note 130, sections 196 (1)(b), 201, and 207B.

When producing advertising services, Alphabet Inc. interposes its entities in the global Google value chain multiple times.[183] The same is likely to occur in the production of cloud web services. The Alphabet group does not have cloud storage facilities in New Zealand. It is also unlikely that its New Zealand entities control the cloud web servers or properties of the group for ad placement or technology that runs real-time ad auctions. New Zealand's Google entities can perform only targeting and advertiser advisory functions on their own behalf; all other services are provided to New Zealand customers on behalf of an entity that controls the group's properties and technology necessary for the provision of these services. Without such control, New Zealand's Google entities cannot be regarded for tax purposes as principals in any transactions with customers of their cloud web services and advertising services.

If Google New Zealand Ltd. cannot act as a principal, it cannot be a reseller of cloud and advertising services. A "reseller" is a person "that sells something they have bought to someone else."[184] This concept is more relevant to goods than to services. Buying and selling implies a transfer of ownership. A service is usually produced and consumed at the same time, which makes the "transfer of ownership" and the resale of services technically impossible. This might explain why the OECD transfer-pricing guidelines do not explain how the resale price method applies to the resale of services, and offer only an explanation with respect to the resale of goods.[185] In the sales context, ownership arises only in relation to some outcomes of a service and only after the service is provided. Nevertheless, not only is the reseller model popular among tech giants operating in New Zealand, but also, as this section explains, Google New Zealand Ltd. has brought it to a new level by claiming to be a "reseller" and a "facilitator" of the same sales.

Until the middle of 2018,[186] Google New Zealand Ltd. was providing "marketing and service support" services to Google Asia Pacific Pte. Ltd. for a fee "based on the level of expenses, as agreed between parties."[187] Initially, revenue from all intragroup transactions had been included in the financial statements of the company filed in

183 For more detail, see Competition and Markets Authority (UK), "Online Platforms and Digital Advertising: Market Study Final Report, 1 July 2020" (https://assets.publishing.service.gov.uk/media/5fa557668fa8f5788db46efc/Final_report_Digital_ALT_TEXT.pdf), at paragraph 5.209 and at 265, table 5.1.

184 *Oxford Dictionary of English*, 3d ed., entry "reseller."

185 OECD transfer-pricing guidelines, supra note 180, at paragraph 2.37.

186 Google New Zealand Limited Financial Statements, Financial Year Ended 31 December 2018, at 10, subparagraph (d)(ii). See also Google New Zealand Limited Financial Statements, Financial Year Ended 31 December 2022, at 10, subparagraph (c)(i).

187 Google New Zealand Limited Financial Statements for the Year Ended 31 December 2017, note 2(d)(i) (https://app.companiesoffice.govt.nz/companies/app/service/services/documents/84C7A2AE470C945F04CF0769F6823D1B).

New Zealand.[188] However, in response to the introduction of the statutory anti-avoidance permanent establishment provision,[189] Google New Zealand started reporting its intragroup transactions differently and began paying significant service fees to other entities of the Alphabet group.[190] No material changes in the business operations of Google New Zealand Ltd. had taken place. As of 2018, the Income Tax Act 2007 requires that the domestic transfer-pricing rules be interpreted consistently with the OECD transfer-pricing guidelines.[191] According to these guidelines, "the cross-border reorganisation of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements,"[192] would normally be driven by economic reasons.[193] The lack of such reasons behind the change in reporting of sales revenue by Google New Zealand Ltd. surely should have attracted the attention of Inland Revenue. However, whether it attracted Inland Revenue's attention, let alone triggered a response, is not known by the general public. Google New Zealand Ltd.'s reporting and tax behaviour did not change in 2018. The four-year time bar for a reassessment and a possibility of its extension,[194] the seven-year time bar for a reassessment of cross-border transfer-pricing arrangements,[195] and the lengthy tax audit, administrative appeal, and litigation process mean that even if a reassessment has taken place, the public may not find out about it until many years later, unless the company discloses this information in its own financial statements before the reassessment becomes public by some other means. For example, in a recent tax-avoidance case that involved a multinational group (Frucor Suntory New Zealand Limited), the commissioner of inland revenue challenged deductions claimed in 2006 and 2007, but the first court decision in this dispute was not rendered until 2018.[196] Also in Google's case, if a tax dispute between Google New Zealand Ltd. and the commissioner of inland revenue

188 Financial statements of Google New Zealand Ltd. from 2010 and later years, and financial statements of Google Payment New Zealand Ltd. from 2010 to 2015, can be found at https://companies-register.companiesoffice.govt.nz. See also Victoria Plekhanova, "Taxation of Global Digital Matchmakers: A Tentative Step Forward?" (2018) 24:1 *New Zealand Business Law Quarterly* 69-89, at 71-74.

189 Income Tax Act 2007, supra note 94, section GB 54.

190 Financial Statements, Financial Year Ended 31 December 2018, supra note 186, at 28, note 24.

191 Income Tax Act 2007, supra note 94, section GC 6(1B), inserted on July 1, 2018 by the Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 (2018 No. 16), section 40(3).

192 OECD transfer-pricing guidelines, supra note 180, at paragraph 9.1.

193 For examples of economic reasons, see OECD transfer-pricing guidelines, ibid., at paragraph 9.4.

194 Tax Administration Act 1994, supra note 62, section 108.

195 Income Tax Act 2007, supra note 94, section GC 13(6).

196 *Frucor Suntory New Zealand Limited v. Commissioner of Inland Revenue*, [2018] NZHC 2860.

is settled, it is highly unlikely that the details of the settlement will be published or explained in the company's financial statements.

The reaction of Inland Revenue to the company's new reporting model is also unknown. Under this model, Google New Zealand Ltd. makes two mutually exclusive statements in its financial statements. It calls itself a reseller of the services of Google Asia Pacific Pte. Ltd., but it also refers to Google Asia Pacific Pte. Ltd. as its customer, which acquires "resale and other support services" relating to advertising on Google properties or Google Network members' properties as well as services relating to Google Cloud offerings.[197] The company does not report any revenue from sales to external parties. As shown in figure 2, in 2023, Google New Zealand Ltd. declared revenue of $84,262,985, most of which was a "commission/service fee."[198] This amount was reduced by the amount of "cost of sales and services" and "operating costs," resulting in a pre-tax profit of $23,371,628.[199] In the same year, the company paid $959,422,411 as service fees to other companies of the Alphabet group for undisclosed services.[200] This fee has exceeded the company's revenue in the same year more than 11 times.

If Google New Zealand Ltd. were a reseller, it would include the revenue generated from the sales of its advertising and cloud computing services in its financial statements.

In explaining the nature of its business in New Zealand, Google New Zealand Ltd. says that it "*facilitates*: (1) the purchase of advertisement inventory through Google Ads, Google Ad Manager as part of the Authorised Buyers marketplace, and Google Marketing Platform, among others; . . . (2) the offering of advertising on other bases such as cost-per-impression, which means an advertiser pays based on the number of times their ads are displayed on Google properties and Google Network Members' properties; and . . . (3) the sale between its customer Google Asia Pacific Pte Ltd and the end-user [of cloud services]."[201]

A "facilitator" is a "person that makes an action or process easy or easier,"[202] and is different from a "reseller." In the sales context, a facilitator is an intermediary and can be an agent of one or both parties to the transaction. The same person can be a reseller and a facilitator at the same time, but only in relation to different transactions, because the two roles are mutually exclusive. According to Google New

197 Financial Statements, Financial Year Ended 31 December 2023, supra note 170, at 11-12, subparagraphs (c)(i) and (iii).

198 Ibid., at 20.

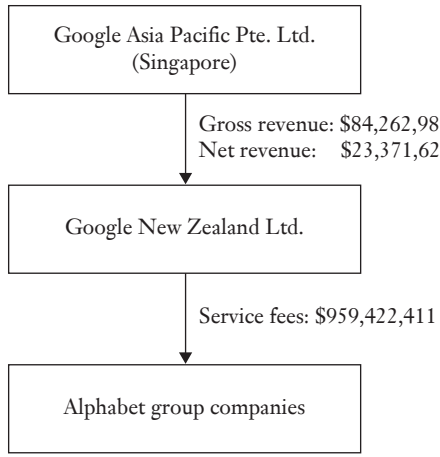
199 Ibid., at 5.

200 Ibid., at 30, note 20(a).

201 Ibid., at 11, note 2(c)(i) and (iii) (emphasis added).

202 *Oxford Dictionary of English*, supra note 184, entry "facilitator."

FIGURE 2 Revenue Reported by Google New Zealand Ltd. in Its Financial Statements, 2023



Zealand Ltd., however, reselling means facilitation, and reseller fees are, in fact, remuneration for facilitation.[203]

Google New Zealand Ltd. refers to NZ IFRS 15[204] in support of its claim that it acts as an agent. It emphasizes its lack of control over the advertising inventory before it is transferred to the advertiser, but says nothing about its responsibility to customers and its level of discretion in establishing prices.[205] In making a similar determination in relation to cloud computing services, Google New Zealand Ltd. claims agent status because "it does not control the Cloud service before it is transferred to the end-user."[206] It also says that "[t]he Company . . . considers whether it is primarily responsible for fulfilling the contract, has inventory risk and has pricing latitude,"[207] but does not elaborate on whether it has such responsibilities, bears such risks, or influences pricing.

NZ IFRS 15 distinguishes principal considerations from agent considerations on the basis of the nature of the promise to a customer—that is, an obligation to supply a good or service or to arrange such a supply.[208] A principal controls a good or service

203 Financial Statements, Financial Year Ended 31 December 2023, supra note 170, at 11-12, note 2(c)(i) and (iii).

204 NZ IFRS 15, supra note 113.

205 Financial Statements, Financial Year Ended 31 December 2023, supra note 170, at 11, note 2(c)(i).

206 Ibid., at 12.

207 Ibid.

208 NZ IFRS 15, supra note 113, at paragraph B34.

prior to its transfer to a customer.[209] Control is established on the basis of various indicators,[210] and does not need direct involvement in performance, and may exist even when a subcontractor is involved.[211] The company's explanation, together with its admission that it does not enter into contracts with the consumers of its advertising and cloud computing services, means that Google New Zealand Ltd. is an agent of Google Asia Pacific Pte. Ltd. and bears an obligation only to arrange the supply of services of Google Asia Pacific Pte. Ltd. An agent needs only to account for its commission on a net basis.[212] The commission is the markup on the cost of the agency function,[213] as agreed by Google New Zealand Ltd. and Google Asia Pacific Pte. Ltd.

If Google New Zealand Ltd. is a facilitator of the cloud and advertising services that Google Asia Pacific Pte. Ltd. supplies to customers in New Zealand, then the arrangement between Google New Zealand Ltd. and Google Asia Pacific Pte. Ltd., under which these supplies take place, appears to meet all of the criteria of the anti-avoidance permanent establishment provision introduced in 2018.[214] That is:

- Google Asia Pacific Pte. Ltd. is a non-resident supplier,[215] whereas Google New Zealand Ltd. is an independent agent and a facilitator of the supply;[216]
- Google New Zealand Ltd. is associated with Google Asia Pacific Pte. Ltd., since they both have the same ultimate parent;[217]
- Google New Zealand Ltd. derives all of its income from Google Asia Pacific Pte. Ltd. or entities associated with it,[218] since Google New Zealand Ltd. claims that its only customers are two entities of the Alphabet group;
- Google New Zealand Ltd.'s activity is not preparatory for or auxiliary to the facilitated supply;[219]
- income of Google Asia Pacific Pte. Ltd. from the facilitated supply is not within the scope of the double taxation agreement (DTA) between New Zealand and Singapore,[220] because Singapore reserved the right for the entirety

209 Ibid., at paragraph B34A.

210 Ibid., at paragraph B37.

211 Ibid., at paragraph B35.

212 Ibid., at paragraphs B36 and B37A.

213 OECD transfer-pricing guidelines, supra note 180, at paragraph 7.34.

214 Income Tax Act 2007, supra note 94, section GB 54.

215 Ibid., section GB 57(1)(a).

216 Ibid., section GB 57(1)(b).

217 Ibid., sections GB 57(1)(c)(i) and YB 2(3).

218 Ibid., sections GB 57(1)(c)(ii) and YB 2(3).

219 Ibid., section GB 57(1)(d).

220 Ibid., section GB 57(1)(e).

of article 12 of the multilateral instrument[221] not to apply to its covered tax agreements, including its DTA with New Zealand;[222]

- section YD 4B(3) of the Income Tax Act 2007 does not apply because of the existence of New Zealand-Singapore DTA;[223]
- income of Google Asia Pacific Pte. Ltd. from the facilitated supply is not attributable, other than under section GB 57 of the Income Tax Act 2007, to its permanent establishment in New Zealand;[224] and
- the arrangement between Google Asia Pacific Pte. Ltd. (a non-resident supplier) and Google New Zealand Ltd. (a facilitator) has a purpose or effect of affecting the imposition of New Zealand income tax on Google Asia Pacific Pte. Ltd., by directly[225] and purposefully[226] avoiding New Zealand income tax liability for Google Asia Pacific Pte. Ltd., which is a non-resident entity of a large multinational group.[227]

If all of the criteria of the anti-avoidance permanent establishment provision are met, the non-resident seller (Google Asia Pacific Pte. Ltd.) has to attribute its sales revenue and related costs to its permanent establishment in New Zealand and pay income tax there. Whether such an attribution and payments have been taking place has not been disclosed to the public. This secrecy, in light of the opaque and confusing reporting of Google New Zealand Ltd. and the lack of changes in its tax behaviour in New Zealand, undermines both public trust in the integrity of New Zealand's tax system and its administration, and trust in the private sector.

SUMMARY AND CONCLUSION

Many countries rely on voluntary tax compliance through self-assessment, and try to balance taxpayers' privacy and confidentiality rights with the government's revenue needs. Although this article has focused on New Zealand, the conclusions reached are relevant to many other welfare states that have open economies and protect the confidentiality of corporate tax information. Welfare states tend to have

221 Organisation for Economic Co-operation and Development, Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting, released on November 24, 2016.

222 Republic of Singapore, "Status of List of Reservations and Notifications upon Deposit of the Instrument of Ratification, Acceptance or Approval" (www.oecd.org/tax/treaties/beps-mli-position-singapore-instrument-deposit.pdf); see the notification on article 2 and the reservation to article 12.

223 Income Tax Act 2007, supra note 94, section GB 57(1)(f).

224 Ibid., section GB 57(1)(g).

225 Ibid., section GB 57(1)(h)(iii).

226 Ibid., section GB 57(1)(i).

227 Ibid., section GB 57(1)(j).

relatively high and progressive income taxes to enable the redistribution of funds and to provide public goods. High tax burdens make these states "potentially vulnerable to eroding tax morals and extensive underground activity that can evade taxation."[228] Such vulnerability deepens when a welfare state has an open economy, relies on voluntary tax compliance, protects the tax information of all taxpayers, and has weak or corrupted enforcement institutions.

According to Stiglitz, in democratic societies "there should be a strong presumption in favor of transparency and openness in government."[229] The same can be said about collective action, including taxation. A decision whether or not to pay tax may look like the choice of the individual taxpayer, but the outcome of this choice either contributes to or impedes the funding of public goods, which makes every taxpayer's choice part of a collective action. This choice depends, among other things, on the taxpayer's trust of other taxpayers' integrity and of the institutions governing taxation or having an impact on it. This trust, if developed rationally, is a result of the assessment of comparable information about both the taxes paid by other taxpayers and the responses of the governing institutions to other taxpayers' misbehaviour, including the misbehaviour that affects the availability or quality of comparable tax information. The availability of such information, as this article has argued, is critical for the operation of a tax system premised on voluntary compliance.

When it comes to income tax paid by corporate entities, the availability of tax-related information to the public is especially important, because the taxation of investors' income derived through a company can be deferred, and, if a company is part of a multinational group and controlled by non-residents, the company's income in a host country can be reduced through economically unsound intragroup transactions that shift its profits to overseas entities of the group. Both tax deferral and cross-border profit shifting mean that entities of foreign multinational groups have more opportunities relative to other taxpayers to access public goods in a host country without adequately contributing to the funding of those goods. If these free-riding opportunities are unconstrained, other taxpayers will bear the burden of underpaid tax and, inevitably, will question the integrity of the state's tax system. This is what has been happening in New Zealand, and the non-compliant behaviour of some individual taxpayers may be a response to concerns that multinationals operating in the country are not paying their fair share and that the governing institutions are unable or unwilling to address the issue.

This article has explained how the existing institutional settings have created and continue to maintain a tax information deficit in New Zealand. This deficit, it is argued, erodes public trust in the integrity of New Zealand's tax system and trust in the private sector. The case study of the Google business of the Alphabet group in New Zealand has demonstrated how this group has taken advantage of the existing institutional settings. Since 2018, the financial statements of the group's entities

228 Bjørnskov, supra note 35, at 639.

229 Stiglitz, supra note 1, at 2.

operating in New Zealand as Google New Zealand Ltd. have become so obscure that even people with knowledge of tax rules have been struggling to understand what exactly Google New Zealand Ltd. is doing in New Zealand and what its functions and risks are within the Alphabet group. The fact that Google New Zealand Ltd. pays a service fee that does not match its business income catches the attention of New Zealand media regularly.[230] However, there has been no reaction—at least no public reaction—from Inland Revenue, the institution administering taxation, or from the External Reporting Board, the institution regulating financial reporting.

When domestic law protects the confidentiality of corporate tax information, as is the case in New Zealand and many other countries, financial reports become the only means by which the public can access some tax information about certain companies. Unfortunately, New Zealand's financial reporting regime does very little to alleviate the tax information deficit. The regime's reference to the needs of primary users, and its labelling of these needs as its primary objective,[231] create an impression that the regime seeks to satisfy the needs of these users. However, as a closer look reveals, the regime in fact fails to achieve this goal, and is ineffective especially when it comes to regulating the behaviour of privately owned foreign multinationals.

First, the regime sets high in-scope thresholds for the reporting of for-profit entities, which enables most entities of foreign multinational groups to escape mandatory disclosure of financial information. Second, the regime grants exclusive rights to financial information only to primary users. Third, by narrowing the definition of primary users and the information they are entitled to, the financial reporting regime limits the scope of information that should be disclosed. Fourth, the regime views auditors as providers of monitoring services to reporting entities and protects their privacy. This approach boosts the commercial logic of the auditing industry, making it unable to assist in keeping the managers of its client reporting entities accountable for companies' finances and reporting. The Google example confirms a concern that the anticipation of future audit fees can lead to auditors allowing a lower quality of financial reporting by managers.[232] Privacy protection—which appears to be a rationale behind de facto anonymous auditors' reports of Google New Zealand Ltd.—

230 Chris Keall, "Google NZ Pays Almost $1 Billion of In-House Fees, Weighs Impact of NZ Signing Up for OECD's Pillar Two Tax Crackdown," *New Zealand Herald*, May 30, 2024 (www.nzherald.co.nz/business/google-nz-pays-almost-1-billion-of-in-house-fees-weighs-impact-of-nz-signing-up-for-oecds-pillar-two-tax-crackdown/RNL2O347GZCBFH5KL5QWTGW7LU); Chris Keall, "Google NZ Pays $870M Fee to US Parent, Books $78M Local Revenue," *New Zealand Herald*, May 25, 2023 (www.nzherald.co.nz/business/google-nz-pays-870m-fee-to-us-parent-books-78m-local-revenue/2Q4JPQUURBCAXMC5MJG7HJLXTI); and Terry Baucher, "The Week in Tax: A Closer Look at Inland Revenue Operations. Is Google Taking the Government for a Ride? And a Warning About the New Bright-Line Test," *interest.co.nz*, June 6, 2021 (www.interest.co.nz/news/110727/week-tax-closer-look-inland-revenue-operations-google-taking-government-ride-and-warning).

231 For more detail, see the discussion document, supra note 83, at paragraph 2.2.

232 Hayne and Salterio, supra note 48, at 434.

allows individual auditors to remain unaccountable to the users of the reports and to the general public.[233] Fifth, New Zealand's financial regime is indifferent to the fact that many auditing firms are themselves multinationals. Meanwhile, the multinationalization of the providers of assurance services eases the cross-border transfer of knowledge and expertise, including experience in making financial disclosure less meaningful without formally breaching the IFRS. Sixth, New Zealand's current financial reporting regime, despite its regular amendments, fails to incentivize good reporting behaviour. The financial statements of Google New Zealand Ltd. discussed in this article are by any measure opaque and confusing, but the regime has no effective instruments to make the company change its reporting behaviour. Although a new standard, NZ IFRS 18, has introduced the concept of "obscured information," which, presumably, can address situations related to tax information, this standard becomes compulsory for reporting entities only as of January 2027.[234] Moreover, it reproduces the existing approach to the wrongdoings of a reporting entity,[235] which makes it very difficult to establish such wrongdoing. In particular, the misbehaviour of a reporting entity will be considered to be wrongdoing only if it could reasonably be expected to influence any decisions made by the primary users of the specific reporting entity's general-purpose financial statements.[236] Such influence (or lack of it) is to be established on the basis of the characteristics of those users while also considering the entity's own circumstances.[237] On the surface, NZ IFRS 18 appears to strengthen the reporting requirements for entities, but in reality it offers no instruments that encourage meaningful compliance with the reporting standards.

Finally, the External Reporting Board has failed to assess the effects of its decisions on New Zealand's tax base, voluntary tax compliance, and business competition. The board has not sought to place all New Zealand entities of large multinational enterprises under the scope of New Zealand's financial reporting regime, because they have opportunities for cross-border profit shifting that are unavailable to stand-alone business entities. Nor has the board attempted to increase the disclosure requirements for tier 2 for-profit entities of foreign multinational groups. In fact, the External Reporting Board is against such increases. In May 2024, the IASB issued a new standard, IFRS 19, "Subsidiaries Without Public Accountability: Disclosures," which requires such entities to disclose more information than is currently required for tier 2 for-profit entities in New Zealand. The standard is voluntary. The External Reporting Board has not attempted to incorporate this standard into New Zealand's standards for for-profit entities and make it compulsory, but instead has opted for the

233 The financial statements of Google New Zealand Limited are audited by the Australian company Ernst & Young Australia International Pty. Ltd.; the author's reports have handwritten signatures "Ernst and Young" but no names. See supra note 129, at 4.

234 NZ IFRS 18, supra note 126.

235 Ibid., appendixes B, B3, and B4.

236 NZ IAS 1, supra note 125, at paragraph 7.

237 Ibid.

status quo, until "the IASB reconsiders the scope of IFRS 19."[238] The External Reporting Board has also not sought to strengthen New Zealand's assurance standards.

In combination with the confidentiality of corporate income tax returns, managers' discretion as to what financial information will be revealed in financial reports, and the separate-entity approach to the taxation of multinational enterprises, the flaws in New Zealand's financial reporting regime help to keep foreign multinationals almost invisible to public view, even when they, like the Google entities, dominate the country's markets.

The failure to hold foreign multinationals accountable for their aggressive tax planning or advice, and opaque and confusing financial reporting or assurance, will inevitably affect (or has already affected) the tax morale of individuals residing in New Zealand. If tax morale decreases, New Zealand, as a welfare state with an open economy, has no choice but to rely more on formal tax enforcement and to make the responses of Inland Revenue and the External Reporting Board to the tax, reporting, and assurance misbehaviour of entities, especially the entities of large foreign multinational groups, transparent to the public. Coordination between Inland Revenue and the External Reporting Board, if not subordination of the latter to the former, is also necessary so that the actions (or inactions) of the External Reporting Board do not undermine the revenue-raising efforts of Inland Revenue. Improved financial reporting could prevent Inland Revenue from allowing New Zealand entities of foreign multinational groups to evade proper scrutiny if their public financial disclosures do not align with what they report to tax authorities. Enhanced transparency in financial reporting could also ease public concerns in New Zealand about the perceived unfair tax contributions of foreign multinationals to the economy. A simpler and much cheaper alternative to enhanced financial reporting would be an amendment of the Tax Administration Act 1994 with a rule that requires all entities of multinational groups operating in New Zealand to publish their income tax returns, supported by a sizable fine for non-compliance with this tax reporting.

The diversity of factors affecting voluntary tax compliance requires multiple approaches rather than a "one-size-fits-all" solution.[239] Mandatory disclosure of corporate tax returns by companies of multinational groups, and increased transparency of the institutions governing the tax and reporting behaviour of these multinationals, are approaches that can potentially improve the voluntary tax compliance and tax behaviour of both multinationals and other taxpayers, including individuals, and enhance their trust in central government and the private sector. Empirical studies are needed to confirm this hypothesis and to substantiate a trust-mediated link between tax transparency and tax compliance. However, for these studies to take place, multinationals and governments should first become transparent to the people in a meaningful way.

238 New Zealand External Reporting Board, "Update for Tier 2 For-Profit Entities: Status of IFRS 19 Subsidiaries Without Public Accountability: Disclosures" (www.xrb.govt.nz/dmsdocument/5142).

239 Alm, supra note 20, at S46-54.

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Policy Forum: Editors' Introduction—Trade Policy

When the Income War Tax Act was introduced in 1917, customs duties accounted for 55 percent of Canadian federal government revenue. Tariffs were a key component of government revenue, but this changed over the course of the next 100 years. As shown in figure 1, revenues from personal and corporate income taxes first exceeded customs revenues in 1935. By 2023-24, income taxes brought in over 50 times more than customs revenues. When speaking of government revenue, tariffs no longer had a place in the conversation.

In 2025, tariff revenue has returned to the discussion of government revenue in two ways, primarily as a result of developments in the United States. First, US President Trump has repeatedly suggested that the income tax could be replaced with tariff revenue as part of an economic growth strategy. In reality, even the most aggressive revenue-optimized tariff regime would raise far less revenue than income tax in the United States. Second, the desire of the new president and Congress to cut taxes may require some positive source of revenue to offset the budget impact of an income tax cut.

Moreover, tariff discussions in the United States have implications for countries that may face a US tariff. In just the first three weeks of the new US administration, the US president has either imposed tariffs or made haphazard tariff threats on a long list of items from countries including (as of this writing) China, Mexico, Denmark, Taiwan, Colombia, and Canada, with all countries facing the threat of tariffs for aluminum and steel as well as the imposition of "reciprocal tariffs" in the event that any country imposes or increases tariffs on its imports of US goods. These threats have led residents of these countries to learn more about how tariffs work, both for exports, now potentially subject to US tariffs, and for imports that may become subject to domestic countervailing tariffs.

In this Policy Forum, we present two articles that contribute to this renewed discussion of tariffs as tax policy.

In the first article, Jennifer Farrell and Scott Wilkie argue that trade policy and international tax policy are intrinsically connected. The international tax avoidance targeted by the base erosion and profit shifting project of the Organisation for Economic Co-operation and Development has, at its origin, multinational enterprises trading goods and services and operating across national borders. Whatever steps that authorities take to limit tax avoidance by multinational enterprises will necessarily have an impact on trade. Moreover, the authors argue that the implicit subsidies granted to favoured enterprises offered under a country's income tax rules often escape the scrutiny that would be focused on the same favours delivered through

FIGURE 1 Share of Federal Government Revenue from Income Tax and Customs Duties



Note: Federal government revenue is defined to include all sources of federal revenue, excluding social insurance contributions (employment insurance, unemployment insurance, and the Canada and Quebec pension plans).

Sources: For historical tax revenue sources from 1867 to 1975, Statistics Canada table 11-516-X, "Historical Statistics of Canada," series H1-18 (www150.statcan.gc.ca/n1/pub/11-516-x/sectionh/4057752-eng.htm#1); for current tax revenue sources, Canada, Department of Finance, "Fiscal Reference Tables" (www.canada.ca/en/department-finance/services/publications/fiscal-reference-tables.html).

trade policy. If the US government's actions in 2025 lead to deeper reflection on the linkage between trade and tax policy around the world, this article provides a good starting point for understanding that these two policy spheres should perhaps never have been delinked.

In the second article, Eloise Brouillard engages with the legal and administrative mechanics of tariffs. She explains the importance of international and regional trade agreements, such as the Canada-United States-Mexico Agreement, as well as the role played by organizations that have developed standards and guidelines for international tariffs, including the World Trade Organization and the World Customs Organization. By standardizing over 5,000 groups of products into a harmonized tariff schedule, countries have been able to align their production, export, and import regulations and administration to facilitate international trade. The author explores how rules of origin and customs valuation are applied, and how they affect trade. In

the present turbulent environment for trade policy, this article provides a valuable primer for policy makers on the implementation of tariff policy.

If the United States' tariff threats become a reality, we anticipate that these two contributions will be the beginning of a renewed scholarly and policy focus on the design of tariffs and the linkages between tax and tariff policy more broadly.

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Policy Forum: Reflections on the Relationship Between International Tax and Trade Law and Policy, and International Tax Avoidance

Jennifer E. Farrell and Scott Wilkie*

PRÉCIS

Les politiques et lois fiscales, les politiques et lois commerciales et les perceptions corrélatives de ce qui constitue de l'« évitement fiscal à l'échelle internationale » sont intrinsèquement liées, mais trop souvent, ces domaines font l'objet d'examens séparés qui ne prennent pas cette relation en compte, pourtant une nécessité. Toutefois, un manque de compréhension de ce lien et des intérêts des États les uns par rapport aux autres tels qu'ils sont mobilisés notamment par l'intermédiaire de leurs régimes fiscaux affaiblit la cohérence théorique et pratique des lois fiscales et commerciales. En outre, la distinction profonde entre l'évitement fiscal à l'échelle internationale discutable par contraste avec l'évitement de l'impôt qui se produit purement, voire incontestablement, naturellement parce que les régimes fiscaux et juridiques des États fonctionnent différemment au mieux de leurs intérêts n'est pas suffisamment bien comprise dans l'évaluation du caractère adéquat et approprié des intérêts fiscaux des pays les uns par rapport aux autres. Cet article offre des observations sur ces corrélations et un cadre pour les analyser tant dans la pratique que dans la conception des politiques fiscales et commerciales.

ABSTRACT

Tax policy and law, trade policy and law, and consequential perceptions of what constitutes "international tax avoidance" are intrinsically connected, but too often these fields are examined separately without a necessary awareness of this connection. However, without understanding this connection, and states' interests in relation to each other as mobilized among other ways through their tax systems, both the theoretical and practical coherence of tax and trade law are undermined. In addition, the profound distinction between impugnable international tax avoidance when contrasted with what is merely, if not incontrovertibly, naturally occurring avoided tax because states' legal and tax regimes operate differently according to their interests, is not well enough understood in evaluating the adequacy and suitability of

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countries' fiscal interests in relation to each other. This article offers observations on these connections and a framework for considering them as much in practice as in tax and trade policy design.

KEYWORDS: TAX AVOIDANCE ■ INTERNATIONAL TAXATION ■ INTERNATIONAL TRADE ■ OECD ■ BEPS ■ MULTINATIONAL CORPORATIONS

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INTRODUCTION

This article has the modest objective of drawing attention to the intrinsic connection between international tax and trade law and policy. This connection might seem obvious, or perhaps has been taken for granted, but the tenor of the continuing international tax conversation around the base erosion and profit shifting (BEPS) project of the Group of Twenty (G20) and the Organisation for Economic Co-operation and Development (OECD) suggests otherwise. Indeed, by avoiding or being unaware of the influence of trade on the international tax world, the conversation misses the point of systematically reconciling different legal and tax regimes that have grown out of states' unique characteristics, needs, and resources. Instead, the focus of international tax under the BEPS banner has been on the self-interested misbehaviour of multinational enterprises (MNEs). We question whether international tax avoidance[1] intentionally results in subsidies, discrimination, or other economic trade effects, and might be impugnable according to trade and competition regulation as discriminatory "state aid" if implemented, whether overtly or covertly, through systemic aspects of a tax system. At the heart of this question is whether evergreen tax planning, in which MNEs are the immediate economic actors, is in effect directed by states, reflecting their economic self-interests. Put simply, the international tax-avoidance or tax-saving strategies of MNEs may be no different from more traditional trade subsidization instruments regulated by international trade law (such as tariffs and customs duties) through which states seek an advantageous trade or investment position.

1 For these purposes, we define international tax avoidance as MNEs utilizing differences in the laws of individual jurisdictions to minimize or eliminate tax liabilities.

Little, if any, attention is devoted to questioning why the tax rules that MNEs utilize in their global business structures and transactional practices *are as they are*, and whether state tax rules reflect *deliberate systemic support* for MNEs' tax planning that encourages various kinds of economic activities in the interests of the state applying those tax rules.[2] Instead, something of a status quo exists, where MNEs' strategies for leveraging normative state tax rules tend to be conflated with inherently malicious and thus problematic international tax avoidance. The penchant of tax authorities for justifying the non-recognition of otherwise legally effective transactions through general anti-avoidance and transfer-pricing rules and administrative practices exemplifies an underlying fiscal moralism that is both misplaced and dangerous.

Perceived international tax avoidance by MNEs has been dissected from technical perspectives, primarily within or deriving from the BEPS work, and from geopolitical, global justice, and fairness perspectives, but primarily within a tax silo. This fiscally narcissistic and solipsistic analysis takes for granted "international tax" as doctrinal and self-contained. But tax and trade do not exist in silos, in either domestic or international environments. They are simply means by which a state's broad fiscal choices, including decisions about competitive trade and investment concerns, are implemented. Focusing on tax rules without considering states' purposeful trade behaviours and relationships is an empty exercise. Yet very little has been said about how international tax rules and derivative planning by MNEs to avoid tax interact with international trade law and policy.

What many take for granted as the "international tax system" did not emerge out of thin air. Instead, international tax rules and practices (such as foreign tax credits and tax treaties) reflect states' domestic legal concessions to the internationalization of their taxpayers' activities, and their attempt to attune distinct tax and legal regimes through reciprocal coordination.[3] The League of Nations' work in the 1920s and 1930s on the international dimensions of taxation, the foundation on which "international taxation" was built, arose from efforts to mitigate trade distortions caused by excessive ("double") taxation. This work of evaluating and crafting inter-nation tax accommodations necessarily entailed an understanding that states' tax policy and law could be, or at least could be seen as, the source of national aid and subsidy, and could consequently generate trade distortions and discrimination.

2 The direction of this discussion draws on Scott Wilkie, "Pillar 2—'What's It All About?'" (2023) 110:4 *Tax Notes International* 499-510; and Scott Wilkie, "Op-Ed: The Apple Case: 'Wrong' Questions, Misguided Answers, Regulatory Distortion?" *EU Law Live*, October 8, 2024 (https://eulawlive.com/op-ed-wrong-questions-misguided-answers-regulatory-distortion).

3 Scott Wilkie, *Insights About the Role of the First Sentence of Article 25(3) of the Organisation for Economic Co-operation and Development Model Tax Convention Drawn from Principles Manifest in the Vienna Convention on the Law of Treaties* (Rotterdam: International Fiscal Association, forthcoming).

The connection between trade and tax is commonly understood, almost without exception, with reference to indirect taxation—customs duties, tariffs, and forms of sales and consumption taxation. Historically, however, the influence of direct income tax on trade and investment was also acknowledged,[4] and MNEs' use of international income tax planning in today's modern tax era undeniably has an impact on trade. A few examples of tax-trade ties will not only explain this argument but also reinforce the need for a constructive and overdue examination of the tax-trade connection, untethered from parochial and limiting perceptions of international tax, which in the present political environment may prove dangerous.[5]

EXAMPLES OF TAX-TRADE TIES

Necessary Retrospection

In the 1940s, as the League of Nations was evolving into the United Nations, a dispute arose between nascent trade and tax committees about who should regulate international tax in the interest of international trade harmony.[6] It was recognized that systemic features of the way international enterprises were taxed could deliver public subsidies to private interests, with resulting trade distortions. The original General Agreement on Tariffs and Trade, the GATT 1947, arose in part from a lack of agreement between the tax and trade factions of the debate over whether income tax, an acknowledged influence on trade, should fall within the purview of tax or trade regulation.[7] The traders went their own way with the GATT 1947, which was originally

4 See Mitchell B. Carroll, "History of Movement To Remove Tax Barriers to International Trade," in Mark Eisner, Robert L. Cochran, and Edgar L. Burtis, *Tax Barriers to Trade* (Philadelphia: Tax Institute of America, 1941), at 205-9; and Jennifer E. Farrell, *The Interface of International Trade Law and Taxation* (Amsterdam: International Bureau of Fiscal Documentation, 2013), at 11-14.

5 The challenges to international trading relationships and countries' "identities" are considered in Michael Ignatieff, "Canada, Trump and the New World Order," *Financial Times*, January 18, 2025 (www.ft.com/content/b8b59846-730a-4a29-a2e3-d0dda791c06b). Gillian Tett, educated as an anthropologist, regularly offers astute commentary on the forces at work that are manifest in economics and business guises; see, for example, Gillian Tett, *Anthro-Vision: A New Way To See in Business and Life* (New York: Avid Reader Press, 2021). John Ralston Saul's prescient philosophical examination of globalism and his treatment of "positive nationalism" is also a provocative reminder of the economic connections between countries, which generate the kinds of interactions that give rise to tax policy and "international tax law." See John Ralston Saul, *The Collapse of Globalism: And the Reinvention of the World* (Toronto: Penguin Canada, 2005). At stake in what we always inaccurately refer to as international taxation are connections that are inherently in the nature of trade—in goods, services, and ideas captured in intellectual property; consequently, trade invokes attention to sovereignty, as does taxation. See Wolfgang Schön, "Taxation and Democracy" (2019) 72:2 *Tax Law Review* 235-303.

6 Farrell, supra note 4, at chapter 2.

7 The negotiating drafts of the International Trade Organization (the ill-fated predecessor of the GATT 1947) contained explicit income tax content: Farrell, supra note 4, at 16-23.

intended as an interim step toward a broader international trade organization, while tax regulation essentially disappeared from the remit of the United Nations.[8] The point for the present analysis, though, is that the linkage between international tax and trade evolved more or less seamlessly from the League of Nations' seminal work.[9]

The OECD developed its interest in—some might say preoccupation with—"harmful tax competition" in the late 1990s and early 2000s.[10] That work, framed by an abhorrence of international tax avoidance and tax havens, focused on the systemic attributes of states' income tax regimes that amounted to means for delivering subsidies. The malcontents of record were MNEs, but implicitly the challenge was to states' deployment of public financial assistance through their tax rules. In the early 2000s, the OECD refocused its tax competition project, although with less vigour, on transparency and international tax reporting. There are various reasons why this might have been so, including concerns of some countries about being denied the use of tax rules to subsidize their MNEs. But there was also a growing realization by the OECD that interventions to proscribe certain international tax rules, notably controlled foreign corporation (CFC) rules, might be discriminatory in the trade regulation context and offend World Trade Organization (WTO) rules.[11] In fact, several developing countries formally expressed dissatisfaction with the OECD project and its compatibility with WTO rules.[12] This weaponization of trade rules against international tax policy, or states' tax rules emanating from international tax policy, was not the first example of such action, and has not been the last.

The GATT 1947/WTO Tax Litigation

Another notable marker of the connection between tax and trade law is a dispute that was litigated in the WTO, beginning in the 1970s and extending into the 2000s, over the disputed discriminatory effects of the United States' direct income tax rules that preferred the (non)taxation of foreign sales income. These rules—the domestic international sales corporation (DISC) rules, which were succeeded in the course of the dispute by the foreign sales corporation (FSC) rules and ultimately the extraterritorial income exclusion (ETI) rules—are close proxies for the foreign affiliate or,

8 Although nothing substantive resulted from the UN Fiscal Commission, the United Nations has a fascinating history of tax work. See Farrell, supra note 4, at chapter 2.

9 See Michael Daly, *Is the WTO a World Tax Organization? A Primer for WTO Rules for Policy Makers* (Washington, DC: International Monetary Fund, 2016). The title of the paper adopts the moniker of institutional trade regulation, the WTO (World Trade Organization), to provocatively question whether there is effectively a world tax organization.

10 Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998); and Organisation for Economic Co-operation and Development, *Towards Global Tax Co-operation: Report to the 2000 Ministerial Council Meeting and Recommendations by the Committee on Fiscal Affairs* (Paris: OECD, 2000).

11 See Farrell, supra note 4, at 201-3 and references therein.

12 Ibid.

more broadly, CFC rules.[13] They are direct income tax rules that, according to various tax policy prescriptions informed by notions of international tax jurisdiction based on the patchwork of tax treaties and the structure of foreign tax credits, abandon the notion of taxing a US foreign corporation's income. The allegation was that the United States was in effect aiding—that is, subsidizing—its MNEs to the detriment of undistorted and non-discriminatory trade. The United States' DISC, FSC, and ETI rules were found to be discriminatory and subsidizing and were impugned in the context of trade law.[14]

The GATT 1947, which framed a rigid and "old economy" perception of trade mostly in tangible goods, generally prohibited discrimination that was traceable to direct income taxation.[15] The WTO agreements of the mid-1990s more explicitly acknowledged the connection between trade law and tax as a source of impugnable trade distortions.[16] While the General Agreement on Trade in Services (GATS) carved out some income tax content, anticipating a conflict between a tax treaty-based mutual agreement procedure and the WTO's dispute settlement process, the GATS offered a way of preferring one forum over the other for what would inherently be a direct income tax dispute.[17]

13 GATT Panel Reports, Belgium—Income Tax; France—Income Tax; Netherlands—Income Tax; US—DISC; US—FSC; Appellate Body Report, US—FSC; Panel Report, US—FSC (Article 21.5—EC); Appellate Body Report, US—FSC (Article 21.5—EC); Panel Report, US—FSC (Article 21.5—EC II); Appellate Body Report, US—FSC (Article 21.5—EC II); Decision of the Arbitrator, US—FSC (Article 22.6—US).

14 An early response by the United States to other states seeking to challenge the legitimacy of the DISC and FSC rules was to point out that exemptions for foreign-incorporated business income (participation exemptions) were equivalent to the US rules. In 1981, an agreement ("the 1981 understanding") was reached between the disputing parties, drawing a distinction between foreign-incorporated income earned in foreign jurisdictions, which is what the participation exemption regimes entailed, and foreign income that was actually or constructively that of domestic taxpayers: see General Agreement on Tariffs and Trade (GATT), "Tax Legislation," document no. L/5271, December 18, 1981.

15 While income taxes generally fall outside the scope of the GATT, measures restricting access to income tax advantages do violate the GATT non-discrimination rules. See Farrell, supra note 4, at 73.

16 The agreements that interact with income taxes include the General Agreement on Tariffs and Trade 1994 (GATT 1994), the General Agreement on Trade in Services (GATS), the Agreement on Subsidies and Countervailing Measures (SCM Agreement), and the Agreement on Trade-Related Investment Measures (TRIMS). For a comprehensive examination of the tax-related WTO rules, see Farrell, supra note 4, at 41-205; see also Daly, supra note 9, at 29-40, for a recent examination of the WTO jurisprudence on taxation.

17 The tax exceptions in articles XIV(d) and XXII(3) to the GATS national treatment rule were added as a result of resistance by the United States, which argued for a "total, direct tax-carve out" during the drafting stage of the GATS. See Farrell, supra note 4, at 190-91. Changes to the United Nations model double taxation convention agreed by the UN Committee of Tax Experts near the end of 2024 may compound the tension between trade regulation and dispute settlement for income tax matters typically thought to be the exclusive province of income tax

G20/OECD BEPS 1.0 and 2.0

The OECD's work against international tax avoidance was revived during the 2008 global financial crisis, resulting in two initiatives commonly labelled BEPS 1.0 and BEPS 2.0.[18] The BEPS work has been prolific, and scholarly literature is replete with critiques and some guarded praise. The work has also exposed or reasserted problematic international tax-planning techniques that place MNEs at an advantage. However, the BEPS work hinges on a narrow perception of fiscal base erosion and ignores the impact of international tax planning on—and indeed as a response to—countries' fiscal and legislative signals about trade and underlying subsidization. Why is this a problem? Because there is very little evidence-based work on the extent of base erosion and zero work on trade impact.[19] BEPS is trying to solve a problem without knowing how and to what degree tax drives or frustrates trade and investment behaviour.

Thus, while BEPS is presented as having addressed perceived problems with international tax planning, it leaves systemic subsidization untouched. This may be attributable in part to the general failure of BEPS, in its preoccupation with tax-avoidance symptoms, to critically address the utility and incidence of corporate income taxation. Almost any direct income tax regime that assists taxpayers in undertaking certain activities bears the marks of aid or subsidy, even though their existence according to trade law might be debated. For example, assistance delivered through the scientific research and experimental development rules is a clear example of public systemic intervention that is designed to influence—really, discriminate in favour of—targeted economic activities, whether sectoral or more taxpayer-focused. Another example is the non-taxation of foreign-incorporated business income—that is, business income as the foreign affiliate regime conceives it—presumably in the

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treaties. Novel changes to the UN model's article 25 with reference to the forum for resolving trade and investment treaty disputes regarding national treatment, presented ostensibly as an extension of the GATS approach, have recently been criticized as so far-reaching as to override the national treatment meant to be protected by the GATS; see Robert Danon and Adolfo Martín Jiménez, "The U.N. Model Tax Convention's Attempt To Override Investment Treaties: A Critical and Normative Assessment" (2025) 117:6 *Tax Notes International* 825-51.

18 The BEPS 1.0 work is comprehensively documented on the OECD website: Organisation for Economic Co-operation and Development, "Base Erosion and Profit Shifting (BEPS)" (www.oecd.org/en/topics/base-erosion-and-profit-shifting-beps.html). BEPS 2.0 commenced in 2021 to tackle the absence of consensus reached in BEPS 1.0 on taxing the digital economy. See, inter alia, Organisation for Economic Co-operation and Development, "Statement on a Two-Pillar Solution To Address the Tax Challenges Arising from the Digitalisation of the Economy—8 October 2021" (www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm).

19 Some empirical work on the quantification of BEPS does exist, although quantitative estimates vary and often rely on "non-trivial assumptions." See Nadine Riedel, "Quantifying International Tax Avoidance: A Review of the Academic Literature" (2018) 69:2 *Review of Economics* 169-81, at 169 (https://doi.org/10.1515/roe-2018-0004).

expectation from Canada's perspective that the internal rate of return on its investment of uncollected tax in a taxpayer's business activities will ultimately contribute to the generation of national wealth. These examples of assistance, aid, or subsidy are presumably intended to be in Canada's interest and are not merely quixotic, episodic, or gratuitous.[20]

Perhaps the real target of the BEPS work is the homogenization of states' tax and private-law regimes in the image of a universal ideal that may or may not be consistent with the fiscal character of any state. But a more careful examination suggests latent trade insecurity in an environment where the "old," readily observable badges of trade have been eclipsed by the digital economy, where MNEs can seemingly be everywhere and nowhere at once.[21] The concerns expressed in BEPS 1.0 and 2.0 about suitable parameters of tax jurisdiction are, fundamentally, trade concerns. That is to say, the concerns are about the distributional effects of tax regimes and the private-law prescriptions to which tax rules are an accessory—that is, trade distortions and discriminatory outcomes that the law effectively institutionalizes unless, in the spirit of the history of trade regulation, something is done about it on the income tax front.

An important question thus arises: Do emerging tax changes, notably key components of pillar 2 of BEPS 2.0, deliberately encourage these effects but ignore or even seek to obscure them through what seem superficially to be "good" tax policy and practice? For example, the strictures of pillar 2 are essentially avoided by states that enact a compatible minimum tax. It is questionable whether elements of pillar 2 offend trade rules, such as the undertaxed profits rule (UTPR).[22] This prediction is reminiscent of the earlier experience with the OECD's harmful tax competition project. Moreover, questions arise as to what prevents those states from "returning" that tax to key business sectors through non-fiscal "subsidies," and what recourse, if any, exists to contest that kind of public intervention. While such recourse will necessarily implicate WTO trade subsidy rules that broadly cover non-fiscal matters, there are serious questions about the effectiveness of the WTO in resolving disputes in a

20 For a useful analysis, from a US perspective, of systemic public assistance embedded in direct income taxation, see Edward D. Kleinbard, *We Are Better Than This: How Government Should Spend Our Money* (New York: Oxford University Press, 2015).

21 Economic geographers imagine what is commonly labelled globalization or globalism—much more effectively than tax analysts do—as the outcome of compressing time and space, which is possible to the extent that the modalities of business and business products shed physical existence and become "intangible," virtual, and infinitely mobile. For a provocative view of this notion of "globalization," see David Harvey, *Marx, Capital, and the Madness of Economic Reason* (New York: Oxford University Press, 2018); for a more mundane but directly tax-oriented view, see Edward D. Kleinbard, "Stateless Income" (2011) 11:9 *Florida Tax Review* 699-773.

22 See Jeffrey Owens and Joy W. Ndubai, "Evaluating the Interaction Between the Compatibility of the Global Anti-Base Erosion Proposal with International Trade Rules," in Julien Chaisse and Cristián Rodríguez-Chiffelle, eds., *The Elgar Companion to the World Trade Organization* (Cheltenham, UK: Edward Elgar, 2023), 506-34.

timely manner, as the United States' DISC/FSC/ETI dispute illustrates.[23] In effect, both pillar 2 and the responses thereto (that is, non-fiscal incentives) create apparent compatibility issues with trade rules—eventualities that the OECD has overlooked. The question is whether, respecting the origins of modern international taxation, "tax rules" really amount to trade regulations.

The EU Fiscal State Aid Litigation and Foreign Subsidies Regulation[24]

The most crystallized relationship between international tax avoidance and trade rules can be found at the regional level within the European Union fiscal state aid jurisprudence. Any doubt that MNE international tax planning was impacting trade or frustrating trade rules is removed by the proliferation of EU fiscal state aid cases.[25] The scope of article 107(1) of the Treaty on the Functioning of the European Union (TFEU), the anti-state aid provision, is tested primarily by direct income tax cases focused on transfer pricing, as most recently exemplified by the controversial *Apple* decision of the Court of Justice of the European Union (ECJ).[26] State aid rules—that is, competition and trade rules—are employed to tackle perceived revenue losses from MNEs' tax-planning structures; however, the economic impact on trade and competition itself is not detailed.

The EU fiscal state aid ruling may seem a distant concern for a Canadian tax readership; however, in July 2023, the European Union extended the reach of its state aid rules to non-EU countries through the newly enacted foreign subsidies regulation (FSR) rules.[27] The FSR rules take a different approach to state aid by targeting companies operating in the European Union that receive state aid from non-EU countries. The rules do not target an EU member state, such as Ireland in the *Apple* case, but instead target companies operating in the European Union and receiving a subsidy from their non-EU home countries. When a foreign subsidy is shown to harm the EU internal market, the foreign government must withdraw aid or face sanctions. This means that companies operating in the European Union must report any state aid they have received from their home countries. The rules do not exclude tax benefits, whether overt or covert, from their reach. Moreover, there are no rules for determining what type of tax "subsidization" derived from non-EU tax

23 At present, the WTO's Appellate Body is paralyzed and unable to adjudicate appeals (since 2016, the United States has blocked the appointment of new judges). Even when functional, the WTO dispute settlement process is protracted.

24 See *EU Law Live*, supra note 2, for comments on the recent *Apple* decision.

25 For the European Commission fiscal state aid rulings, see European Commission, "Tax Rulings" (https://competition-policy.ec.europa.eu/state-aid/tax-rulings_en).

26 See *EU Law Live*, supra note 2.

27 European Union, Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market (PE/46/2022/REV/1), OJ L 330, December 23, 2022.

systems may frustrate the FSR rules.[28] This raises the thorny issue of what type of fiscal state aid falls under the FSR rules, but it is clear that they are intended to cover taxation. A 2020 white paper by the European Commission specifically noted that foreign subsidies might include "income tax reductions," "preferential tax treatment or fiscal incentives such as tax reliefs," and "corporate tax regimes providing selective incentives" that finance "the subsidiary located in the EU through intragroup transactions."[29] This language suggests the broad application of FSR rules to tax subsidies, including overt subsidies (such as targeted tax relief) and covert or systemic tax planning of the sort that has been challenged in the EU state aid cases. The ultimate impact of the FSR rules on non-EU countries remains unknown. An EU state aid-style complaint—or, more pointedly, a "state aid 2.0" era—against, for example, Canadian companies operating in the European Union that benefit from Canadian outbound rules such as direct tax breaks or systemic tax benefits is certainly possible.

The Canadian Digital Services Tax

The final example of the tax-trade connection relates to the proliferation of digital services taxes (DSTs) enacted by various countries in lieu of a pillar 1 agreement on taxation of the digital economy.[30] In August 2024, the United States Trade Representative (USTR) formally challenged Canada's DST under the Canada-United States-Mexico Agreement (CUSMA) dispute settlement mechanism.[31] The USTR argues that the Canadian DST breaches Canada's commitments under CUSMA's chapter 15 (cross-border trade in services) and chapter 14 (investment). The question arises as to why Canada initiated a DST to counter a perceived unfairness arising from international tax avoidance, arguably without doing due diligence in investigating the trade implications of the DST and the ultimate tax incidence of the DST. Technology companies have responded with their own "tariff-like" measures to offset the burden of DSTs by shifting the cost of the tax to customers.[32] Other countries' unilateral DSTs have been subject to investigation under section 301 of the US Trade Act

28 This presents significant questions about the reach of EU trade and competition law when third-country trade flows arise, as mentioned in *EU Law Live*, supra note 2.

29 European Commission, *White Paper on Levelling the Playing Field as Regards Foreign Subsidies*, COM(2020) 253 final (Brussels: EC, June 17, 2020), at 8 and 46.

30 Digital Services Tax Act, SC 2024, c. 15, section 96.

31 Office of the United States Trade Representative, "United States Requests USMCA Dispute Settlement Consultations on Canada's Digital Services Tax," *Press Release*, August 30, 2024 (https://ustr.gov/about-us/policy-offices/press-office/press-releases/2024/august/united-states-requests-usmca-dispute-settlement-consultations-canadas-digital-services-tax).

32 For example, Google Ads applies jurisdiction-specific surcharges to select jurisdictions operating DSTs. See Google Ads Help, "Jurisdiction-Specific Surcharges" (https://support.google.com/google-ads/answer/9750227?hl=en).

of 1974.[33] However, all countries challenged by the USTR are subject to agreements that terminate retaliatory tariffs by the United States, conditional on the removal of unilateral DSTs upon the adoption of a pillar 1 multilateral agreement.[34] Canada is not a party to such agreements, and the DST has been challenged under CUSMA (not as a section 301 complaint), leaving Canada's DST in a precarious position.

REFRAMING INTERNATIONAL TAX ANALYSIS THROUGH A TRADE LENS

The foregoing examples illustrate a historical and sustained connection between tax and trade laws and policy relating to international tax planning by MNEs.

In reframing international tax analysis through a trade lens, the starting point for any inquiry about "tax avoidance" by MNEs is to question what state interests, if any, represent implicit state sponsorship or state aid. The delivery of "aid" through felicitous tax rules is a topical issue in international trade and competition law and policy. However, the BEPS 1.0 and BEPS 2.0 initiatives have not explored international tax avoidance through a trade lens; instead, they have focused attention solely on the impact of base erosion. Further, only recently has the UN Tax Committee (the United Nations' Committee of Experts on International Cooperation in Tax Matters) begun to consider the relationship between tax and trade law.[35] Whether the systemic features of tax systems leading to international tax avoidance are impermissible—that is, whether they constitute distortionary (discriminatory) "aid" or "subsidy"—is a live issue in the European Union concerning the application of the TFEU[36] and the object of challenges under the WTO rules.[37] Still, there is an incorrect perception that direct income taxation is beyond the scope of trade regulation and has little to do with trade.[38]

33 For a chronology of the USTR section 301 complaints against other countries' DSTs and subsequent agreements suspending retaliatory tariffs, see Office of the United States Trade Representative, "Section 301—Digital Services Taxes" (https://ustr.gov/issue-areas/enforcement/section-301-investigations/section-301-digital-services-taxes).

34 Ibid.

35 United Nations, Department of Economic and Social Affairs, Committee of Experts on International Cooperation in Tax Matters, *Relationship of Tax, Trade and Investment Agreements*, document no. E/C.18/2021/CRP.36 (New York: United Nations, October 4, 2021), at 10.

36 See European Commission, supra note 25.

37 See supra note 23 and the accompanying text.

38 Farrell's analysis, supra note 4, contends with this trade and tax law tension. Despite the common perception that direct taxation, notably corporate income taxation, stands apart from trade and competition regulation, a close examination of trade law casts serious doubt on the correctness of this preconception; one of the most cogent reasons for taking account of trade and competition law, in what tax practitioners commonly regard as exclusively tax issues, is to ensure that tax policy and law responses are coherent.

We posit that an appreciation of the trade undertones of international tax is largely missing from the ongoing international tax-avoidance conversation. Attention to states' self-interests is not incipient nationalism reminiscent of the kind that generated so much wreckage in the first part of the 20th century. A genuinely international outlook can emerge only from the pursuit by states of mutual self-interest. As Professor Dani Rodrik has expounded as a lonely voice, the intersection of states' interests that is manifest in trade emphasizes each state's place in a global environment precisely because states are different.[39] Rodrik's well-known "trilemma" asserts that, in a global economic environment, a state can achieve only two out of the following three outcomes: democracy, sovereignty, and trade-generated wealth. That is, any one of these tends to support or enable a second one and to frustrate or detract from the third. For example, global free trade is impaired by regulations imposed by democratic institutions as manifestations of a nation-state's political and economic sovereignty. John Ralston Saul would describe this as positive nationalism,[40] while others with stronger trade affiliations would call it protectionism. By the same token, the guardrails of democratic institutions and a country's insistence on the hegemony of its sovereignty undermine unlimited trade and the underlying political and fiscal features of other countries. The connection between trade as the inter-nation medium for self-interested global economic participation on the one hand, and tax as the institutional enabler of fiscal choices for which trade is both a reflection and projection on the other, makes a deeper examination of the connections between tax law and trade, and more specifically tax law as a source of states' financial assistance to trade, particularly important. In sum, avoided tax may not be tax avoidance; as the BEPS action 11 report somewhat contritely admits, tax avoidance may be in the eye of the beholder.[41]

39 Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: Norton, 2011).

40 See Saul, supra note 5.

41 See Organisation for Economic Co-operation and Development, *Measuring and Monitoring BEPS, Action 11—2015 Final Report* (Paris: OECD, 2015) (herein referred to as "the BEPS action 11 report"). In effect, this report makes two revealing observations, though not with this economy of language: (1) one country's tax avoidance is another country's tax and fiscal policy; and (2) no one knows how to measure BEPS incontrovertibly. Essentially, tax avoidance emanates from MNEs' responsiveness to signals from their home countries' tax regimes (see *EU Law Live*, supra note 2) and, as tax-based trade and competition law decisions of the ECJ reflect, systemic tax-based public intervention in trade flows alters them. The perception in these comments of a state's national interest pursued with "tax subsidies" reflects astute observations by Kleinbard, supra note 20. According to Kleinbard, tax analysis should more closely examine why we tax, what we intend to achieve with taxation, and how we ensure that the fiscal targets are not over- or underachieved depending on the precision of the tax tools. His analysis understands what we might call "informed internationalism," to be contrasted with "blind international tax-ism," which seems to dominate the present international tax conversation, perhaps because of the incapacity of many discussants to address the deep connections between tax and trade policy.

The conventional perception of MNEs as "bad actors," justifying novel and possibly unworkable recriminations, particularly with BEPS 2.0, ignores this trade connection. What if international tax avoidance by MNEs de facto operates as a trade subsidy intended by the state whose tax rules deliver the benefit? Direct tax rules are more nuanced and covert as mechanisms for creating trade benefits, yet they are no different in their impact from the use of traditional tariffs and customs duties to manipulate trade. How does that alter the discussion? This question becomes more pointed if the obscurity surrounding this question is informed by two additional observations.

First, fundamentally, all of the BEPS discussions concern the legitimacy and viability of corporate income taxation and, among other things, the incidence of tax at the corporate level. Related to this is the principled basis for recognizing, if not institutionalizing, the fiscal significance of private-law constructs, which may be acceptable and necessary in a commercial environment but have dubious fiscal importance.[42] Ignoring this issue and attending to the BEPS issues may ignore the disease in favour of merely treating symptoms.

Second, the international tax debate ignores the political features of MNEs, which operate like pseudo-states. A useful lens for this analysis is the work of Professor Saskia Sassen and the notion of "territory, authority, rights" (TAR). According to Sassen, nation-states share the following features: hegemony over territory; the generation and exercise of legal authority within that territory; and the exercise of legal rights.[43] Does an MNE also share these features? An MNE has a legal existence that is a composite, unique in each case, of rules of law in the various political jurisdictions in which it "resides" and operates. As a result, an MNE's existence has legal authority; its components even have legal authority as a blend of various states' laws and practices, because, fundamentally, its construction is authorized. An MNE's operation within that authority gives rise to enforceable rights and the opportunity to create new rights and entail obligations within the legal regimes in which it operates. Its domain is the territory in which it exerts economic influence. In other words, each MNE has its own vicarious political existence that nevertheless effectively simulates that of a unique nation-state. At the same time, the international tax conversation is dominated by political states' interests and relationships only as they might influence

42 That is, private-law fictions, exemplified by the legal personality of corporations, and coupled with the infinite varieties and effects manifest in contracts, effectively permit the fragmentation and reassembly of economic flows and relationships as "bespoke creations," which are the ultimate source of much of the disaffection with international tax avoidance. One may posit that pillar 2 denies the fiscal significance of private law, while not denying its significance for other purposes, by imagining a universal international regime for measuring and parsing tax rights with respect to a consolidated measurement of MNE income.

43 An efficient explanation of Sassen's views can be found in Saskia Sassen and Ada Van Roekel-Hughes, "Deciphering the Global: Its Spaces, Scales and Subjects" (2008) 29 *Social Thought & Research* 3-18. For a more developed version of TAR, see Saskia Sassen, *Territory, Authority, Rights: From Medieval to Global Assemblages* (Princeton, NJ: Princeton University Press, 2006).

taxpayers within what amounts to a tax silo. MNEs operating as de facto states through their bespoke adoption and sculpting of pertinent political states' laws, as traders and effectively as the sources of their own institutional and political authority as they shape it on a dynamic basis, are as ignored as the fundamental corporate tax issue. In this light, MNEs are not merely trading within political states but are, in effect, silent partners in any treaty.

CONCLUSION

International tax planning by MNEs, enabled by countries' income tax laws, may de facto operate as a tax subsidy or advantage, comparable to traditional trade taxes (such as tariffs and customs duties). This prompts the question: What policy—not just what tax policy—ought to be considered for a more critical and informed understanding of the deep connection between income tax and trade?

Income taxation is a tool, but not a tool for its own sake, as much of the international tax conversation seems to assume. Rather, income tax is a tool for implementing fiscal and economic policy that originates outside the tax system as a manifestation of a country's national personality. The pursuit of national personality entails tradeoffs with different but like-minded countries, and these tradeoffs in turn supplement and complement what each country can do for itself. This is trade arising from the intersection of enlightened national self-interests that can be effectuated without conceding sovereignty of any kind, including fiscal sovereignty, and it runs contrary to OECD assumptions that encourage sameness and universality of legal and tax regimes.

Countries' income tax laws—in fact and even by design—operate to effectuate tax subsidies and foster (relative) advantages comparable to those usually identified with traditional trade taxes. This reality invites a heightened and more critical awareness of what international tax avoidance connotes, why avoided tax by MNEs is not always or necessarily malign tax avoidance, and why understanding taxation, in light of the trade and investment it influences, is essential to devising intelligent tax policy and resulting tax law.

Pointedly, this observation necessitates a genuine and focused examination of corporate income taxation in all its dimensions, notably as a primary vehicle for insinuating public financing into ostensibly private economic activities, which the BEPS initiative (and the tax changes it inspires) continues to be misguided about. Deeper exploration of international tax avoidance through a trade policy lens will enrich the discourse on international tax policy, especially in these politically fragmented times.

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Policy Forum: The Basis of Customs Duties and Implications of Tariff Tensions

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PRÉCIS

Plus que jamais, les entreprises évoluent dans une chaîne de valeur profondément mondialisée, où les chaînes d'approvisionnement commerciales sont déployées et intégrées à l'échelle mondiale. Le commerce international de marchandises constitue un élément important à plusieurs niveaux. Dans cet article, nous nous intéressons aux implications du commerce international en matière de douanes, et plus particulièrement aux tarifs de douane, un sujet largement discuté ces derniers mois. L'objectif de l'auteur est de fournir un aperçu des fondements de l'application des droits de douane, de leurs implications sur les recettes nationales, ainsi que de leur impact sur les coûts d'acquisition des biens et sur les stratégies de chaîne d'approvisionnement. Enfin, dans le contexte actuel, l'auteur réfléchit aux implications des pressions tarifaires douanières amorcées en 2018 et à la nouvelle phase visant directement le Canada.

ABSTRACT

More than ever, businesses operate within a profoundly global value chain, where commercial supply chains are deployed and integrated on a worldwide scale. International trade in goods is an important element on several levels. This article explores the implications of international trade in terms of customs and, particularly, tariffs, a subject that has become widely discussed in the past months. The author provides an overview of the application basis of customs tariffs, their implications for national revenues, and their impact on the costs of acquiring goods and supply-chain strategies. Finally, in the current context, the author reflects on the implications of customs tariff pressures that began in 2018 and the new phase directly targeting Canada.

KEYWORDS: CUSTOMS ■ DUTIES ■ TARIFFS ■ INTERNATIONAL TRADE

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INTRODUCTION

Unless otherwise stated, this article is current as of February 15, 2025.

In the months following the election of President Trump in November 2024, the world has braced for a new chapter in the trade war that he initiated in 2018. Much was said during the presidential campaign and has been said in the post-election tumult, leaving many uncertainties about the measures that will likely be adopted and their duration. However, one thing is clear: President Trump will use tariffs as a powerful tool during his second term. The weeks following the election showed a shift from the earlier primary focus on Chinese goods. On February 1, 2025, a first wave of 25 percent tariffs on goods from Canada and Mexico was announced under a national emergency measure, despite the Canada-United States-Mexico Agreement (CUSMA), before being paused for 30 days. A key objective mentioned by President Trump—beyond border security, migrants, and fentanyl—is a reduction in the United States' trade deficit. An additional 10 percent tariff on Chinese goods was implemented on February 4, and a few major executive orders were signed in the following week. Notable among these were the reintroduction of tariffs on steel and aluminum products, announced on February 10,[1] and the introduction of reciprocal tariffs on February 13,[2] meant to retaliate against customs and non-customs taxes,

1 A 25 percent tariff, due to apply on March 12. See Darren Major and Catharine Tunney, "'Trump Slaps 25% Tariffs on Steel and Aluminum Imports 'Without Exceptions,'" *CBC News*, February 10, 2025 (www.cbc.ca/news/politics/trump-steel-aluminum-canada-1.7455173).

2 United States, White House, "Fact Sheet: President Donald J. Trump Announces 'Fair and Reciprocal Plan' on Trade," February 13, 2025 (www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-announces-fair-and-reciprocal-plan-on-trade).

including the Canadian digital services tax (DST).[3] Various unimplemented trade measures have been extended to other countries, including tariffs on Danish goods in association with the Greenland territory threat, and punitive tariffs against Colombian goods amid deportation flights that were announced and later suspended. As of mid-February, much uncertainty remains for the coming months, including the future of CUSMA. Around the world, economic partners and leaders, including Canada, are working to mitigate the effects of the trade war.

For decades, during an era of low duty rates, tax experts might not have attended closely to the rules and principles of tariff application. Amid current trade tensions, this article offers an overview of the customs tariff principles and a consideration what lies ahead given the political environment, particularly in the United States. The first part of the article discusses the international trade of merchandise, while the second part focuses on the rules of tariff application, financial impacts, and implications for supply-chain strategies. Finally, the last part reflects on the deep economic ties between Canada and the United States, and what tariff increases could mean for businesses.

INTERNATIONAL TRADE

Global economic development is fuelled by the increasing volume of international trade. The merchandise exports indicator demonstrates international trade's significant contribution to overall economic expansion, with a growth rate increasing every year.[4] In the last 75 years, global exports grew at an average annual rate of 6 percent. Between 2002 and 2022 alone, the value of merchandise imports quadrupled, from US$6.5 trillion to US$25.67 trillion.[5] During the same period, the world's gross domestic product (GDP) nearly tripled, from US$34,917 trillion to US$101,225 trillion.[6]

The movement of goods translates into opportunities for economic development, but there are also deep financial implications for the international trade of merchandise. Goods crossing borders require an official declaration upon entry into a country, territory, or trading zone. Extensive data related to the goods must be declared, for multiple purposes, including securing the country's border and collecting the proper taxes and duties to release goods for free circulation in the country of importation.

3 Catherine Lévesque, "Trump Rolls Out Reciprocal Tariffs: 'Canada Is Going To Have To Start Paying Up,'" *National Post*, February 13, 2025 (https://nationalpost.com/news/trump-rolls-out-reciprocal-tariffs-canada-is-going-to-have-to-start-paying-up).

4 World Trade Organization, "The WTO in Brief" (www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr_e.htm).

5 World Trade Organization, "WTO Stats," under the Indicators tab, "International trade statistics, Merchandise imports by product group—annual (Million US dollar), SI3_AGG -TO - Total merchandise" (https://stats.wto.org).

6 Macrotrends, "World GDP 1960-2025," under the Economy tab, "GDP" (www.macrotrends.net/global-metrics/countries/wld/world/gdp-gross-domestic-product).

The applicable tariff rate,[7] based on the type and country of origin of the goods, results in customs duties charges when applied to the value of goods being imported.

As a result of initiatives of the World Trade Organization (WTO) and an increase in regional trade agreements (RTAs), tariffs had been a relatively minor revenue-collecting instrument for most countries for decades. Then, in 2018, during the first Trump administration, the United States began increasing some tariffs, with a strong focus on Chinese goods. US tariff actions sent shock waves through global supply chains, which had been built over decades and had deep linkages to China. Many companies worked to redesign sources of supplies in order to mitigate the tariffs' impact, but moving sources requires time and effort.

During the run-up to and following the 2024 US election, tariffs have regained public attention, as President Trump has threatened to impose tariffs on several countries, including key trading partners Canada and Mexico. With tariffs being a concern for everyone now, a discussion of the tariff application rules and their effects on prices, companies' competitiveness, and sourcing strategies is especially relevant.

The Fundamentals of Tariffs

Tariffs are a tax imposed on imported goods in the course of trade with a foreign country. Customs tariffs applied by the importing country are generally based on the type of goods being imported, their country of origin, and any applicable trade agreements. When a tariff is deemed applicable by the importing country, customs duties must be paid by importers in order to import the goods into free domestic circulation. Tariffs provide revenue for governments and give "a price advantage to locally-produced goods over similar goods which are imported."[8] This mechanism can be used to enhance the competitiveness of domestic industries against foreign competitors entering the domestic market. Tariffs on imports can be applied either as a specific duty amount or as an ad valorem rate, or as a combination of the two. Most customs duties are applied as ad valorem taxes, calculated as a percentage of the value of the imported goods.[9]

Basis of International Trade Rules

Regulating international trade among numerous nations is inherently complex, a mission pursued by the WTO, counting 166 members, with the objective of reducing trade barriers and developing an inclusive trading system.[10] For decades, a general

7 See World Trade Organization, "Glossary," entry "ad valorem tariff" (www.wto.org/english/thewto_e/glossary_e/glossary_e.htm).

8 World Trade Organization, "Tariffs" (www.wto.org/english/tratop_e/tariffs_e/tariffs_e.htm).

9 World Trade Organization, "Technical Information on Customs Valuation" (www.wto.org/english/tratop_e/cusval_e/cusval_info_e.htm).

10 Supra note 4.

reduction in trade barriers has been observed on two fronts. First, RTAs between countries have proliferated, increasing from 83 in 2000 to 373 in 2024.[11] These agreements, such as CUSMA, aim to open trade between the signatory countries by reducing or eliminating tariffs. Second, among WTO members, trade-weighted average tariffs applied on a most-favoured-nation[12] (MFN) basis decreased from 7.1 percent in 1996 to 3.7 percent in 2021, a drop of 47 percent.[13] In 2021, Canada's MFN trade-weighted average tariff rate stood at 3.03 percent.[14] Increases in tariffs impose a form of trade barrier by reducing competitiveness of some countries' industries, limiting market access, and increasing the global cost of goods.

Financial Implications

Source of National Revenue

The imposition of tariffs on goods moving across borders comes with financial implications, both for countries collecting customs duties and for importers paying them. Since the creation of the WTO, import taxes collected on international trade as a proportion of countries' national revenues have been steadily decreasing. According to World Bank statistics, import taxes represented 6.7 percent of countries' national revenues worldwide in 2007. This figure declined by 34 percent over the next 14 years, down to 4.4 percent in 2021.[15] On average, national revenues are not materially dependent on the collection of duties, but there are significant differences between countries.

At the country level, 2022 World Bank data show that the proportion of national revenues collected from customs duties ranges from 0 percent to 40 percent. Key countries involved in the current trade tensions have customs revenue ratios below the world average of 4.4 percent, with China at 2.9 percent, Mexico at 1.7 percent, the United States at 3.1 percent, and Canada at 1.6 percent (excluding other excise taxes and duties specific to products).[16] Apart from programs like duty

11 World Trade Organization, "Regional Trade Agreements Database" (https://rtais.wto.org/UI/PublicMaintainRTAHome.aspx).

12 The MFN concept is discussed in the next section.

13 Monia Snoussi-Mimouni and Edvinas Drevinskas, "Tariffs Applied by WTO Members Have Almost Halved Since 1996," *Data Blog by the WTO Secretariat*, April 13, 2023 (www.wto.org/english/blogs_e/data_blog_e/blog_dta_13apr23_e.htm).

14 World Bank, "World Development Indicators," under the World Development Indicators database, under the series "Taxes on International Trade (% Revenue)" (https://databank.worldbank.org/source/world-development-indicators/Series/TM.TAX.MRCH.WM.FN.ZS).

15 World Bank, "Taxes on International Trade (% of Revenue)," (2022) (https://data.worldbank.org/indicator/GC.TAX.INTT.RV.ZS?end=2022&start=1972&view=char).

16 Canada, Department of Finance, 2023 Budget, Budget Plan, March 28, 2023, at 207, table A1.6.

drawback and duties relief,[17] customs duties represent a definitive tax. Tariffs are not the only import taxes that contribute to national revenues, since many countries impose additional taxes on imported goods, such as the goods and services tax (GST) in Canada and the value-added tax (VAT) in the European Union. Those taxes are not discussed in this article.

A Cost of Doing Business

Tariffs create additional costs for importers moving merchandise into a country or territory. Importers absorb these customs duties in a few ways: by raising prices passed on to customers, by reducing profit margins when the market does not allow for price increases, or through a combination of the two, depending on the market and the commercial level at which the goods are imported and sold.

When a company extracts or produces goods in a country for the purpose of selling them abroad, the tariff policy of the destination country becomes a key factor affecting competitiveness. When tariffs are imposed on goods from a specific origin, the exporter faces a cost disadvantage against producers that are not affected by the same measures. Importers in the destination country might try to reorganize their source of supply to avoid goods from the country of origin that is being targeted by the additional tariffs. If only one country is being targeted, alternative sources of supply might remain overseas. In the case of general tariff increases, however, companies might try to eliminate tariffs completely by bringing back production or sourcing goods domestically, depending on the cost-benefit analysis. Overall, tariffs create cost increases, either directly by imposing tax on the goods, or indirectly by allowing uncompetitive costs to be added to domestic production.

Industries exporting goods to a country that is applying increased tariffs are directly impacted. Once tariffs are implemented, exporters are at a competitive disadvantage against domestic companies, as well as against exporters from other countries that are not subject to the same tariffs. Some exporters may have to lower their prices to compete with non-affected sources in the market; alternatively, they could be asked to "deliver duty paid," increasing the costs to market, or they may

17 Canada Border Services Agency, *Memorandum* D7-4-3, "NAFTA Requirements for the Duty Drawback and the Duties Relief Programs," October 21, 2024. The duty drawback program is designed to help Canadian companies remain competitive in international markets by refunding duties paid on imported goods that are later exported. The program can help Canadian companies compete in export markets by removing domestic duties from their commercial goods. The program grants a drawback (refund) of duties that were paid on imported goods if

- the goods are eventually exported in the same condition, or
- the goods are consumed or expended through a manufacturing process and eventually exported.

The duties relief program allows for the deferral of duties at the time of importation on imported goods that will subsequently be exported either in the same condition or after being consumed, expended, or used in the processing of other goods.

simply lose market share, reducing or stopping exports to that country. In such situations, exporters may try to enter new markets with lower tariff barriers. However, physical distance might be an issue, with cycle-time impact and transportation costs affecting the landed costs of goods.

For example, when the Trump administration in 2018 imposed a 25 percent tariff on some Chinese goods imported into the United States, certain sources of supplies were reorganized among American companies. In 2017, goods originating from China accounted for 21.9 percent of total imports into the United States; in 2022, Chinese imports were 17.1 percent, a drop of 22 percent. However, imports into the United States did not fall overall because the decrease in the share represented by Chinese goods was offset by increases from several other countries. Notably, Vietnam doubled its share of US imports, from 2 percent to 4 percent, and five other countries increased their share by half a point—Mexico, Canada, South Korea, Thailand, and India.

China's export profile underwent adjustment as a result of US tariff policy. In 2017, before the tariff war, the United States accounted for 19 percent of Chinese exports, followed by Hong Kong (12.3 percent), Japan (6.1 percent), South Korea (4.5 percent), and Vietnam (3.2 percent). Five years later, China's export profile showed the same top five countries, but the share of Chinese exports to the United States had fallen to 16.1 percent, followed by Hong Kong (8.2 percent), South Korea (4.5 percent), Japan (4.1 percent), and Vietnam (4.1 percent).

These statistics demonstrate the influence of tariff pressures on the sourcing of goods and the global picture of trade between countries, with importers reacting in various ways to remain competitive. Vietnam offers a good example of the supply-chain reorganization that occurred following the United States' tariff increase on Chinese-origin goods. Between 2017 and 2022, China's export share to the United States decreased while its export values to Vietnam doubled. On Vietnam's side, the Chinese-origin pressure translated into an opportunity to increase, by 2.8 times, the value of its exports to the United States. These transformations highlight the importance of the country-of-origin determination and its direct impact on the tariff rate. For example, when goods exported from one country, such as China, are transformed in another country, such as Vietnam, strict rules govern whether a new country-of-origin determination can be applied. The next section discusses the rules on origin and tariff application, to understand how supply chains, production, and sourcing may get reorganized in response to tariff changes.

In the current environment, globally integrated and deployed supply chains contribute to global economic growth. Over decades, countries and industries have specialized their practices to optimize cost and production worldwide. When there are limited trade barriers in the form of tariffs, companies compete to be the most efficient and to win the market. In making sourcing decisions, companies weigh economic criteria in considering total landed costs, the costs of getting merchandise A to point X, including the price of the merchandise, transportation cost, and the cost of importing. When tariffs are applied, duties increase the landed costs of procuring goods from overseas suppliers, which becomes an important cost-competitiveness factor.

PRINCIPLES OF TARIFF APPLICATION

Tariffs are translated into customs duties by the application of a process based on three key characteristics of the goods imported: the tariff classification number, the origin of the goods, and the value of the goods for customs purposes. While the tariff rate is defined country by country, several elements and concepts are managed at a concerted global level, based on the work and agreements of the WTO and the World Customs Organization (WCO).[18]

Tariff Classification Number

The tariff classification number is determined by the Harmonized Commodity Description and Coding System, generally referred to as the harmonized system (HS), which is a product nomenclature developed by the WCO for assigning codes to harmonized commodity descriptions. The HS comprises more than 5,000 commodity groups; each group is identified by an international HS 6-digit code, which is extended to a 10-digit code at the country level. The result is a structured and uniform classification system. The tariff classification number is used to determine the tariff rate applicable to goods upon importation. Figure 1 shows Canada's Customs Tariff 2025[19] listing the MFN[20] rate of 7 percent for tariff classification number 9507.90.10.10 in Canada.

Origin of the Goods

Once the classification of goods is defined, the country of origin is required to determine the applicable tariff, because the rate may vary depending on the origin of the goods. In figure 1, the classification number could have either a tariff of 7 percent for MFN countries, or a free preferential tariff for qualifying origins. In a nutshell, the origin is the country where the goods were grown, extracted, or manufactured, not the country from which they were exported. Rules of origin may differ between countries, but generally they are defined in accordance with WCO guidance, which sets the origin based on the country where the goods were wholly obtained or substantially transformed.[21]

18 The World Customs Organization (WCO), created in 1953 from the Customs Cooperation Council, is an independent intergovernmental body whose mission is to improve the efficiency of customs administrations.

19 Canada Border Services Agency, "Customs Tariff 2025" (www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/2025/menu-eng.html).

20 The MFN principles are explained in the next section.

21 World Customs Organization, "Rules of Origin—Handbook" (www.wcoomd.org/-/media/wco/public/global/pdf/topics/origin/overview/origin-handbook/rules-of-origin-handbook.pdf).

FIGURE 1 Tariff Classification Number 9507.90.10.00

95 - 6

CUSTOMS TARIFF - SCHEDULE

Tariff Item	SS	Description of Goods	Unit of Meas.	MFN Tariff	Applicable Preferential Tariffs
9507.90		**-Other**			CCCT, LDCT, GPT, UST, MXT, CIAT, CT, CRT, IT, NT, SLT, PT, COLT, JT, PAT, HNT, KRT, CEUT, UAT, CPTPT, UKT: Free
9507.90.10	00	- - -Sportsperson's fishing line, in retail packages	-	7%	

Source: Canada Border Services Agency, "Customs Tariff 2025" (www.cbsa-asfc.gc.ca/trade-commerce/tariff-tarif/2025/menu-eng.html), version T2025-1.

In the context of global supply chains, substantial transformation is a key concept. At a global level, countries recognize the substantial transformation criterion, but the rules related to HS changes and/or minimal value-added requirements may vary between countries or RTAs.[22] In Canada, substantial transformation is defined as the process of undergoing fundamental change such that the new goods are different from the original ones. For example, wood that is imported and then transformed into a table undergoes a substantial transformation.

The origin dictates the potential tariff treatment available, whether MFN or preferential, depending on the country. The MFN concept was established to create non-discriminatory tariffs between partners, and is now a general measure of tariff barriers.[23] WTO members might be involved in RTAs, favouring trade within the signatory group, as well as applying lower tariffs on goods from developing countries. These situations, represented in the "Applicable Preferential Tariffs" column of the Customs Tariff, could result in lower or no tariffs. In figure 1, if the goods qualify for the UST code ("United States Tariff"), they benefit from a tariff-free rate rather than the 7 percent MFN tariff. This simple example highlights the importance of the rules of origin and qualifying treatment in tariff determination.

With the two characteristics of origin and classification number, the applicable tariff for the goods being imported can be established. The next step is to determine the value of the goods for customs purposes, which is the basis on which the tariff rate is applied.

22 World Trade Organization, "Technical Information on Rules of Origin" (www.wto.org/english/tratop_e/roi_e/roi_info_e.htm).

23 World Trade Organization, "Principles of the Trading System" (www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm).

Customs Valuation

Customs valuation is the procedure for determining the value of goods, which is used to calculate the duty payable to import goods subject to an ad valorem tariff.[24] The customs procedure, defined under the WTO valuation agreement,[25] is a set of rules designed to establish a fair, uniform, and neutral model for the valuation of goods for customs purposes; the use of arbitrary or fictitious values is prohibited. The rules are applied by WTO members, which currently trade 98.1 percent of worldwide exports.[26] The basic customs valuation method refers to the transaction value of goods. This method determines the value of goods on the basis of the price actually paid or payable for the goods when they are sold for export to the country of importation, with certain adjustments. The price of the goods, with the required adjustments, provides a clear, non-biased value of the goods, which both parties agree to sell and buy at, to transfer the property of the goods. To arrive at the economic value of the goods, certain additions to the price paid are required in order to account for elements that are not included in the price, such as material and components provided free of charge on consignment, some commissions, and royalties and licence fees. Customs valuation represents the complete economic value of the goods, without related-party influence.

All goods must be valued for importation. Whether or not the goods are sold, customs declaration and proper taxes and duties must be paid. In cases where there is no transaction value—for example, where there are no sales for export, or where there are limitations on the use of the transaction value method—the customs value is determined using one of five alternative methods, applied in hierarchical order. The alternative methods, like the transaction value method, are designed to ensure a fair and consistent determination of the value of imported goods, following the spirit of the transaction value method to arrive at the complete economic value of the goods. Strict valuation rules ensure that there is no arbitrary determination of the base on which tariffs are applied.

In a tense trade environment, the use of customs values as the base for tariff application will receive increased scrutiny to ensure compliance with valuation rules. As tariff rates are raised, some importers might consider modifying transfer-pricing methods and revising contractual agreements to see whether the customs value can be decreased, thus reducing the base on which the tariffs are applied. Diligence is required when those factors are reviewed. Customs valuation is a complex area, with related parties' limitations and additions to the transaction value creating additional risk factors. In a 2018 study analyzing 487 US Customs and Border Protection (CBP)

24 Supra note 9.

25 World Customs Organization, "WTO Valuation Agreement" (www.wcoomd.org/en/topics/valuation/overview/wto-valuation-agreement.aspx).

26 World Trade Organization, *World Trade Statistical Review 2023* (Geneva: WTO, 2023), at 58, table A4.

rulings, it was found that valuation between related parties, adjustments to transaction value for economic aid (assistance), and royalties created the greatest complexity for importers.[27] The determination of sales for export, and particularly optimization of the first-sale rule[28] for US imports, provides additional complexity. In companies, cross-functional diligence is essential for a compliant valuation determination. In an environment of tariff pressure, elements impacting the imposition base will gain attention, both from customs authorities to ensure that the proper duties are assessed, and from importers to minimize the impact of tariffs. Strategies affecting the valuation of goods, such as transfer pricing or contract changes affecting additions to transaction value, must be assessed for regulatory compliance before implementation. To mitigate valuation risks, importers should reinforce controls and audits to prevent costly non-compliant situations.

Exceptional Measures on Applicable Tariffs

The current US tariff measures were announced under the International Emergency Economic Powers Act (IEEPA),[29] illustrating that MFN and RTA tariff principles remain subject to a country's unilateral change under national security or emergency measures. Under chapter 31 of CUSMA, Canada or Mexico could still initiate a request for dispute settlement on these measures.[30] Similarly, under the WTO agreement, China requested a dispute consultation with the United States on February 5, attempting to resolve the disagreement over the incremental tariff without litigation.[31]

Canada also applied an exceptional measure against China, in August 2024, announcing "a 100 per cent surtax on all Chinese-made electric vehicles (EVs), effective October 1, 2024, and its intent to impose a 25 per cent surtax on imports of steel

27 Eloise Brouillard, "La gestion de la conformité de l'évaluation en douane chez les multinationales" (thèse de doctorat, Université de Sherbrooke, École de gestion, 2023) (https://savoirs.usherbrooke.ca/handle/11143/20437).

28 For customs valuation, the transaction value must be defined as the price actually paid or payable for the merchandise when sold for exportation to the United States. In multi-tiered transactions, such as those involving intermediaries, the first-sale rule allows the importer to use the price of the first sale, which is typically lower than the price of the last sale. The first-sale rule can be used, when qualifying as a bona fide sale for export, to lower the customs valuation and thus reduce the duties. United States International Trade Commission, *Use of the "First Sale Rule" for Customs Valuation of U.S. Imports* (Washington, DC: USITC, 2009).

29 Using IEEPA to impose such tariffs could be challenged in the United States. Congress has the constitutional authority on taxes and duties.

30 Office of the United States Trade Representative, "Agreement Between the United States of America, the United Mexican States, and Canada 7/1/20 Text," at chapter 31, under the heading "Dispute Settlement" (https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between).

31 World Trade Organization, "China Initiates WTO Dispute Complaint Regarding US Tariff Measures," February 5, 2025 (www.wto.org/english/news_e/news25_e/ds633rfc_05feb25_e.htm).

and aluminum products from China under section 53 of the *Customs Tariff*."[32] Canada was not the first country to apply surtaxes on Chinese-made EVs; the United States announced a 100 percent tariff in May 2024, while some measures have also been applied by the European Union. Under section 53 of Canada's Customs Tariff, actions can be taken to suspend or withdraw rights or privileges or to impose a surtax on the usual duties. Section 53 can be invoked to protect domestic industries from unfair competition or some practices in international trades.

DISCUSSION

Much has already been written, particularly in the popular press, regarding the effect and implications of increased tariffs on the commercial ties between Canada and the United States. With the two countries sharing the longest border in the world, their close geographical proximity has naturally favoured economic cooperation, limiting transportation costs and the cycle time required to import and export goods. In 2023, the United States was involved in 63 percent of Canada's total trade, exports and imports combined, with a value of US$717 billion. In terms of exports alone, 77 percent of goods value went to Canada's neighbour,[33] 16 percent of it crude oil, illustrating their strong economic ties.

The relationship is undeniable on both sides, but considering the respective sizes of the economies, the dependency is smaller for the United States. On the US export side, while Canada represents the largest export market for US goods, at 18 percent of exports value in 2023, the United States' more balanced export partnership across countries makes it relatively more resilient to potential retaliatory tariffs. On the US import side, Canada represents the third biggest source of imported goods (13 percent) behind Mexico and China, the three countries targeted by the February 1 measures. These statistics show a global picture, but some specific industries are more heavily dependent or intertwined. For example, energy products were subject to a lower 10 percent tariff. Overall, the commercial relationship between the two countries shows a deep and strategic interdependency that cannot be eliminated overnight.

The commercial ties between Canada and the United States were built on strong and stable trade agreements. Implementing a general 25 percent tariff could have long-term consequences and trigger deep changes in supply-chain strategies. The 2018 tariff increases on Chinese goods imported into the United States demonstrate that supply chains may have to be reorganized, with some sourcing being moved to other countries. With the United States imposing tariffs on goods from both Canada

32 Canada, Department of Finance, "Canada Taking Further Action To Protect Workers and Critical Industries Against Unfair Chinese Competition," *News Release*, October 1, 2024 (www.canada.ca/en/department-finance/news/2024/10/canada-taking-further-action-to-protect-workers-and-critical-industries-against-unfair-chinese-competition.html).

33 Trading Economics, "Canada Exports by Country" (https://tradingeconomics.com/canada/exports-by-country).

and Mexico, despite CUSMA, trade assumptions in business strategies and investments will have to be reviewed. Significant impacts can be expected if no further agreements are reached before March. This current situation highlights a new disruptive risk to consider for global supply-chain strategies, despite the RTAs in place.

On Canada's export side, the risks are significant for many industries because American companies might reorganize their supply chains to source goods domestically or from overseas countries that are not affected by US tariffs. Finding new commercial partners for Canadian companies might not be done quickly or easily, considering the many constraints involved, such as additional transportation costs and cycle-time impacts. Under these pressures, it is important for exporters to use trade incentive programs such as Canada's duty drawback program when they qualify, to limit the impact of duties on goods being exported. It is relevant to note that the US duty drawback program will not be allowed for these specific new tariffs on Canadian goods,[34] which will have a bigger impact on US manufacturers that import materials or components for manufacturing in the United States before those goods are exported to non-domestic markets. Goods may have multiple cross-border movements, or use components from overseas sources, during the full production life cycle, and the US duty drawback program could have been used to stimulate manufacturing in the United States for the overseas market. In the current situation, however, it is reasonable to expect that companies might be motivated to produce goods outside the United States for non-domestic markets, unless they can source everything domestically.

On Canada's import side, considering that goods from the United States accounted for 49 percent of imports in 2023, retaliatory tariffs are likely to translate into price increases. In the first weeks of 2025, Canadian leaders mentioned many strategies in response to US tariffs. The first to be implemented was two waves of 25 percent retaliatory tariffs on US$155 billion worth of American goods,[35] with other measures to be announced later, effective only if the United States moves forward with its tariffs on Canadian goods. It is difficult to judge the effectiveness of these measures and the next actions to be taken on both sides of the border. However, pursuing negotiation of a new stable trade environment should be the best alternative to secure jobs and industries. Uncertainty is harmful to business development, and it would be in the best interest of both countries to pursue negotiations for favourable

34 The orders state that "no drawback shall be available with respect to the duties imposed pursuant to this order." See David E. Bond, Gregory Spak, Ian Saccomanno, and Samuel Scoles, "President Trump Imposes 25% Tariffs on Canada and Mexico, and 10% Tariffs on China," *White & Case*, February 2, 2025 (www.whitecase.com/insight-alert/president-trump-imposes-25-tariffs-canada-and-mexico-and-10-tariffs-china).

35 Canada, Department of Finance, "Canada Announces $155B Tariff Package in Response to Unjustified U.S. Tariffs," *News Release*, February 1, 2025 (www.canada.ca/en/department-finance/news/2025/02/canada-announces-155b-tariff-package-in-response-to-unjustified-us-tariffs.html).

international trade, low duties, and open commercial borders, as a way of optimizing supply chains and the prices of goods.

CONCLUSION

This most recent phase of the trade war is opening the door to an unprecedented situation, making it difficult to predict the outcome of the coming months. One thing is certain: investments and global supply-chain strategies are not stimulated by an environment in which RTAs, ratified by member countries, cannot provide a stable and known base for international trade. It would be in everyone's best interest to renew existing agreements or reach new agreements that pursue stability and provide a known basis for trade to operate.

Efforts focused on collaboration between countries, aimed at maintaining and developing commercial opportunities for Canadian companies both domestically and internationally, should be rethought, given the changing reality of international trade as we have known it for decades. This period of disruption and its severe impact on Canada could create momentum for the transformation and repositioning of Canadian industries—for example, the development of long-term, more resilient strategies to reduce future risks and dependencies on changes in other countries' trade policies. However, such transformation cannot be achieved overnight; it will require time and effort.

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Finances of the Nation

A BRIEF LOOK AT THE ROLE OF FEDERAL PAYMENTS IN LIEU OF TAXES IN MUNICIPAL FINANCES

*Jennifer Robson**

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.*

One understudied aspect of intergovernmental fiscal arrangements is the system of payments in lieu of taxes (PILT) made to local tax authorities. In light of ongoing changes to the government of Canada's real property holdings, this article reviews published federal data on PILT transfers made in 2019 to 2023 for nine cities of interest, including both cities in the National Capital Region. The article also uses city-level published data, gathered from municipal budget and fiscal documents, to assess the importance of federal PILT transfers to these municipalities. The analysis shows that the fiscal impact of PILT payments varies substantially across cities, but concludes that the PILT program is a blunt instrument that is not well suited to addressing fiscal pressures at the municipal level.

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: PROPERTY TAXES ■ MUNICIPAL FINANCE ■ MUNICIPAL TAXATION ■ INTERGOVERNMENTAL ■ FEDERALISM

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INTRODUCTION

Lands and properties belonging to the Crown, whether federal or provincial, are exempt from taxation. This a longstanding principle in Westminster governance[1] and, in a decentralized federation like Canada, it helps to ensure the separation of different orders of government.[2] This principle is also explicit in the Constitution Act.[3] Notwithstanding the exclusion of federal properties from local taxation, since 1950 the government of Canada has issued grant payments to municipal governments that are equivalent to local taxes on federal lands and properties.[4] The program underwent reforms in 1980 and again in 2000, but has remained essentially unchanged over the last 25 years.[5] Provincial governments make similar payments for lands and properties that they own. These payments recognize the value of the municipal services received by government properties and offset the loss in local tax revenues resulting from the properties' exemption from taxation. Moreover, the grants are made regardless of the spillover effects, in terms of local economic development, generated by federal or provincial public institutions and activities.

When there is a large presence of public rather than private institutions within a municipality, local governments may look to these grants as a reliable source of revenue, counting on regular annual payments from provincial or national orders of government. However, because of the discretion necessarily involved in administering these grant programs, municipalities can find themselves in conflict with the paying orders of government. Moreover, when municipalities are subject to provincially mandated changes to local property taxes that do not apply to Crown lands and buildings, there can be frequent occasion for intergovernmental conflict.

This article briefly reviews the nature and process of grants made in lieu of local taxes, focusing on the federal regime for ease of comparability. Key principles from the legislation and jurisprudence are discussed, with particular attention being paid

1 David Torrance and Lorna Booth, *Finances of the Monarchy* (London, UK: UK Parliament, House of Commons Library, 2024).

2 Harry M. Kitchen and Enid Slack, "Special Study: New Finance Options for Municipal Governments" (2003) 51:6 *Canadian Tax Journal* 2215-75; and Harry M. Kitchen and François Vaillancourt, "The Federal Grants-in-Lieu of Property Taxes Program: An Assessment" (1990) 38:4 *Canadian Tax Journal* 928-36.

3 Constitution Act, 1867, 30 & 31 Vict., c. 3, as amended, section 125. For a discussion of exemptions and payments in lieu as they apply to First Nations' reserve lands, see Mike Icton and Devan Mescall, "Policy Forum: Establishing an Urban Reserve—Property Tax Challenges and Opportunities" (2021) 69:3 *Canadian Tax Journal* 835-55.

4 Public Works and Government Services Canada, *Final Report: Evaluation of the Payments in Lieu of Taxes Program* (Ottawa: Office of Audit and Evaluation, 2010), at 1.

5 Pierre Delisle, *La fiscalité locale : municipale, scolaire et régionale*, 3ième édition (Montréal : L'Association de planification fiscale et financière) (https://edoctrine.caij.qc.ca/Association-de-planification-fiscale-et-financiere/Livres/fiscalite_locale_municipale_scolaire_et_regionale/c-2a898e89-9310-732f-a042-064b118c65bd-9/).

to a recent dispute between Canada's capital city and the government of Canada. Finally, the article presents new data on the value of payments reported by the federal government and their relative share of the budgets of nine municipalities, selected as illustrative cases. The results suggest that municipalities show a great deal of variation in their reliance on these federal transfers, but that solutions to the fiscal pressures facing those cities are best found outside the federal grant program.

DETERMINING THE VALUE OF THE GRANT

At the federal level, payments for offsetting local taxes are determined according to the Payments in Lieu of Taxes Act[6] and regulations under that act. Similar legislative or regulatory frameworks exist at the provincial level for bodies such as hospitals, colleges, universities, jails, and provincial Crown corporations such as energy authorities. This article reviews the process and considerations in the federal payments in lieu of taxes (PILT) program. The program is complex, requiring judgments about Crown lands and buildings that are included (or excluded), judgments about the valuation of the properties involved, and judgments about the application of variations within local tax systems. As Justice Martineau wrote in his decision in *Laval*,[7] the federal legislation contains so many schedules and definitions of what is and is not to be considered federal property that it "could easily inspire any lawyer to get creative."[8]

Despite the complexity of the definitions and schedules, some fundamentals are clear. Under the federal legislation, a local tax authority makes an annual application to the government of Canada. The application must include the local tax bylaw outlining the formula applied to taxable properties, a list of federal properties within the local boundaries, and, in the first application, the appraisal for each property under the official assessment (or a referral to the public body where the official assessment can be accessed). In practice, the application requires the local tax authority to list each property with the roll number, assessed value,[9] each category of local tax, and the total amount of the PILT grant requested. In law, however, it is up to the minister to make the determination of the relevant properties, assess their value, and calculate the applicable property taxes as if the federal properties were taxable.

This, of course, still leaves room for interpretation and dispute, not only in regard to the properties to be included and their assessed value, but also in the application of variations in local rates. Officials working on behalf of the designated minister

6 RSC 1985, c. M-13.

7 *Laval (Ville) v. Canada (Attorney General)*, 2019 FC 1481.

8 Ibid., at paragraph 17.

9 The application form for Quebec municipalities differs from that for all other regions of the country in that it requests assessment values in multiple columns, reflecting different aspects or sources of the information.

(currently the minister of government transformation, public works, and procurement) to implement the program must follow the PILT legislation. That legislation makes clear that the calculation of the grant is based on the value of the federal properties as determined by the minister (section 4(1)), not the assessed value in the local tax rolls. Furthermore, the legislation also states that the calculation is based on the "effective rate," as determined by the minister, that "would be applicable to any federal property if that property were taxable property" (section 2(1)). In other words, the local taxing authority sets the local rates for taxable properties and the federal government must use those rates in its own calculations of the PILT grant.[10] When special rates or exemptions are also part of the local tax regime, federal officials, acting on behalf of the minister, must make reasonable decisions about how to correctly apply those rates or exemptions. In short, it is never the case that a city government simply presents a tax bill to the government of Canada. The federal government is, at all times, exempt from the local tax rules and bound only by its own legislation. In fact, because federal properties are also exempt from local building permitting, municipal governments may not have the most accurate information about changes to the value of federal buildings.

FEDERAL-MUNICIPAL DISAGREEMENTS

Where a local authority disputes[11] the federal calculation (which must be shared by federal officials with the local authority), the matter can be heard by the Payments in Lieu of Taxes Dispute Advisory Panel, an arm's-length body mandated by the PILT legislation to provide advice to resolve disputes about calculations of property values, property dimensions, applicable effective tax rates, and penalties in case of late payments. The advice is provided to the minister of government transformation, public works, and procurement or to the heads of federal Crown corporations (such as Canada Post, the Canadian Broadcasting Corporation, and the National Capital Commission), which independently administer their own PILT payments. The panel is ultimately advisory only and not quasi-judicial. In fact, municipalities regularly pursue PILT disputes with the government of Canada not through the panel but through the courts.

For example, in 2010, a dispute between the city of Montreal and the Montreal Port Authority (a federal Crown corporation) was resolved only at the Supreme Court. In that case, the justices held that courts must show deference to administrative decisions made under the federal PILT legislation, though the court also found that federal officials must not play fast and loose in their calculations. "Their calculations cannot be based on a fictitious tax system, but must be based on the system that actually exists at the place where the property in question is located," the court

10 Kitchen and Vaillancourt, supra note 2.

11 For a historical discussion of the nature of municipal concerns with PILT systems, see Kitchen and Slack, supra note 2.

wrote.[12] In other words, the order of government making the PILT payment must adopt the local property tax framework as it exists in each jurisdiction, as if federal properties were private and taxable.

To give a more recent example of a dispute, in 2023 the city of Ottawa filed an application for judicial review in Federal Court, arguing that the government of Canada had improperly reduced its PILT payments in 2021 and 2022.[13] In his February 2025 decision, Justice Pamel noted that the case mirrored the dispute involving the city of Montreal and the federal port authority, in that federal officials had exercised administrative reasonableness in applying the effective rate framework, but, in this case, they had done so to the objections of the city.[14] At the heart of the dispute between the city of Ottawa and the federal government was the question whether a change in the local education property tax rates should be applied in the calculation of PILT grants. The city of Ottawa argued that the government of Canada had unreasonably underpaid PILT grants by $10.7 million in each of the 2021 and 2022 taxation years.

In its 2020 budget, the government of Ontario introduced a province-wide cap of 0.88 percent on the business education tax rate, starting in the 2021 taxation year. This rate had previously varied from municipality to municipality across the province. For provincial properties, Ontario provided assurances to municipalities that it would not apply this new reduced rate in its own PILT calculations, effectively suspending the official tax framework when calculating payments.[15] However, the Municipal Finance Officers' Association, a professional association representing more than 5,400 municipal finance officers in Ontario, expressed concerns that the provincial exemption on PILT properties may not be consistent with the applicable legislation; furthermore, the association understood that federal officials would not apply a similar exemption and would instead apply the new province-wide rules in their calculations.[16]

When the regulations for the budget legislation were released, the province had specified that the rate cut would not apply for the purpose of calculating payments in lieu of taxes by provincial entities, municipal utilities, or federal properties. However, as Justice Pamel noted in his decision, the federal PILT legislation does not

12 *Montréal (City) v. Montreal Port Authority*, 2010 SCC 14, at 430.

13 "City of Ottawa Takes Feds to Court Over $22M in Alleged Underpayments," *CBC News*, January 25, 2023.

14 *Ottawa (City) v. Canada (Public Services and Procurement)*, 2025 FC 315.

15 Commissioner of Finance, *The Regional Municipality of Durham Report*, report to the Finance and Administration Committee, Report no. 2021-F-4 (Whitby, ON: Region of Durham, February 9, 2021), at 8-9, paragraph 8.5.

16 Municipal Finance Officers' Association of Ontario, "Comments on the 2020 Provincial Budget's Reduction of the BET Rate in 2021 and Creation of a New Optional Small Business Property Subclass," letter to the Assistant Deputy Minister, Ontario Ministry of Finance, December 16, 2020.

provide federal officials with the discretion to adopt provincial regulations that would apply to federal jurisdiction. Instead, the tax on federal properties must, in law, be calculated as though the properties were taxable.[17] Because the tax on taxable properties had decreased, the PILT on federal properties used that lower rate. In his decision, Justice Pamel also noted that federal officials had contacted their provincial counterparts to advise them of the impact on PILT grant calculations and to urge the province to implement the desired rate cut in a different way, so as to avoid impacts on the federal PILT amounts. Under the circumstances, the court found that federal officials had used the discretion delegated to them under the PILT legislation as intended and as bounded by that same legislation.

In 2024, before Justice Pamel's decision was released, the city of Ottawa and the province of Ontario signed an agreement in which both orders of government committed to engage in advocacy to reach a new agreement with the government of Canada on PILT payments to Ottawa, including a request that the federal government adopt a province-wide standard on applicable tax rates.[18] This broader issue of fiscal arrangements remains unresolved but has been escalated in a public-facing campaign launched by the mayor of Ottawa to draw greater attention to the PILT issue, and to call for changes to the fiscal arrangements between the city and both the provincial and federal governments.[19]

EMERGING CHALLENGES

Another emerging tension in the PILT framework is the government of Canada's aim to significantly reduce its ownership of buildings and its overall property footprint. Indeed, both the city of Ottawa and the province of Ontario have expressed concern about instability in PILT revenues resulting from the disposition of federal properties.[20]

The effort to reduce real estate holdings is not a new endeavour. In 2007, the federal government successfully pursued a policy of selling federally owned office buildings and then leasing them back from the new owners; the policy increased the share of federal properties that are leased rather than owned to nearly 50 percent.[21]

17 Kitchen and Vaillancourt, supra note 2, highlighted the potential perverse incentives arising from the interactions of federal PILT obligations and local business occupancy tax rates. As noted in their 1990 study, federal properties refused to pay higher business occupancy rates on local property taxes.

18 Ontario, Ministry of Finance, "Terms of the Ontario-Ottawa Agreement" (www.ontario.ca/page/terms-ontario-ottawa-agreement).

19 City of Ottawa, "Mayor Says Ottawa Is Facing Financial Crisis Based on Shortfall in Federal and Provincial Funding," *Press Release*, August 8, 2024.

20 Ibid.; and Ministry of Finance, supra note 18.

21 Public Works and Government Services Canada, "Government of Canada Sells Office Buildings To Better Use Taxpayers' Money," *News Release*, August 20, 2007.

When the government of Canada is not the owner of a building but instead makes rental or lease payments, the cost of the owner's property taxes is assumed to be reflected in the cost of the rent or lease. The local taxes owed are in turn payable by the owner to the local tax authority.

In addition to moving away from the ownership of buildings, the government of Canada has also pursued efforts to reduce its overall real estate footprint by reducing the average size of workspaces for individual employees,[22] and it currently has a plan to reduce existing federal office space by 50 percent over the next 10 years.[23] Given that the city of Ottawa is just one of more than 1,000 local tax authorities that receive federal PILT payments, is the future of those payments likely to be a concern outside the National Capital Region, or is this issue specific to the proverbial federal bubble?

Most local tax authorities in Canada receive a very small payment in federal PILT transfers, in dollars, as a share of all federal PILT payments issued, and likely even as a share of their total PILT revenues. In the next section, I use published federal and local data to consider the nominal value, relative shares, and relative importance of federal PILT payments for a sample of nine cities across the country. Data are presented for the years 2019 through 2023. Federal PILT data are taken from annual reporting of PILT amounts by Public Services and Procurement Canada (PSPC). City-level data are gathered from municipal budget and fiscal documents. The selected cities include both municipalities in the National Capital Region—the city of Ottawa and the city of Gatineau. Other cities in the sample include four of Canada's largest cities in four different regions, the city of Vancouver (not the metropolitan area), the city of Calgary, the city of Toronto, and the city of Montreal. Finally, I include three smaller cities that have at least one important federal property—the city of Rigaud, Quebec (which has a large federal training college), the city of Kingston, Ontario (which has a military college and several penitentiaries), and the city of Windsor, Ontario (which has the Ambassador Bridge, one of the busiest border crossings in North America).

FEDERAL AND MUNICIPAL DATA ON PILT TRANSFERS

In table 1, I present the dollar values for the federal PILT payments made to the selected municipalities for 2019 through 2023. For each municipality, I also report the share of total PILT payments that they received in a given year.

As shown in table 1, the selected cities receive more than one-third of all federal PILT payments made to local tax authorities across the country. Of these, the city of

22 Public Services and Procurement Canada, *Public Services and Procurement Canada 2017-18 Departmental Plan* (Ottawa: Public Services and Procurement Canada, 2017), at 20.

23 Public Services and Procurement Canada, "Reducing Office Portfolio Over the Next 10 Years" (www.canada.ca/en/public-services-procurement/services/infrastructure-buildings/managing-federal-property/optimizing-real-property-portfolio/office-space-10-year-plan.html); and Public Services and Procurement Canada, *Public Services and Procurement Canada Departmental Plan 2024-25* (Ottawa: Public Services and Procurement Canada, 2024).

TABLE 1 Major Federal PILT Payments (Nominal Dollars) and Share of Total PILT Payments per Year (Percent), Selected Municipalities

	Panel A Federal PILT payments				
	2019	2020	2021	2022	2023
			nominal dollars		
Vancouver	4,715,469	3,839,480	6,296,451	6,551,149	7,067,055
Calgary	2,439,462	1,675,799	1,515,889	1,599,161	1,662,902
Toronto	6,188,059	6,630,685	6,316,511	6,469,125	6,620,957
Montreal[a]	26,101,990	26,146,566	26,396,946	26,623,541	27,495,488
Ottawa	122,733,776	124,467,868	114,616,830	119,603,764	124,042,964
Gatineau	37,805,429	32,779,091	33,762,215	35,445,481	48,530,973
Kingston	10,882,995	11,045,420	10,155,021	10,388,211	10,863,537
Windsor	734,277	649,805	627,562	638,036	675,247
Rigaud	1,138,844	1,233,572	1,232,681	1,165,043	1,133,521
Total paid to all Canadian tax authorities	562,157,134	555,893,532	552,253,144	570,572,303	609,884,940
	Panel B Share of total PILT payments				
	2019	2020	2021	2022	2023
			percent		
Vancouver	0.84	0.69	1.14	1.15	1.16
Calgary	0.43	0.30	0.27	0.28	0.27
Toronto	1.10	1.19	1.14	1.13	1.09
Montreal[a]	4.64	4.70	4.78	4.67	4.51
Ottawa	21.83	22.39	20.75	20.96	20.34
Gatineau	6.73	5.90	6.11	6.21	7.96
Kingston	1.94	1.99	1.84	1.82	1.78
Windsor	0.13	0.12	0.11	0.11	0.11
Rigaud	0.20	0.22	0.22	0.20	0.19
Total paid to selected Canadian tax authorities	37.84	37.50	36.38	36.54	37.40

PILT = payments in lieu of taxes.

Note: Amounts exclude payments made by federal Crown corporations. These latter are not reported in the Public Accounts of Canada.

a Excludes the separate payment issued to the Comité de gestion de la taxe scolaire de l'Île de Montréal.

Source: Public Services and Procurement Canada, "Viewing Payments in Lieu of Taxes by Taxing Authority," various taxation years; and author's calculations.

Ottawa receives $1 of every $5 of federal PILT payments made, and the total paid to the two municipalities in the National Capital Region (Ottawa and Gatineau) now accounts for 28 percent of all annual federal PILT payments. The majority of federal PILT grants are very small amounts paid to more than 1,000 local tax authorities across the country. Given the concentration of federal properties in the National Capital Region, and the relatively sparse federal presence elsewhere in the country, these data should not be surprising. But knowing what the government of Canada paid is not sufficient for understanding how important the federal PILT payments are to local finances.

In table 2, I report the total PILT revenues for the same nine municipalities. As indicated in the table, not all cities report PILT revenues in their fiscal documents. Since cities receive PILT revenues from both federal Crown corporations and provincial bodies, I also report the share of total PILT revenues arising from the main federal payments reported in table 1.

In Windsor, federal PILT revenues make up less than a third of total PILT grants received. In Montreal, major federal PILT payments account for 10 percent or less of total annual PILT revenues. In Calgary, the percentage is even smaller and has declined to well under 1 percent. However, in the National Capital Region, while the relative share of federal PILT revenues received by the two cities has fluctuated, both cities rely heavily on federal transfers in their total PILT revenues. Again, these percentage estimates do not account for other federal PILT payments made directly by Crown corporations such as the National Capital Commission, which owns a significant amount of property in the region. In the case of Ottawa and Gatineau, the real shares of PILT revenues from all federal sources are likely to be even higher than the values reported in table 2. More remarkable are the two smaller cities of Rigaud and Kingston, whose shares of total PILT revenues from federal sources are highest in this sample, even higher than the shares of the two cities in the National Capital Region. This is indicative of the relative balance in the presence of federal compared to provincial infrastructure in the cities.

To get a sense of the importance of the share of federal PILT payments for local budgets (in terms of the share of all federal PILT payments, as well as the concentration of federal grants in total PILT revenues for a given city), in figure 1 I chart the value of PILT payments made by PSPC (as reported in table 1) relative to total local property tax revenues (panel A) and as a share of total municipal operating budgets (panel B). This approach follows previous work by Kitchen and Slack.[24] Because PILT payments are separate from local property tax revenues (but not always separately reported by municipalities), I treat this as an indicator of how much local tax revenues directly depend on a federal presence and PILT payments.

24 Supra note 2.

TABLE 2 Total PILT Revenues Reported (Nominal Dollars) and Share (Percent) Attributable to Payments from PSPC, Selected Municipalities

Panel A Total PILT revenues reported					
	2019	2020	2021	2022	2023
			nominal dollars		
Vancouver	na	na	na	na	na
Calgary	214,636,000	207,728,000	251,571,000	338,972,000	403,535,000
Toronto	na	na	na	na	na
Montreal	274,855,200	279,132,600	285,843,300	263,590,600	279,204,400
Ottawa	174,700,000	169,800,000	175,700,000	169,100,000	212,500,000
Gatineau	68,641,000	70,877,000	72,728,000	75,854,000	80,901,000
Kingston	16,292,455	17,076,389	16,396,914	16,871,298	16,970,000
Windsor	3,930,986	2,061,318	1,960,000	1,995,000	1,995,000
Rigaud	1,557,865	1,690,187	1,700,103	1,655,442	1,597,629

Panel B Share of PILT revenues attributable to payments from PSPC					
	2019	2020	2021	2022	2023
			percent		
Vancouver	na	na	na	na	na
Calgary	1.14	0.81	0.60	0.47	0.41
Toronto	na	na	na	na	na
Montreal	9.50	9.37	9.23	10.10	9.85
Ottawa	70.25	73.30	65.23	70.73	58.37
Gatineau	55.08	46.25	46.42	46.73	59.99
Kingston	66.80	64.68	61.93	61.57	64.02
Windsor	18.68	31.52	32.02	31.98	33.85
Rigaud	73.10	72.98	72.51	70.38	70.95

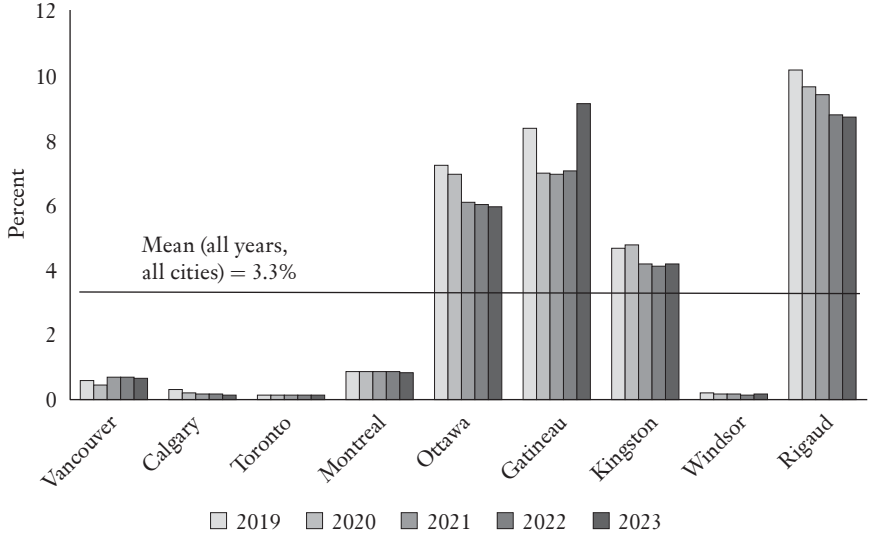
PILT = payments in lieu of taxes; PSPC = Public Services and Procurement Canada.

na = not applicable.

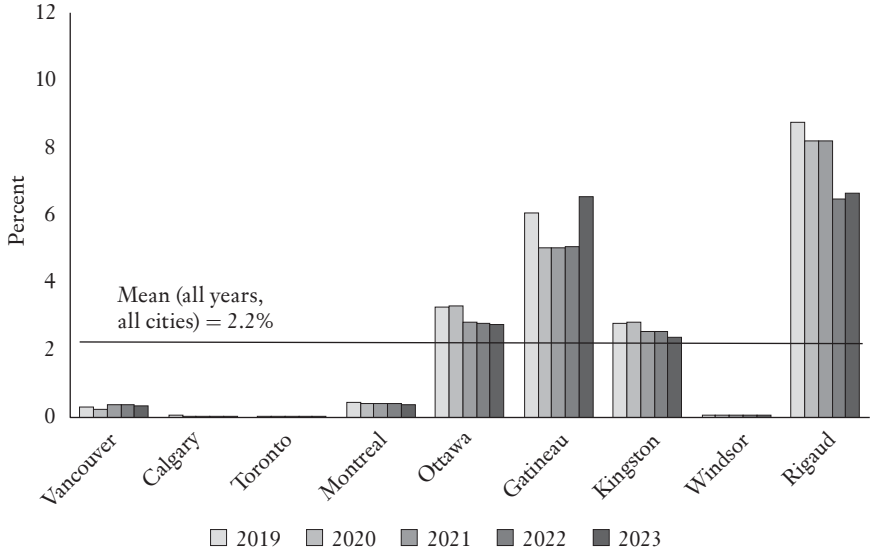
Sources: Municipal data as published in the City of Calgary, *2023 City of Calgary Annual Financial Report* (Calgary: City of Calgary, Corporate Planning and Financial Services Department, 2024); City of Montréal, 2023 Budget et PDI 2023-2032, November 29, 2022; City of Montréal, 2024 Budget et PDI 2024-2033, November 15, 2023; City of Ottawa, 2020 Budget, December 11, 2019; City of Ottawa, 2021 Budget, December 9, 2020; City of Ottawa, 2022 Budget, December 8, 2021; City of Ottawa, 2023 Budget, March 1, 2023; City of Ottawa, 2024 Budget, December 6, 2023; City of Gatineau, 2020 Budget, December 10, 2019; City of Gatineau, 2021 Budget, December 8, 2020; City of Gatineau, 2022 Budget, January 31, 2022; City of Gatineau, 2023 Budget, December 6, 2022; City of Gatineau, 2024 Budget, December 5, 2023; City of Kingston, 2020 Budget, May 25, 2020; City of Kingston, 2021 Budget, January 26, 2021; City of Kingston, 2022 Budget, January 26, 2021; City of Kingston, 2023 Budget, March 21, 2023; City of Kingston, 2024 Budget, January 16, 2024; City of Windsor, 2020 Budget, January 27, 2020; City of Windsor, 2021 Budget, February 22, 2021; City of Windsor, 2022 Budget, December 13, 2021; City of Windsor, 2023 Budget, December 12, 2022; City of Windsor, 2024 Budget, February 2, 2024; City of Rigaud, Annual Finance Report 2019, 2020, 2021, 2022, and 2023; City of Rigaud, 2024 Budget, December 18, 2023; and author's calculations using data from PSPC as reported in table 1.

FIGURE 1 Federal PILT Payments as a Percentage of Total Local Property Tax Revenues and Total Municipal Operating Budgets, Selected Municipalities

Panel A Federal PILT payments as a percentage of total local property tax revenues



Panel B Federal PILT payments as a percentage of total municipal operating budgets



(Figure 1 is concluded on the next page.)

FIGURE 1 Concluded

Sources: Municipal data as published in the City of Vancouver, 2020 Budget, February 18, 2020; City of Vancouver, 2021 Budget, December 8, 2020; City of Vancouver, 2022 Budget, December 7, 2021; City of Vancouver, 2023 Budget, February 28, 2023; City of Vancouver, 2024 Budget, December 12, 2023; City of Calgary, *2023 City of Calgary Annual Financial Report* (Calgary: City of Calgary, Corporate Planning and Financial Services Department, 2024); City of Toronto, 2019 Budget, March 7, 2019; City of Toronto, 2020 Budget, February 12, 2020; City of Toronto, 2021 Budget, January 14, 2021; City of Toronto, 2022 Budget, January 13, 2022; City of Toronto, 2023 Budget, January 10, 2023; City of Toronto, 2024 Budget, February 14, 2024; City of Montréal, 2023 Budget et PDI 2023-2032, November 29, 2022; City of Montréal, 2024 Budget et PDI 2024-2033, November 15, 2023; City of Ottawa, 2020 Budget, December 11, 2019; City of Ottawa, 2021 Budget, December 9, 2020; City of Ottawa, 2022 Budget, December 8, 2021; City of Ottawa, 2023 Budget, March 1, 2023; City of Ottawa, 2024 Budget, December 6, 2023; City of Gatineau, 2020 Budget, December 10, 2019; City of Gatineau, 2021 Budget, December 8, 2020; City of Gatineau, 2022 Budget, January 31, 2022; City of Gatineau, 2023 Budget, December 6, 2022; City of Gatineau, 2024 Budget, December 5, 2023; City of Kingston, 2020 Budget, May 25, 2020; City of Kingston, 2021 Budget, January 26, 2021; City of Kingston, 2022 Budget, January 26, 2021; City of Kingston, 2023 Budget, March 21, 2023; City of Kingston, 2024 Budget, January 16, 2024; City of Windsor, 2020 Budget, January 27, 2020; City of Windsor, 2021 Budget, February 22, 2021; City of Windsor, 2022 Budget, December 13, 2021; City of Windsor, 2023 Budget, December 12, 2022; City of Windsor, 2024 Budget, February 2, 2024; City of Rigaud Annual Finance Report 2019, 2020, 2021, 2022, and 2023; City of Rigaud, 2024 Budget, December 18, 2023; and author's calculations using data from PSPC as reported in table 1.

The particular issues facing those cities with a heavy concentration of federal properties are readily apparent in these figures. These cities include those in the National Capital Region—Ottawa and Gatineau—but also Kingston and Rigaud. In all four cases, the high share of federal properties means that federal PILT grants weigh more heavily in municipal finances.

Kitchen and Slack considered PILT payments from all sources and not only federal payments. However, where federal payments make up the majority of PILT revenues for a city, a comparison to Kitchen and Slack's results for the 2000 taxation year is illustrative. In 2000, all-source PILT revenues were equivalent to 9.5 percent of Ottawa property tax revenues.[25] As of 2023, federal PILT payments were equal to 6 percent of all property tax revenues in Ottawa, down from 7.3 percent in 2019.

The average ratio of federal PILT grants to local property tax revenues is 3.3 percent across the nine cities in the sample (figure 1, panel A). However, the ratio is considerably higher in three of those cities: 9.2 percent in Gatineau, 4.2 percent in Kingston, and 8.75 percent in Rigaud.

25 Kitchen and Slack, supra note 2, do not report on the city of Gatineau, the city of Kingston, or the city of Rigaud.

Likewise, when the contribution of federal PILT payments to overall municipal operating budgets is considered (figure 1, panel B), cities with a heavy concentration of federal properties stand out. Across the sampled cities, federal PILT grants account, on average, for just 2.2 percent of operating budgets. However, in the five cities without a heavy concentration of federal property, average federal PILT revenues account for less than 0.5 percent of revenues from all sources in the local operating budget. In contrast, federal PILT payments make up almost 3 percent of Ottawa's total operating budget revenues and 2.4 percent of Kingston's, while federal PILT payments in both Gatineau and Rigaud contribute upward of 6 percent.

Some cities with a heavy concentration of federal properties may also be more sensitive to changes in federal PILT grants if local property taxes, which PILT payments offset, also form a larger share of their total operating revenues. In figure 2, I find that the picture is more mixed. Across the nine cities, local property taxes make up a little more than half (56 percent) of operating budgets, with revenue from other sources, such as provincial transfers and user fees, making up the rest. The cities of Calgary, Gatineau, and Rigaud are considerably above this mean. But only in Gatineau and Rigaud is it the case that property taxes are so important to local revenues and, simultaneously, the lands and properties that might otherwise be taxable are federally owned and therefore generating PILT grants.

CONCLUSION

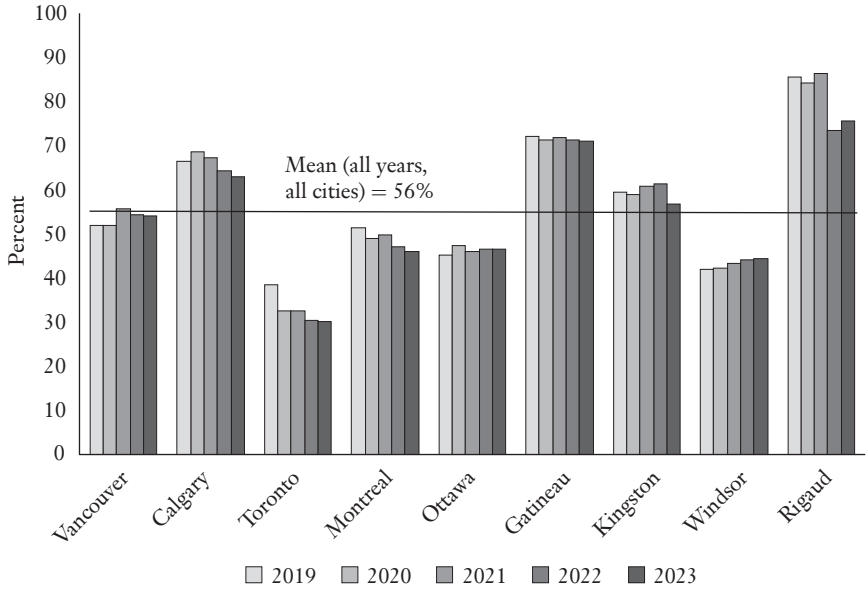
PILT payments have both positive and negative aspects. On the one hand, a large share of PILT grants in a municipal budget may be seen as an asset, providing a steady source of transfer income that is relatively easy to collect. On the other hand, this is true only so long as the local tax authority can count on a continued federal (or provincial) physical presence in the community. If federal (or provincial) officials reduce the Crown's property footprint, a long-term change to a 6 or 8 percent share of the operating budget can be significant, particularly in cities that may already be facing fiscal challenges. For example, the mayor of Ottawa has warned residents that, absent resolution of the dispute over federal PILT grants, local residents will continue to have to make up the difference in higher property taxes.[26] But should the PILT system apply differentially in cities with an outsized federal presence? Should the system be viewed as a sort of fiscal backstop?

In their review of municipal government finance options, Kitchen and Slack[27] concluded that the fundamentals of the PILT system were largely sound and that where cities had concerns, they were largely related to speed and transparency in process rather than dollar amounts. The PILT legislation and regulations apply to all municipalities and local tax authorities equally. The system does not give the government of Canada discretion to consider the fiscal room occupied by its PILT

26 Supra note 19.

27 Supra note 2.

FIGURE 2 Share of Total Operating Budget Finances Through Local Property Taxes, Selected Municipalities



Sources: Author's calculations using municipal data as published in the City of Vancouver, 2020 Budget, February 18, 2020; City of Vancouver, 2021 Budget, December 8, 2020; City of Vancouver, 2022 Budget, December 7, 2021; City of Vancouver, 2023 Budget, February 28, 2023; City of Vancouver, 2024 Budget, December 12, 2023; City of Calgary, 2023 *City of Calgary Annual Financial Report* (Calgary: City of Calgary, Corporate Planning and Financial Services Department, 2024); City of Toronto, 2019 Budget, March 7, 2019; City of Toronto, 2020 Budget, February 12, 2020; City of Toronto, 2021 Budget, January 14, 2021; City of Toronto, 2022 Budget, January 13, 2022; City of Toronto, 2023 Budget, January 10, 2023; City of Toronto, 2024 Budget, February 14, 2024; City of Montréal, 2023 Budget et PDI 2023-2032, November 29, 2022; City of Montréal, 2024 Budget et PDI 2024-2033, November 15, 2023; City of Ottawa, 2020 Budget, December 11, 2019; City of Ottawa, 2021 Budget, December 9, 2020; City of Ottawa, 2022 Budget, December 8, 2021; City of Ottawa, 2023 Budget, March 1, 2023; City of Ottawa, 2024 Budget, December 6, 2023; City of Gatineau, 2020 Budget, December 10, 2019; City of Gatineau, 2021 Budget, December 8, 2020; City of Gatineau, 2022 Budget, January 31, 2022; City of Gatineau, 2023 Budget, December 6, 2022; City of Gatineau, 2024 Budget, December 5, 2023; City of Kingston, 2020 Budget, May 25, 2020; City of Kingston, 2021 Budget, January 26, 2021; City of Kingston, 2022 Budget, January 26, 2021; City of Kingston, 2023 Budget, March 21, 2023; City of Kingston, 2024 Budget, January 16, 2024; City of Windsor, 2020 Budget, January 27, 2020; City of Windsor, 2021 Budget, February 22, 2021; City of Windsor, 2022 Budget, December 13, 2021; City of Windsor, 2023 Budget, December 12, 2022; City of Windsor, 2024 Budget, February 2, 2024; City of Rigaud Annual Finance Report 2019, 2020, 2021, 2022, and 2023; City of Rigaud, 2024 Budget, December 18, 2023.

payments in the revenues and budgets of the local tax authority. Amending the legislation to provide special payments to cities that rely more heavily on federal PILT revenues could create a perverse incentive for local tax authorities to reduce the diversity of their revenue streams in order to boost federal grant payments, which might be seen as more reliable or easier to collect.

It is also not clear that the government's efforts to reduce its real estate holdings should necessarily result in a net reduction of revenues to local authorities. If properties are sold, the new owners become responsible for paying local property taxes. If, as appears to be part of the federal aim, most of the properties are sold for redevelopment, assessed values should be expected to increase and, with them, municipal property tax revenues.

The federal PILT program is not well suited to playing the role of fiscal backstop to municipal finances. It is a blunt instrument, largely oriented to making thousands of small payments to municipalities across the country. Given the constitutional division of roles and responsibilities, it is also not clear that the responsibility for providing a fiscal backstop to cities should lie with the federal government. In fact, a full accounting of the fiscal support provided by federal properties in local communities, whether inside or outside the National Capital Region, would also necessarily account for the net economic benefit provided by the activities taking place on Crown lands and in government buildings.

Communities that are home to important concentrations of government properties are still cities with the same powers and governance as other municipalities with more diverse local economies. They can exercise some choice, within the bounds of their own responsibilities, in deciding on the mix of revenue sources they continue to rely on. This is not a new challenge. In 1958, just eight years after the launch of the federal PILT program, Dupré observed that Canadian municipalities were facing increasing fiscal pressures.[28] He encouraged municipalities to look for ways to diversify their own-source revenues rather than relying so heavily on local property taxation (and its substitute in the form of PILT grants): "[I]t is plain that alternative revenue sources must be accorded the closest consideration. Municipalities will have to look to the further development of present government grants and sales taxes, and to other taxes hitherto untapped, such as a motor vehicle user's tax."[29]

That advice is still relevant today.

28 J. Stefan Dupré, "The Property Tax in Canada" (1958) 51 *Proceedings of the Annual Conference on Taxation Under the Auspices of the National Tax Association* 77-84.

29 Ibid., at 83.

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Personal Tax Planning

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

SORRY, EH? HOW A US-CITIZEN SPOUSE CAN COMPLICATE CANADIAN TAX-SAVING STRATEGIES

*Megan Dalton and Bilaal Bana*****

Although Canadian-resident spouses can implement effective income-splitting strategies to limit their income tax exposure, this planning is often more complex when one spouse is a US citizen. Because US citizens are subject to US tax laws, many common Canadian income-splitting strategies must take additional US obligations into account, particularly income and gift taxes. Key strategies that may need to be reconsidered include the payment of family expenses by the higher-income spouse and the use of joint accounts, spousal loans, spousal registered retirement savings account contributions, pension income splitting, tax-free savings accounts, and the use of a Canadian family trust. This article assesses each of these strategies under Canadian tax law, examines how the strategy would be treated under US tax law, and discusses the impacts on a US-citizen spouse and their non-US-citizen spouse. The article also highlights the importance of seeking advice to navigate the complexities of tax planning in this situation and demonstrates that, without proper planning, these Canadian couples could face adverse tax consequences.

KEYWORDS: INCOME SPLITTING ■ SPOUSE ■ US ■ ATTRIBUTION ■ GIFT TAXES ■ PRESCRIBED RATE LOAN

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Planification fiscale personnelle

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TU M'NIAISES…COMMENT UN CONJOINT CITOYEN AMÉRICAIN PEUT COMPLIQUER LES STRATÉGIES D'ÉCONOMIE D'IMPÔT AU CANADA

*Megan Dalton et Bilaal Bana*****

Les conjoints résidant au Canada peuvent mettre en œuvre des stratégies efficaces de fractionnement du revenu pour limiter leur exposition à l'impôt sur le revenu, mais cette planification est souvent plus complexe lorsqu'un des conjoints est citoyen américain. Comme les citoyens américains sont assujettis à la législation fiscale américaine, de nombreuses stratégies canadiennes courantes de fractionnement du revenu doivent tenir compte des obligations américaines supplémentaires, en particulier l'impôt sur le revenu et l'impôt sur les dons. Les stratégies clés qui peuvent devoir être réexaminées comprennent le paiement des dépenses familiales par le conjoint ayant le revenu le plus élevé et l'utilisation de comptes conjoints, les prêts au conjoint, les cotisations au compte enregistré d'épargne-retraite du conjoint, le fractionnement du revenu de pension, l'utilisation d'un compte d'épargne libre d'impôt et l'utilisation d'une fiducie familiale canadienne. Cet article évalue chacune de ces stratégies au regard de la législation fiscale canadienne, examine comment la stratégie serait traitée en vertu de la législation fiscale américaine et discute des effets sur un conjoint citoyen américain et son conjoint non citoyen américain. L'article souligne également l'importance de demander conseil dans ce contexte de planification fiscale complexe et montre que l'absence de planification appropriée peut entraîner des conséquences fiscales négatives pour ces couples canadiens.

MOTS CLÉS : FRACTIONNEMENT DU REVENU ■ CONJOINT ■ AMÉRICAIN ■ ATTRIBUTION ■ IMPÔT SUR LES DONS ■ PRÊT AU TAUX PRESCRIT

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Selected US Tax Developments

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

EXAMINING THE US INCOME TAX RULES APPLICABLE TO US EXPATRIATES

*Michael J. Miller***

US citizens and resident aliens are subject to income taxation on worldwide income, as well as gift and estate taxation on worldwide assets. Avoiding those rules by becoming a non-resident alien can yield substantial US tax benefits. In order to minimize the US tax benefits of expatriating, a variety of special rules apply to certain individuals who relinquish their US citizenship or cease to be "long-term residents" of the United States. This article discusses the special income tax rules applicable to "covered expatriates."

KEYWORDS: UNITED STATES ■ EXPATRIATION ■ DEFERRED COMPENSATION ■ TRUSTS

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Current Tax Reading

Co-Editors: David G. Duff, Jinyan Li, Alan Macnaughton, and Michael Veall*

Allison Christians, "Tarrifying! A Brief U.S. History" (2025) 118:5 *Tax Notes International* 695-710

Reuven S. Avi-Yonah, Doron Narotzki, and Tamir Shanan, *From Relic to Relevance, The Resurgence of Tariffs*, Law & Economics Working Papers 290 (Michigan: University of Michigan, Law School, 2025) (https://repository.law.umich.edu/law_econ_current/290)

Sweeping and high tariffs are being imposed by US President Trump against American trading partners, with potentially terrifying and disruptive effects. As a topic, tariffs have become a part of everyday conversations and the subject of scholarly research. These two articles are examples of the latter.

In "Tarrifying! A Brief U.S. History," Christians provides an excellent account of tariffs in the United States, starting with the "Revenue Era" (1789-1860), then the "Protectionist Era" (1861-1929), the "Liberalization Era" (1934-2016), and now the "America First Era" (2016-present). In her view, tariffs "have served as a primary source of federal revenue, a tool for economic development and protection, a lever for negotiating favorable trade terms with other countries, a means of delivering sanctions against other countries, and a divider of domestic politics."[1] It was the McKinley tariff of 1890 that introduced the concept of "retaliatory" tariffs, permitting higher rates on imports from countries that unjustly discriminated against US products. This concept is now being applied by President Trump. However, instead of retaliating against only some countries, "Trump tarrifies the world."[2]

Christians explains that US trade policy has historically swung (sometimes violently) between protectionism and liberalization and has been used as a political and economic tool. President Trump's return to the protectionist tradition "appeals to

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1 At 695.

2 At 709.

those who blame today's economic insecurity on trade liberalization and globalization," and "reflects tensions and contradictions in U.S. trade policy that have always been present."[3] Christians wisely cautions that "[i]t remains to be seen how Trump's gamble with tarrifying the world plays out."[4]

In "From Relic to Relevance, The Resurgence of Tariffs," Avi-Yonah, Narotzki, and Shanan examine tariffs as a potential pillar of fiscal policy and assess the feasibility of a tariff-based tax system. Relying on historical lessons and economic modelling, they evaluate such a system's revenue potential, equity implications, administrative challenges, and legal constraints. In their view, tariffs alone cannot sustain a modern tax system. When used strategically, however, tariffs can, together with consumption-based taxes, offer an alternative to existing revenue structures. They recognize the fact that the US federal government derives close to 50 percent of its revenue from personal income taxes and about 35 percent from payroll taxes. Such heavy reliance on individual taxpayers raises a key policy question: "Are we maximizing our revenue sources in the most effective and equitable way?"[5] They argue for a more diversified and sustainable revenue system that can include tariffs.

JL

Michael L. Schler, "The State of the Federal Income Tax System: Poor" (June 2025) 187 *Tax Notes Federal* 1643-78

Jasper L. Cummings Jr., "Literalism vs. the Economic Substance Doctrine" (March 2025) 186 *Tax Notes Federal* 2023-37 (https://www.taxnotes.com/lr/resolve/7rbgl)

Tracey M. Roberts, "The Tax Trench Deepens" (2025) 28:2 *Florida Tax Review* (forthcoming) (http://dx.doi.org/10.2139/ssrn.5180981)

How healthy is the income tax system in the United States? "Poor," says Schler in the title of his article. Cummings Jr. does not say so in his article, but he shares the sentiment: the defunding of the Internal Revenue Service (IRS) and the judicial shift toward textual interpretation or liberalism "cannot be good for the IRS or the fisc."[6] Roberts is slightly less pessimistic, writing that "to the extent that the Court continues to observe the separation of powers in respect of their relationship with the legislature and legislative prerogatives, the tax system is likely to remain resilient."[7]

3 At 710.

4 Ibid.

5 At 54.

6 At 2037.

7 At 1643.

Among the reasons given for their views, the authors, individually and/or collectively, identify the following main reasons:

- Tax legislation is difficult because Congress is gridlocked. The last bipartisan tax legislation was passed when Ronald Reagan was president. Tax legislation is passed as part of the reconciliation bill. The reliance on reconciliation is not good for the tax system for a variety of reasons, including: tax measures are limited in term; each tax measure is intended to increase or decrease revenue; the revenue estimate takes account of the revenue cost of an increase in the IRS's budget; and, because Treasury regulations are not subject to the revenue constraints that apply to reconciliation, there is a heavy reliance on regulations rather than legislation.[8]
- The difficulty in passing tax legislation also means that technical corrections that are necessary to carry out the intent of Congress cannot be made through legislative changes, with the result that unintended tax benefits have not been eliminated.
- Tax legislation inevitably contains errors that need fixing, and when Congress is unable to fix those errors, the negative effect of the errors on the tax system is "greatly exacerbated by the increasing literalism [textualism] of the courts."[9]
- Regulations that close legislative gaps have been found to be invalid by the courts. The economic substance doctrine has been interpreted by the courts without considering congressional intent. As Cummings Jr. notes, "The Supreme Court's literalism and disdain for regulations will bring an entirely new day to the federal tax law."[10]
- Failure to fund the IRS and the Supreme Court's approach to statutory interpretation make it difficult to enforce tax law.

The confluence of various factors related to Congress, the courts, and the executive branch canvassed in these articles paints a rather pessimistic picture of the state of the US income tax system.

In terms of broad policy ambitions and roles, the Canadian income tax system is similar to the US federal income tax system. Is it likely that the Canadian system will share a similar fate? What can be done to ensure the sustainability of the Canadian system? Perhaps it is time to have a Carter-like system review of the Income Tax Act.

JL

8 This is a point highlighted by Schler. Roberts also discusses this in the context of assessing the US Supreme Court's decisions that limit executive branch interpretive authority.

9 Schler, at 1650.

10 At 2037.

Rebecca Morrow, "Tax on Tips," *Yale Law & Policy Review* (forthcoming) (http://dx.doi.org/10.2139/ssrn.5239427)

"No tax on tips!" President Trump's campaign promise to exempt tips from income tax has now been formally proposed in legislation in the US Congress. Isn't that great news for tips earners? It depends.

In this article, the author explains why the tax exemption would be bad for the 37 percent of US restaurant employees who earn less than the amount of the standard deduction (US$15,000 for single filers in 2025). It would be bad because the exemption would save no taxes for employees who have no tax liability to begin with. Even worse, the exemption would reduce their earned income tax credit (which is similar to the Canada workers benefit) and future social security benefits, which are calculated on the basis of earnings. The article illustrates this point by using the example of Carol, a 38-year-old single parent with an 18-year-old child:

> In 2024 . . . her earnings of $15,080 made her eligible for an Earned Income Tax Credit of $4,213. If tips were excluded from her income, that credit would drop to $1,505. Assuming that Carol retires in thirty years, Social Security will pay her $3,259 monthly if tips remain included in her wages but only $950 monthly if tips are excluded.[11]

The author argues that the exemption of tips from income tax fails to help and can actually harm tipped workers. She rejects "no tax on tips" slogans and instead proposes, among other things, to encourage restaurant employers to directly pay all workers the federal minimum wage ($7.25) and to allow workers to keep their tips.

Through careful analysis of the effect of the tax exemption of tips, this article reminds us that tax slogans are hardly good tax policies. Instead of helping low-paid, hard-working tipped workers, exempting tips can actually hurt them.

JL

Doron Narotzki, "Tax Treaties in the Wind" (2025) 13:2 *Penn State Journal of Law & International Affairs* 1-37 (http://dx.doi.org/10.2139/ssrn.5242242)

Double taxation agreements (DTAs) are the only international tax law instruments that affect the taxing rights of sovereign states and the tax liability of taxpayers. Since the Second World War, DTAs have been the bedrock of the international tax regime, promoting cross-border trade and investment through the elimination of double taxation, and fostering tax certainty and predictability for taxpayers by following the model conventions developed originally by the League of Nations and then by the Organisation for Economic Co-operation and Development (OECD) and the United Nations. The network of DTAs grew rapidly during the post-war economic boom in the 1960s and 1970s and globalization in the 1990s, following the end of

11 At 1.

the Cold War. It has supported global economic growth. However, few DTAs have been concluded recently. Because DTAs are important in signalling mutual trust and diplomatic relationships, the recent rise in nationalism and protectionist policies (such as those introduced by US President Trump) can undermine the foundation of DTAs—mutual trust and economic benefit.

This article explains why DTAs are like a candle in the wind, flickering uncertainly in the "gusts of rising nationalism."[12] It warns that the international community faces a critical choice now: adapt to the changing landscape, or risk the collapse of the cooperative structure of DTAs.

Among the gusts of rising nationalism, the article identifies a number of worrying signs: the enactment by the United States (and other countries) of domestic legislation to override treaty provisions, challenging the principle of *pacta sunt servanda* (good faith); Russia's suspension of its DTAs with 38 countries in 2023; and an increasing use of tariffs. There is a concurrent movement toward multilateralism (such as the base erosion and profit shifting [BEPS] project of the OECD and the Group of Twenty), but there is growing concern over the lack of inclusivity and the continuing dominance of established and powerful countries. The author sees the decline of DTAs as part of a much larger geopolitical shift toward economic self-interest. The decline has significant implications. The author writes:

> Overall, tax treaties are far more than just a technical mechanism, in fact the same outcome that tax treaties are supposed to result in, eliminating double taxation, could be achieved through unilateral measures or domestic policies. Thus, the true significance of tax treaties lies not in their technical function, but in their role in fostering international cooperation, promoting capital neutrality, and aligning economic interests among states.[13]

The author recognizes that neutrality (capital import neutrality, capital export neutrality, capital ownership neutrality) is a key objective of international tax policy and tax treaties. He recommends redefining neutrality as economic sovereignty neutrality in order to "better align with contemporary priorities, focusing on *economic sovereignty* rather than the old ideals of global capital allocation."[14] Instead of following the current practice of basing treaty language on the OECD model convention, which leaves little room for original drafting to address specific national economic circumstances, the author advocates for a "more selective and strategic approach" and argues that countries "should focus on developing a tailored framework with trusted partners, one that reflects mutual economic objectives and trust and offers a cohesive vision for cross-border cooperation."[15]

12 At 2.

13 At 15-16.

14 At 27 (emphasis added).

15 At 37.

Overall, this article anticipates the decline of tax treaties and suggests a pragmatic approach to keep them from being swept away by the gusts of nationalism and polarization of the global economy.

JL

Rifat Azam, "The Global Minimum Tax and Intra Western Tax Competition"
(2026) 44:1 *Berkeley Journal of International Law* (forthcoming)
(http://dx.doi.org/10.2139/ssrn.5266322)

The global minimum tax (GMT), known as pillar 2, has recently been introduced in Canada and more than 20 other countries and jurisdictions, including most member states of the European Union, Australia, South Korea, Japan, Indonesia, and the United Kingdom, but not the United States, China, or India. In fact, US President Trump issued an executive order in January 2025 to disavow the GMT. In May 2025, the US House of Representatives passed new section 899 of the Internal Revenue Code, which declares the UTPR (the undertaxed profits [payments] rule, one of two key elements of the GMT) to be one of the "unfair foreign taxes" against US persons, and authorizes additional penalty taxes as a retaliation measure.[16]

The current US position on the GMT is opposite to that of countries that have implemented the GMT, and of the global tax deal that was reached in 2021 by close to 140 jurisdictions, including the United States. The US position also exemplifies the country's longstanding exceptionalism, or even imperialism, in international taxation. The design of the GMT was originally inspired by the two minimum taxes introduced by the United States during President Trump's first term—GILTI (global intangible low-taxed income) and BEAT (base erosion anti-abuse tax). But the incorporation of GILTI into the GMT's IIR (income inclusion rule) and the BEAT into the UTPR were not approved by the United States. The American demands to treat GILTI as "equivalent" to the IIR and to remove the UTPR have, thus far, been rejected by the OECD BEPS Inclusive Framework, which oversees the design, interpretation, and implementation of the GMT. Major influencers of the Inclusive Framework are European countries. As a result, there is a faceoff between the United States and Europe over GILTI and the GMT.

In this article, the author provides a comprehensive and critical analysis of the conflict of positions and the underlying geopolitical dynamics and divergent economic and fiscal interests of the United States and Europe. After explaining the GMT, the author makes two important contributions to the literature on the GMT. First, he offers evidence and insights on the rise of tax competition within and between the United States and Europe, which he dubs the intra-western tax competition. Second, he shows that the GMT will not prevent international tax competition in general by illustrating new forms of tax competition at the global level, including tax competition

16 HR rep. 119-106, 119th Cong. (2025), section 112028, "Enforcement of Remedies Against Unfair Foreign Taxes." The US Senate will consider the bill in June 2025. Other unfair foreign taxes include the digital services tax (DST) and the diverted profits tax (DPT).

through the qualified domestic minimum top-up tax and the substance-based income exclusion rules.

The author draws several interesting and important conclusions. First, the GMT would intensify (rather than curb) tax competition, particularly among western nations. Second, the introduction of the GMT has shifted international tax competition into more opaque and potentially more distortive forms, such as refundable tax credits and state subsidies. Third, the GMT emerged as a "mechanism to regulate [the] rivalry [between the United States and Europe] while ostensibly promoting global tax cooperation."

JL

Hugh J. Ault, Brian J. Arnold, and Graeme S. Cooper, eds., *Comparative Income Taxation: A Structural Analysis*, 5th ed. (Alphen aan den Rijn, the Netherlands: Kluwer Law International, 2025)

This book is a leading text on comparative income taxation. It covers the income tax systems of nine developed countries (Australia, Canada, France, Germany, Japan, the Netherlands, Sweden, the United Kingdom, and the United States) as well as China and India. The fifth edition reflects changes in these countries' domestic tax laws and tax treaties from June 2019 to September 2024. Maintaining the structure of the fourth edition, part I of the new edition includes the country descriptions, and parts II, III, and IV focus on thematic discussions, namely, basic income taxation, the taxation of business organizations, and international taxation. In light of the extensive changes in international taxation, part IV adds new sections to address countries' responses to the BEPS action 2 report on hybrid mismatch arrangements and the BEPS action 4 report on base erosion through interest and other financial payments. Part IV also discusses the BEPS project and EU anti-tax-avoidance directives.

As recent global tax reform efforts show, countries facing common tax problems may have different approaches to solving those problems. By presenting a comparative analysis of some of the most important structural and design issues in income taxation, this book can help readers better appreciate the areas of convergence and divergence in countries' approaches and, perhaps more important, some of the policy and design reasons underlying those approaches.

In the vast body of literature on income taxation, especially international or comparative taxation, this book stands alone. It provides sufficient technical description of the tax laws of multiple countries to enable readers to appreciate how countries' tax laws differ, or are similar despite ostensible differences, but it is not as detailed as publications geared to practitioners tend to be. The book discusses tax laws as what they are or what they can realistically become (in light of their country-specific and international contexts and in accordance with basic principles), not as what they ought to be from an aspirational or purely theoretical perspective.

As a contributing author to this work, I might be somewhat biased in my views of it. You can the read the book to determine whether that is the case.

JL

Trevor Tombe, "Deep Dive: What a Pro-Growth Tax Reform Might Look Like," *Hub*, June 24, 2024 (https://thehub.ca/2024/06/24/deepdive-what-a-pro-growth-tax-reform-might-look-like)

This readable article provides a high-level tour of a number of proposed reforms of the Canadian system, which the author argues would increase fairness, reduce disincentives to work, help Canada attract and retain high-skilled workers, incentivize investment, and reduce compliance costs. The article can be seen overall as a plea for substantial tax reform.

One example the author uses in support of his argument is Estonia. Estonia has a flat 20 percent tax on personal income above a basic exemption, a 20 percent value-added tax, and a 20 percent corporate income tax. Importantly, however, the Estonian corporate income tax exempts all profits that are reinvested, and taxes only profits that are distributed to owners—measures that substantially increase the incentive to invest. The author argues that this broad-based approach is far better than distortionary, targeted tax measures and subsidies. The author notes that Mintz has advocated this kind of approach to Canada's corporate tax.[17] (Mintz's study also mentions an alternative corporate cash flow tax and the alternative of a tax on rents, which is closely related to an excess profits tax.[18] It is clear, however, that Canada's actual recent tax changes, the phasing out of faster writeoffs that began in 2024, go in exactly the wrong direction.[19])

Tombe also highlights Canada's high effective personal income tax rates. He notes that while the rates do tend to rise with income, they are often highest (exceeding 70 percent in Ontario!) for families with children and an income of $50,000—the level at which tax and transfer benefits for children begin to be clawed back. He believes that this may be a significant work disincentive. He also highlights research by Dahlby and Ferede,[20] which finds that Canada's revenue-maximizing personal tax

17 Jack Mintz, "A Proposal for 'Big-Bang' Corporate Tax Reform" (2021) 14:21 *SPP Research Papers* [University of Calgary School of Public Policy] 1-26. It is worth highlighting this important proposal. Mintz's abstract (ibid., at 1) begins with the pithy but, in my view, accurate statement that "Canada's corporate income tax is a mess." Although Mintz does not claim that an approach that would tax distributed profits (including share buybacks), accompanied by the taxation of passive income within the corporation, would be a panacea, he does argue that it would be a vast improvement over the current system. He also argues that the Canadian corporate income tax system has so many tax preferences (which would be eliminated under his approach) that the revenue-neutral distributed profits tax would be about 16 percent at the federal level and 11 percent at the provincial level—rates that are a little lower than current corporate tax rates.

18 Robin Boadway and Jean-François Tremblay, *Corporate Tax Reform: Issues and Prospects for Canada* (Toronto: Mowat Centre, April 2014).

19 Trevor Tombe, "Canada Just Started the Largest Tax Increase You've Never Heard Of," *Hub*, May 16, 2024 (https://thehub.ca/2024/05/16/trevor-tombe-canada-just-introduced-the-largest-tax-increase-youve-heard-of).

20 Bev Dahlby and Ergete Ferede, *What Are the Economic Costs of Raising Revenue by the Canadian Federal Government?* (Vancouver: Fraser Institute, 2022).

rate is around 50 percent and its revenue-maximizing corporate income tax rate is around 30 percent. I emphasize, as I believe Tombe would, that the optimal tax rates for stimulating growth are well below the optimal rates for maximizing tax revenue. In any case, I would agree with him that, at least with respect to the current tax system, increases in tax rates are unlikely to generate much if any new revenue. Canada is very close to peak tax.

The Tombe article has other points of interest. For example, it documents that the tax regime with the lowest rates in Canada (Alberta) has higher taxes than the tax regime with the highest rates in the United States (California). Some readers might want to point out that Canadian payroll taxes are somewhat lower—but then US social security payments are more generous than Canada's old age security payments. In any case, the author argues that the top income tax rates in Canada should be reduced in order to attract and retain talent. I discuss this further in the review of research by Blit, Skuterud, and Zhang that follows.

Tombe concludes the article by considering ways in which Canadian taxes could be simplified to reduce compliance costs, as well as the radical reform of increasing taxes on consumption. The latter idea is consistent with a separate article by the same author that promotes the virtues of imitating Ireland's tax regime of relatively low personal income tax rates and very low corporate tax rates. In Ireland, these low rates are "paid for" by a high value-added tax rate of 23 percent.[21] Noting the political challenge in raising Canada's GST/HST to such a level,[22] Tombe instead suggests that a pro-growth tax reform could raise RRSP and TFSA contribution limits and introduce new ways of saving for investment. However, the point of such measures is to provide incentives to potentially big savers who are more likely to be affluent. But a tax system with high limits or no limits on savings contributions could be vulnerable to tax avoidance, and, at least to some observers, would reduce the system's progressivity and might require other offsets. Alternative approaches might be to emulate the Swedish system, which essentially taxes returns on investment at low but non-zero rates, or to achieve much of what a registered investment plan might accomplish through the Mintz proposal of subjecting private corporations to a distributed profits tax. As always, the devil would be in the details, particularly in the provisions for the taxation of passive income.

In any case, such discussions of tax reform seem particularly worthy of consideration in the context of increased trade tensions with the United States. It can be argued that Canada has already lost the trade war because, regardless of what happens

21 Trevor Tombe, "What Canada Can Learn from Irish Prosperity," *Hub*, October 31, 2024 (https://thehub.ca/2024/10/31/trevor-tombe-what-canada-can-learn-from-irish-prosperity).

22 Tombe does not elaborate on this in the article, but the political challenge of raising consumption taxes does seem clear. See, for example, the federal Liberal campaign promise in 1993 to remove the GST (which did not occur), the federal Conservative campaign promise in 2006 to reduce the GST (which did occur), the BC referendum in 2011 on removing the HST, the fact that no Canadian city has adopted congestion charges, and the political failure of what is called the carbon tax, even when its proceeds were distributed back to taxpayers.

with actual tariffs, the threat remains, and that threat will shift investment to the United States. It has been my view that Canada should minimize retaliatory measures, since they reduce growth and increase inflation in Canada. I do not think the argument that Canada needs to inflict pain on US producers by imposing its own tariffs is particularly strong, essentially because the United States is so much bigger. If you only have a knife, don't even think about going to a gunfight.

But without tariff retaliation, what options are left to Canada? One countervailing force may spring from a depreciated Canadian dollar. But a second option could be to offset the tariff effect on investment with innovative and aggressive tax measures. Perhaps Canada, like Ireland, has the potential to be nimbler in tax measures. Moreover, no matter how dire the fiscal situation may be in Canada, it is much worse in the United States. (Indeed, as Tombe notes, one partial explanation for taxes being higher in Canada than in the United States is that Canadian governments, in total, are running somewhat lower deficits on a per capita basis.) Corporate tax measures such as the distributed profits tax approach proposed by Mintz, perhaps enhanced by rate reductions, might be the least expensive way to counter the US tariff initiatives.

MV

Joel Blit, Mikal Skuterud, and Ruiwen Zhang, *The Potential of Canada's International Education Strategy: Evidence from the "MIT of the North,"* Canadian Labour Economics Forum Working Paper no. 74 (Waterloo, ON: CLEF, 2024)

By way of disclosure, I have co-authored research with professors Blit and Skuterud and was a formal discussant when this study was presented by Skuterud at the Immigration Policy: Economic Issues conference held at HEC Montréal in September 2024. The study develops a new and innovative dataset by linking University of Waterloo student records, including grades, with Canadian immigration data and income tax data. The data are anonymized and analyzed in such a way that all results are sufficiently aggregated so that the privacy of any individual student is not compromised.

One goal of the paper is to find which immigrant students are likely to have better earnings streams (and hence pay higher taxes) if they stay in Canada. There is little difference in the transition to permanent residence (PR) between students with stronger and weaker grades, but higher post-PR earnings are associated with STEM fields, higher post-graduate/pre-PR earnings, and a measure of English skills.

Of particular relevance to the taxation literature (and to the article by Tombe discussed above) is evidence regarding the "brain drain"—that is, the tendency of high-ability individuals in Canada to move to another country such as the United States. The article documents that University of Waterloo programs are clearly associated with an inflow into Canada of international students who subsequently generate high earnings, relative to their Canadian-born counterparts. Moreover, international students with better grades have lower rates of outmigration. But the article also estimates that about 20 percent of Canadian-born students outmigrate

within 10 years of graduation (although it should be kept in mind that some return). The authors present evidence that better students have a greater tendency to outmigrate.

While this paper may be a somewhat specialized study with its focus on one university, the authors do float the idea of tax incentives as a means of retaining students, although it is not clear whether their proposal would be restricted to international students. Still, this paper could rekindle the literature on the brain drain, which typically found that income and taxes were significant determinants of the loss of talent to the United States, but tended to suggest that the kind of tax changes required to significantly stem that flow would be large.[23]

MV

James MacGee and Joel Rodrigue, "The Distributional Origins of the Canada-US GDP and Labour Productivity Gaps" (2025) 51, no. S1 *Canadian Public Policy/Analyse de politiques* 76-103 (https://doi.org/10.3138/cpp.2024-049)

By way of disclosure, I edited this article for *Canadian Public Policy/Analyse de politiques* during my tenure there. Like the paper reviewed above, it is related to taxation because it too has implications for analyses of the brain drain.

This study compares average pre-tax incomes in Canada and the United States across the income distribution for the years 1960 to 2020, and analyzes possible reasons for differences. It uses the World Inequality Database, supplemented by the Canadian Survey of Financial Security, the United States Survey of Consumer Finances, and the Global Repository of Income Dynamics. The analysis is based on individual earners. Income reported by couples is evenly split between all people aged 20 and over in the household, and comparisons are made using the OECD purchasing power parity exchange rate.

One of the most important findings is that if we consider income earning as being equivalent to the contribution to real gross domestic product (GDP), the top 10 percent

23 For international inferences drawn in part from an empirical analysis of the relationship between interprovincial migration and tax differences, see Kirk A. Collins, "The 'Taxing' Issue of Interprovincial and Cross-Border Migration" (2008) 34:4 *Canadian Public Policy/Analyse de politiques* 481-99 (https://doi.org/10.3138/cpp.34.4.481). The fact that emigrants from Canada to the United States earned much higher incomes post-migration is documented in David Zarifa and David Walters, "Revisiting Canada's Brain Drain: Evidence from the 2000 Cohort of Canadian University Graduates" (2008) 34:3 *Canadian Public Policy/Analyse de politiques* 305-19 (https://doi.org/10.3138/cpp.34.3.305). For simulations that emphasize that large Canadian tax reductions would be needed to curb outmigration significantly, see Gary L. Hunt and Richard E. Mueller, "Fiscal Policy, Returns to Skills, and Canada-US Migration: Evidence from the Late 1990s" (2013) 39:1 *Canadian Public Policy/Analyse de politiques* 153-82 (https://doi.org/10.3138/CPP.39.1.153). For additional suggestive evidence that financial factors affect the outmigration of high-income individuals, see Stephen Gordon, "The Incidence of Income Taxes on High Earners in Canada" (2020) 53:2 *Canadian Journal of Economics/Revue canadienne d'économique* 437-59 (https://doi.org/10.1111/caje.12433).

of income earners in each country account for three-quarters of the gap in real GDP per adult between Canada and the United States. Much of that difference is further concentrated among the top 1 percent of the income distribution. It is therefore argued that the productivity gap between the countries is heavily concentrated at the top end of the income distribution. Indeed, there is almost no estimated gap in the bottom half of the distribution.

This naturally leads the authors to investigate explanations for the brain drain. The authors construct a model with strong assumptions; in particular, they assume that the underlying distribution of education and ability is similar in the two countries and that net migration to the United States is entirely due to highly skilled Canadians moving south. Their model does show net emigration from Canada from 1960 to 2010, although for more recent years it implies greater emigration than is observed in the data. A key implication of the model is that the emigration of high-income earners from Canada contributes substantially to the income/productivity gap by both lowering the average income in Canada and raising it in the United States. Their model implies that at least 40 percent of those born in Canada whose ability would place them in the top income percentile in Canada live in the United States. Moreover, it suggests that this fraction is rising over time.

The authors also consider the annual social and economic supplement of the current population survey for the United States, which every year samples a few hundred Canadian-born individuals as part of a larger sample. Pooling these numbers from 2000 to 2023, the authors find that such Canadian-born individuals between the ages of 30 and 65 earn on average about one-third more than their American counterparts. This income gap is only slightly reduced when individuals with equivalent levels of education are compared. These findings do suggest that Canadian emigrants have high ability. As a thought experiment, the authors consider the effect of moving those emigrants back to Canada. They roughly calculate that this would notionally increase the average GDP per adult in Canada by about 6 percentage points, reducing the Canada-US gap in GDP per adult by about one-sixth. While I think it is fair to say that there are reasonable doubts that tax rates are driving migration to the United States, the findings of this study should be carefully considered in broader analyses of personal income tax rates in Canada.

MV

Tim Sargent, "Productivity Growth in Canada: What Is Going On?" (2024) 17:17 *SPP Briefing Papers* [University of Calgary School of Public Policy] 1-21

There has recently been much discussion of low productivity growth in Canada, particularly in comparison to the United States. As noted above, such comparisons have been highlighted by recent trade disputes. This article will be a good starting point on the topic for many readers. The broad facts it presents show that while Canadian productivity has been lower than US productivity since measurement of these levels began, Canadian productivity growth was very comparable to US growth until about 2005, such that the gap did not change greatly. But from 2005 until about

2012, a period that included the financial crisis, the gap widened significantly, and in the years immediately following the COVID-19 pandemic, the gap widened more.

For the recent period of 2020 to 2023, the author emphasizes that capital per labour hour has increased only slightly. More important in the author's view is the deceleration in investment in capital and machinery. The author believes that reductions in corporate tax rates during the first Trump administration made Canada less attractive to investors relative to the United States, which suggests that corporate tax policy may have a role to play in boosting Canadian productivity. He also argues that high Canadian personal tax rates reduce savings and therefore investment, and encourage the outmigration of talent.

MV

Seungjin Han and Josip Lesica, "Regressiveness of Differentiated Excise Taxation" (2025) 51:1 *Canadian Public Policy/Analyse de politiques* 77-93 (https://doi.org/10.3138/cpp.2024-009)

This article presents a methodology that could be used more widely in tax analysis. It takes as its example the Ontario beer industry, noting that beer from a microbrewery is subject to a lower rate of tax than beer from a large producer. The authors conduct an extensive empirical analysis of store-level panel data for 2010 to 2015 from the Liquor Control Board of Ontario, matched to the stores' forward sortation areas (FSAs), that is, the first three characters of their postal codes. The authors then further match the data to a custom Statistics Canada tabulation of FSA household sizes and average incomes. With that information, they are able to estimate the extent to which household microbrewery beer expenditures rise as a share of all expenditures on beer.

The tax rate on non-micro beer is about 70 cents per litre, while the tax rate on microbrewery beer is only about 20 cents per litre. Households with an income of $50,000 are more likely to consume non-micro beer as compared to households with an income of $250,000, who consume more microbrewery beer. Using their estimates, the authors calculate that the effective tax rate on beer is about 20 cents per litre higher for the $50,000 income household than that for the $250,000 income household.

MV

Henry Saffer, Markus Gehrsitz, and Michael Grossman, "Do the Effects of Alcohol Excise Taxes Differ by Drinking Level and by Income Level?" (2024) 77:4 *National Tax Journal* 787-811 (https://doi.org/10.1086/732146)

In Illinois in 2009, a significant increase in excise taxes raised prices on alcohol, particularly spirits, for which excise taxes almost doubled. The authors of this article make use of the Illinois experience to estimate the effects of increases in excise taxes on ethanol consumption. Employing a relatively novel synthetic control approach, the authors draw individual household data from other states that did not have an

excise tax increase at that time, and construct a "control" sample of households with the same characteristics as the sample drawn from Illinois that was "treated" by the excise tax increase. They then calculate the effect of the excise tax increase by comparing the treated sample with the synthetic control sample.

Another novel feature of this study is that it uses Nielsen Homescan data, a US nationally representative, longitudinal panel survey of 60,000 individuals older than 25. Households participating in the survey are given scanners and are asked to scan all purchases they bring home. The data do not cover alcohol purchased at bars and restaurants, but may provide accurate estimates of alcohol purchased for home consumption.

The price increases on spirits in Illinois were about 8 percent higher than increases in the control states, with less expensive spirits seeing the largest percentage increases. Wine price changes were much smaller and beer price changes smaller still.

The authors present their results in terms of the effects of increased excise taxes on ethanol consumption. A significant aspect of the Illinois experience is that spirits with their higher ethanol content received the biggest tax increase. The authors found that heavy drinkers reduced their consumption by about 5.5 percent, while moderate drinkers reduced their consumption by about 4 percent. The authors suggest that it is important from a health policy perspective that the effects of the tax increase were stronger for heavy drinkers. They also found that low-income drinkers reduced their consumption by only about 2 percent, while higher-income drinkers reduced their consumption by 5 percent, a finding that supports the view that alcohol tax increases are regressive.

MV

William C. Boning, Nathaniel Hendren, Ben Sprung-Keyser, and Ellen Stuart, "A Welfare Analysis of Tax Audits Across the Income Distribution" (2025) 140:1 *Quarterly Journal of Economics* 63-112 (https://doi.org/10.1093/qje/qjae037)

This article estimates revenue returns to IRS audits in ways that do not appear to be possible yet for academic researchers in Canada. The article focuses on in-person audits of individuals and uses internal IRS data: case-level data, which include logs of time spent by IRS personnel as well as revenue collected; data on other IRS costs associated with audits; and data from a survey that asked audited taxpayers about the time and money they spent during the audit process.

Using this information, the authors estimate that an additional $1 spent auditing taxpayers above the 90th income percentile yields more than $12 in additional revenue. In comparison, audits of below-median income taxpayers yield about $5 per additional dollar of IRS expenditure.

The authors note that the audit rate was reduced by 40 percent between 2010 and 2014, presumably because of IRS budget cuts that began in 2010. In 2010, the rate of in-person audits was 0.21 percent of all returns; in 2014, it was down to 0.11 percent. The authors then come to the surprising conclusion that the percentage loss in

revenue was greater than the percentage reduction in audit cost. That is, the estimated return to the marginal audits that would previously have been conducted but were eliminated was higher than the average return to audits that were actually conducted.

There are two reasons for this finding. First, one might have expected that a reduction in the number of audits would have led to a higher return per audit, assuming that the IRS would prioritize high-return audits. The authors document that this did not occur. For example, audit-rate cuts were not concentrated at the lower end of the income distribution or for other groups with low average audit returns. Hence, the numerator of the return-to-IRS cost ratio did not change very much.

Second, the denominator of the cost ratio increased because there are increasing returns to scale in auditing. Marginal audits cost less than average audits. Hence, a reduction in the audit rate increased the costs per audit.

One implication of this study is that a return to the former audit rate would substantially increase net revenue. However, the authors caution that such an effect would not hold true for arbitrarily large increases in the audit rate because of diminishing returns in revenue.

The authors also examine the effects of an initial audit on future revenue from the audited individual. They find that, on average, there is a persistent deterrence effect that yields at least three times more revenue than the initial audit. These effects are relatively constant in size across the income distribution.

Finally, the authors consider the welfare consequences of audits. Though the terminology in the article is slightly confusing to me, the authors estimate what they call the marginal value of public funds (MVPF) ratio (what I would call the marginal cost of public funds). They define this ratio as the willingness to pay to avoid an audit divided by the net government revenue raised. The numerator includes the revenue raised from the taxpayer as well as the costs to the taxpayer of the audit itself. The denominator includes the revenue raised by the audit less the cost to the IRS of conducting the audit. The lower the MVPF ratio is, the more efficient a revenue-raising measure is considered to be. For example, if audits were of low cost to compliant taxpayers and to the IRS and raised considerable revenue from a few non-compliant taxpayers, that would suggest a low MVPF ratio. If every dollar raised by audits had no cost to the IRS or the audited, the cost to American society of raising a dollar of government revenue from audits would also be a dollar, with no efficiency cost.

Using the survey of audited taxpayers mentioned above, the authors estimate the MVPF ratio of audits to be 1.30 for low-income taxpayers and 1.15 for high-income taxpayers, which suggests that relative audit rates are too high for the former. The authors also suggest that the MVPF value for high-income taxpayers is particularly low (and hence efficient) by pointing to estimates in the literature, which give MVPF ratios for raising a dollar of regular personal income tax revenue from that group at 1.50 and higher. The authors also emphasize that much of the cost in the numerator of the MVPF calculation is borne by non-compliant taxpayers. They suggest that perhaps that aspect of the inefficiency in tax audits should be given low weight in policy formulation.

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