Unlike some other fields of law, tax law is codified. The Income Tax Act is arguably the most complex legislation in Canada, affecting the lives of almost everyone in the country, directly or indirectly. The pervasiveness of encounters with the tax system and the intimidating technical complexity of the Act make people feel that tax law is different from other kinds of law. Further, the Supreme Court of Canada treats the Act differently from other statutes. In Canada Trustco Mortgage Co. v. Canada, for example, the court said that even though “all statutes, including the Act, must be interpreted in a textual, contextual and purposive way,” “the particularity and detail of many tax provisions” invite a largely textual interpretation. In addition, the court said that the provisions of the Act “must be interpreted in order to achieve consistency, predictability and fairness so that taxpayers may manage their affairs intelligently.” This approach imposes a “burden of perfection” on the drafters of the legislation and encourages the use of more prescriptive and detailed provisions —a pressure that will, over time, make the Act even more singular, inviting more textual interpretation in order to achieve certainty and predictability. Is tax law so different as to be exceptional?

In this article, the authors provide an excellent account of why tax law is seen to be different from other fields of law (a perception reflected in American tax scholarship, tax cases, and public attitudes toward taxation), and they argue that the
The differences thus perceived do not add up to a basis for “tax exceptionalism.” “Tax is law,” the authors conclude.6 They applaud the US Supreme Court decision in Mayo Foundation for Medical Ed. and Research v. United States,7 which declined to carve out an approach to administrative review that is good for tax law alone.

This article has six parts. Following the introduction (part I), part II examines the backgrounds of tax exceptionalism, including the circumstances in which the federal income tax was enacted, the ascendency of economists and public finance economics, the use of the concept of tax expenditures to “divorce” revenue-raising objectives from other objectives, and the “extraordinarily coercive” nature of the mandatory sharing of resources and personal information with the government.

Part III discusses whether tax law is really exceptional. Looking beyond the possible vanity of tax specialists (a desire to feel special or smart by claiming an exalted status), the authors analyze and challenge three more “serious” arguments for tax exceptionalism: (1) that tax law should pursue no social policies; (2) that the absence of a moral imperative for compliance with tax law increases the need for precision in the law itself, in order to ensure compliance; and (3) that the daunting complexity of tax law legislation requires that it be understood, unlike other legislation, as a compendium of rules that must be strictly interpreted according to their plain meaning. The authors argue that the idea that income tax law consists or should consist of strictly construed rules is incorrect, given that tax law makes wide use of standards.

Part IV explains why differences between tax law and other fields of law do not make tax law unique. In part V, the authors argue that tax exceptionalism is not helpful, and they refer both to scholarly work and to judicial opinions, such as the Mayo decision, in order to show why one should apply an issue-by-issue analysis to tax law questions instead of categorically invoking the tax exceptionalism argument. Part VI reiterates the authors’ position that, although tax is different from other fields of law, “each difference should be evaluated in a specific context to determine if tax should be treated differently in that context as a result of the difference.”8

Reading this article may prompt Canadian readers, in approaching the interpretation of the Act, to rethink the question of tax exceptionalism.

J.L.

Alex Ladyman, “A Public Law Perspective on Tax Law: The Proposed Power to Remedy Legislative Anomalies” (2018) 16:1 New Zealand Journal of Public and International Law 67-99

In New Zealand, a recent law reform proposed to provide the commissioner of inland revenue with a power to remedy legislative anomalies in the Inland Revenue

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6 At 49 (SSRN version).
7 562 US 44, at 55 (2011).
8 At 51.
Act by recommending regulations, making determinations, or undertaking administrative actions such as temporarily repealing a law for taxpayers and creating a rule in substitution. This proposed power is intended to be an interim fix until Parliament is able to amend the legislation, and the exercise of the power is subject to various safeguards. In this article, the author discusses the proposed discretionary power from a public-law perspective. He explores how public-law principles, such as the rule of law, parliamentary supremacy, the separation of powers, good administration, and accountability, should apply to the designing of the safeguards. The author recognizes that discretion is essential for administering the tax system (the New Zealand Income Tax Act 2007 alone is 3,510 pages long) and that the commissioner must use this discretion in balancing (1) the duty to collect the highest net revenue and (2) the need to ensure the fairness and integrity of the tax system. He warns, however, that because the proposed power could create rules in substitution for legislation, it could undermine parliamentary supremacy. The article suggests ways of strengthening the safeguards—for example, by making the commissioner publicly accountable for the use of the remedy power. The central thesis advanced in this article is that tax law should be viewed as public law and that public-law principles are important in the design of tax law.

François Vaillancourt and Anna Kerkhoff, “Capital Gains Taxation in Canada, 1972-2017: Evolution in a Federal Setting” (2019) 16:2 eJournal of Tax Research 340-61

This paper traces the evolution of the capital gains tax system in Canada from 1972 to 2017, and it evaluates (1) the impact of capital gains on death taxes, (2) the effect of the general lifetime capital gains exemption (LCGE) (the general regime from 1985 to 1995 and the regime available only for small businesses, farmers, and fishers after 1995), and (3) the driving force behind the changes in inclusion rates in 2000. Among the interesting findings and conclusions are the following:

- Capital gains for both individuals and businesses have increased 174 times in nominal terms (and 30 times in real terms), and capital gains are concentrated in the hands of the three top income groups.
- Death taxes disappeared following the introduction of capital gains tax, “since one of the main purposes of the death tax was to act as a ‘check’ on the incomes of the wealthy and to make up for tax avoidance choices that were used through an individual’s lifetime.”

9 Bill 72-1, Annual Rates for 2018-19, Modernising Tax Administration, and Remedial Matters, at clause 9, cited at 68, note 2.
10 At 71.
11 At 342.
12 At 343.
The general LCGE that applied to all assets is an “inefficient means of stimulating small business investment.”  

The limited LCGE was introduced, among other reasons, to help small business owners and farmers save for retirement, on the grounds that they could not take advantage of registered retirement savings plans (RRSPs), which “often served as a complement to retirement savings for small-business owners and ‘middle’ to ‘high income’ farmers but did benefit ‘low income’ farmers,” and there was no evidence to support the argument that small business owners and farmers cannot make use of RRSPs.

The LCGE benefits the highest-income group and “is not a very useful policy tool.”

The capital gains tax system, in its current form, “plays a role in ensuring tax fairness in Canada” and could be improved, mainly through indexing for inflation.

Jay A. Soled, “Reimagining the Estate Tax in the Automation Era” (2019) 9:3 UC Irvine Law Review 787-828

In this article, Soled makes the case for the US Congress’s imposing a meaningful estate tax in order to raise revenue and reduce wealth inequality in the automation age. He first provides background: (1) the origin, rationale, and design of an income tax that taxes labour more heavily than capital, and (2) the eradication of jobs by automation. He then explains why heavier taxation of capital became necessary when the United States was transformed from an industry-based economy to an automation-based one. At the same time, Soled maintains that, because of the risk of capital flight to tax haven jurisdictions and the deferral of the recognition of capital gains, the taxation of capital income and capital gains under the income tax system is not viable. He proposes instead, as easier to enforce (since taxpayers are less mobile than capital), a broad-based estate tax to function as a tax on deferred or capital income.

Soled’s call for more taxes on wealth or capital joins similar calls by scholars (for example, Picketty) and politicians (for example, US democratic presidential

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13 At 346, citing a study by J.M. Mintz and S.R. Richardson, “The Lifetime Capital Gains Exemption: An Evaluation” (1995) 21 supplement Canadian Public Policy/Analyse de Politiques 174-92.

14 At 347.

15 At 348.

16 At 359.

17 Thomas Piketty, Capital in the Twenty-First Century, trans. Arthur Goldhammer (Cambridge, MA: Belknap Press of Harvard University Press, 2014), at 515; and see Edward N. Wolff, Top Heavy: The Increasing Inequality of Wealth in America and What Can Be Done About It (New York: New Press, 1996), for a proposal of an annual wealth tax.
contender Elizabeth Warren). His proposal is US-centric, but the insights in this article have implications for other countries that have economic structures and political systems similar to the United States’.

J.L.

Adam Chodorow, “Lost in Translation” (2019) 97:3 Taxes: The Tax Magazine 171-93

This article explores the various loss limitation rules in the US Internal Revenue Code (“the Code”), unpacking the purported mischiefs motivating the introduction of these rules, the design features that arguably made them necessary, and the mechanisms by which these rules attempt to limit losses. Canadian readers should find the article interesting, because the Act contains similar rules.

The article classifies as loss limitation rules those that prevent loss transfers, personal loss deductions, “timing games and tax alchemy” (for example, capital loss limitations), property losses claimed when property is functionally retained, non-economic losses, and corporate losses. It lists the root causes of the problems that the loss limitation rules were designed to address: for example, the realization requirement, the preferential treatment of capital gains, the taxpayer unit, and the treatment of each corporation as a separate taxpayer. Recognizing the unlikelihood that these root causes will be removed, the author suggests that “the best we can hope for is to reform the existing provisions, aim them more directly at the problems they are supposed to address, and make them easier to understand and apply.”

Given that the rules aimed at individuals appear to be working fairly well, the paper recommends some changes to the rules affecting corporations.

J.L.

Cameron Rotblat, “Chinese State Capitalism and the International Tax Regime” (2018) 10:1 Columbia Journal of Tax Law 79-138

China’s recent rise as an economic powerhouse has occurred under a unique system of “state capitalism”: “[W]hile the market forces play a significant role in most sectors, the Party-state continues to function as the leading economic actor through its extensive controls over SOEs [state-owned enterprises].” In this article, the author claims that such a unique system may lead China to pursue distinctive international tax policies regarding (1) the allocation of taxing rights, (2) tax competition, and

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18 See “Senator Warren Unveils Proposal to Tax Wealth of Ultra-Rich Americans,” Elizabeth Warren: United States Senator for Massachusetts, Press Release, January 24, 2019 (www.warren .senate.gov/newsroom/press-releases/senator-warren-unveils-proposal-to-tax-wealth-of-ultra-rich-americans).
19 At 177.
20 At 187.
21 At 96.
(3) base erosion and profit shifting (BEPS). He suggests that the continued income taxation of SOEs, many of which receive foreign investment or make investment in foreign countries, means that China will maintain a worldwide system of corporate taxation even though the United States and most other countries have adopted the territorial system. He maintains that the dominant role of SOEs in outbound investment creates “an unusually strong incentive for the Chinese government to encourage SOE managers to minimize the amount of foreign taxes paid through tax planning”22 (for example, by providing tacit state support for international tax planning). He also maintains that China is likely to adopt preferential tax treatment of SOEs through domestic tax legislation and international tax treaties (for example, lower rates of withholding taxes on interest paid to Chinese banks).

J.L.

Craig Eliffe, “The Meaning of the Principal Purpose Test: One Ring To Bind Them All?” (2019) 11:1 World Tax Journal 47-76

The principal purpose test (PPT) is a treaty-based general anti-abuse rule and one of four minimum standards adopted by the Group of Twenty/Organisation for Economic Co-operation and Development (G20/OECD) BEPS project.23 An increasing number of bilateral tax treaties have incorporated the PPT. However, because treaty law is interpreted and applied by tax authorities and courts in individual countries, there is no guarantee that the PPT will be interpreted the same way in all countries. Therefore, although the PPT in theory is international, the PPT in action may remain “state-centric,”24 undermining its policy objective.

In this article, the author argues that the PPT should have an autonomous common meaning, or universal interpretation. To achieve this universal interpretation, according to Eliffe, the tax authorities and courts of all countries need to take a

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22 At 123.

23 It is currently contained in article 29(9) of the Organisation for Economic Co-operation and Development, Model Tax Convention on Income and on Capital: Condensed Version 2017 (Paris: OECD, November 2017) (https://doi.org/10.1787/mtc_cond-2017-en); and United Nations, United Nations Model Double Taxation Convention Between Developed and Developing Countries 2017 Update (New York: United Nations, 2017). Article 29(9) incorporates article 7(1) of the Organisation for Economic Co-operation and Development, Multilateral Convention To Implement Tax Treaty Related Measures To Prevent Base Erosion and Profit Shifting, done at Paris, France, November 24, 2016 (herein referred to as “the MLI”) (www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.pdf), which reflects the minimum standard created in the Organisation for Economic Co-operation and Development, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6—2015 Final Report (Paris: OECD, October 5, 2015) (https://doi.org/10.1787/9789264241695-en).

24 At 47.
consistent approach to interpretation—that is, to “interpret the treaty-based PPT rule in good faith in accordance with the ordinary meaning to be given to the terms in the treaty, as well as in accordance with the treaty’s context and in light of its object and purpose.” The author discusses what such a textual, contextual, and purposive interpretation of the PPT would entail by considering, for instance, the examples provided by the OECD of the PPT’s application. Since the article does not get into the fundamental causes of a state-centric approach to international taxation in general and to treaty interpretation in particular, it is difficult to see how a consistent technical approach to interpreting the PPT can be realized. Nevertheless, the author raises an interesting question and makes a normative argument for an autonomous common meaning for the PPT as a global standard.

J.L.

Kerrie Sadiq, Adrian Sawyer, and Bronwyn McCredie, “Jurisdictional Responses to Base Erosion and Profit Shifting: A Study of 19 Key Domestic Tax Systems” (2019) 16:3 eJournal of Tax Research 737-61

The G20/OECD BEPS project has generated a body of “soft law” in the form of minimum global standards (the substantive activities or nexus requirement for preferential tax regimes, the PPT for preventing treaty abuse, country-by-country reporting by multinational corporations, and dispute resolution through the mutual agreement procedure [MAP]); common practices; and recommendations. In order for such soft law to take effect, it needs to be incorporated into “hard law” in the form of domestic tax law or treaty law. The authors conducted a survey of 19 jurisdictions with respect to the implementation of BEPS measures, and they report their preliminary findings in this article. The jurisdictions surveyed are Australia, Canada, China, Hong Kong Special Administrative Region, India, Indonesia, Japan, Korea, Malaysia, the Netherlands, New Zealand, Nigeria, the Philippines, Singapore, South Africa, Thailand, the United Kingdom, the United States, and Vietnam.

The authors explain that the 19 jurisdictions considered in the survey are a diverse group—members and non-members of the OECD and the G20, with different levels of economic development and various degrees of financial sophistication. Of these 19 jurisdictions, all except the Philippines are members of the BEPS inclusive framework and are committed to implementing the BEPS minimum standards. The findings can be summarized in the following table.

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25 At 76.

26 The paper includes 17 tables, which summarize the data on the implementation of each aspect of the BEPS project as well as other kinds of engagement with the project. This table is based on the information reported in the article.
The 19 jurisdictions have implemented other BEPS measures in varying degrees. For example, 12 jurisdictions have taken some form of action to address the challenges of the digital economy analyzed in BEPS action 1; 10 jurisdictions are taking some form of action in respect of hybrid mismatch arrangements, which are addressed in BEPS action 2; 11 jurisdictions have indicated their compliance with the controlled foreign company rules in BEPS action 4; and 15 jurisdictions are responding to the recommendations on transfer pricing in BEPS actions 8-10.

The authors also report on the differences in unilateral responses to the problem of BEPS. For example, Korea, the Netherlands, the Philippines, Thailand, and the United States have not, in response to the BEPS project, adopted unilateral measures to address tax avoidance, while other jurisdictions have adopted such measures. (The United Kingdom and Australia, for example, have adopted the diverted profits tax).

Andrés Báez Moreno and Yariv Brauner, *Taxing the Digital Economy Post BEPS . . . Seriously*, University of Florida Levin College of Law, Legal Studies Research Paper series no. 19-16 (Gainesville, FL: University of Florida, Levin College of Law, 2019) (https://ssrn.com/abstract=3347503)

To address the challenges of taxing the digital economy, two main types of proposals have been advanced: new tax instruments, such as the digital services tax in the European Union; and the retooling of existing tax instruments, such as virtual permanent establishment and minimum taxes. This paper proposes a withholding tax on digital transactions. It describes the key advantages of the withholding tax, such as (1) its effectiveness in taxing business-to-business transactions by focusing on base-eroding payments (and thus avoiding ring-fencing); (2) the familiarity of the withholding mechanism; and (3) the enhancement of taxing rights in the source country. The authors also discuss in detail the main design issues of the tax, such as rates and exemptions, and its implications for tax treaties, international trade law, and European law. According to the authors, the withholding tax is a solution superior to the various alternatives because it can be implemented unilaterally or
multilaterally, and because it is feasible, not requiring “wide consensus over a complex web of rules.”

J.L.

Guglielmo Maisto, Stephane Austry, John Avery Jones, Philip Baker, Peter Blessing, Robert Danon, Shefali Goradia, Johann Hattingh, Koichi Inoue, Jurgen Ludicke, Toshio Miyatake, Angelo Nikolakakis, Frank Portgens, Kees van Raad, Richard Vann, and Bertil Wiman, *Dual Residence of Companies Under Tax Treaties*, International Tax Studies no. 1-2018 (Amsterdam: IBFD, 2018)

The tiebreaker for dual residence of companies in article 4(3) of the OECD model convention and its commentary was revised in 2017. The revision replaced the former “place of effective management” (POEM) test with a non-mandatory resolution through the MAP mechanism. For the purposes of the MAP, revised article 4(3) requires the contracting states to consider the POEM in addition to other relevant factors, such as the place of incorporation. In the absence of the MAP, a dual-resident company is not entitled to any relief or exemption, as article 4(3) describes, “except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.” The anti-abuse purpose of this revision is evident, as is the enhanced uncertainty for taxpayers.

In this lengthy article, the authors, who are tax experts in both civil-law and common-law countries, express their concern that the revision may, among other things, cause international double taxation, create legal uncertainty, and grant excessive discretion to competent authorities. In part 2, the authors discuss the difficulty of interpreting the POEM test because of the differences between the domestic laws of common-law and civil-law countries. For example, the application of domestic-law management (central or effective) tests relies on factual circumstances and the legal qualification of facts. Because common-law countries’ rules on the burden of proof (taxpayers bear the burden) may vary considerably from those of civil-law countries (typically, the government bears the burden), the application of the same test for tax residence may lead to different conclusions. The fact-intensive nature of these tests also renders their interpretation inevitably difficult.

27 At 59.

28 The revised article 4(3) of the Organisation for Economic Co-operation and Development, *Model Tax Convention on Income and on Capital: Full Version 2017* (Paris: OECD, 2019) (herein referred to as “the OECD model convention”) (https://doi.org/10.1787/g2g972ee-en) has also been included in article 4(3) of the *United Nations Model Double Taxation Convention*, supra note 22; and article 4 of the MLI, supra note 22.

29 Tax courts’ decisions since 2010 on the tax residence of companies are summarized in the annex of the publication, at 80-84.
In part 3, the authors consider the meaning of POEM under article 4(3) of the OECD model convention and the interpretation of this test by domestic courts by reference to article 3(2) of the OECD model convention. The authors recommend that a new definition of POEM, reliant on substance-based factors, be added to article 4, such that a POEM is defined as a “place where key management and commercial decisions that are necessary for the conduct of the business as a whole are in substance made.” Such a treaty definition would create an autonomous meaning of POEM. The authors also recommend revising article 4(3) of the OECD model convention so that a company is deemed to be a resident “only of the State in which the POEM is situated”; if the POEM cannot be determined, the company “shall be deemed to be a resident of the State in which the business or such activity as it conducts is primarily carried on.”

Following a review of treaty practices in part 4, part 5 provides a thorough and critical analysis of the 2017 revision of article 4(3). To begin with, the authors argue that not all dual residence is the result of treaty abuse: dual residence may be the result of oversight or may arise in a variety of contexts, such as genuine mergers of companies, globalization, and industry-specific business models. Even in the case of treaty abuse, the abuse could be addressed by general domestic and treaty-based anti-avoidance rules rather than by the deletion of the POEM tiebreaker in article 4(3). The authors proceed to identify several problems that the application of the revised article 4(3) is likely to pose, such as (1) inaction by the tax authorities when it comes to resolving the dual residence problem, (2) the limitations on judicial remedies for taxpayers, and (3) the implications of this revised provision for other provisions of the treaty.

In their conclusion, the authors reiterate their position that POEM should be maintained as a tiebreaker, since it is used by the majority of tax treaties. If the new article 4(3) is to remain, they suggest ways of reducing certain of its adverse ramifications, such as double taxation and legal uncertainty.

J.L.

Stanley I. Langbein and Max R. Fuss, “The OECD/G20-BEPS-Project and the Value Creation Paradigm: Economic Reality Disemboguing into the Interpretation of the ‘Arm’s Length’ Standard” (2018) 51:2 The International Lawyer 259-409

Transfer pricing is one of the most difficult areas of international taxation, even though the transfer-pricing rules in over 100 countries purportedly adhere to the arm’s-length principle. Among the reasons for this difficulty is the lack of consensus on the meaning of the arm’s-length principle and the practical challenges in applying it. Transfer pricing has also been one of the most common strategies used by
multinational enterprises (MNEs) to shift profits to low- or no-tax jurisdictions and thereby avoid tax in the jurisdictions where business activities take place. It is no surprise that 4 of the 15 BEPS actions have sought to tackle the issue of transfer pricing.32 The goal of these BEPS actions is to align transfer-pricing outcomes with value creation, a goal that is consistent with the overarching goal of the BEPS project—that is, to tax profits where the economic activities generating the profits are performed and where value is created (the “value creation” principle). However, the value creation principle has been controversial.

In this book-length article, the authors defend the value creation principle as having “ancient roots” and as being “consonant with long accepted ideals” of international taxation.33 They see the value creation paradigm “not as a departure from international norms but as a useful, if not profound, elaboration of it.”34 To demonstrate the ancient roots of value creation, the authors trace three phases in the historical development of transfer-pricing concepts prior to the BEPS project: the initial phase, which established the transfer-pricing regime; the second phase, which featured the articulation of the methods (one-sided) of transfer pricing; and the third phase, featuring the “comparability factors” and functional analysis approach.

Part II of the article shows that during the initial phase, the value creation paradigm was consistent with the overarching goals of the international tax system: (1) the allocation of tax base according to the economic allegiance of the tax base involved (as conceived by the League of Nations in the 1920s), (2) the taxation of business income at source, and (3) the creation of an arm’s-length standard, which was developed in the 1930s and 1940s.

Part III discusses the relation of the value creation paradigm to the changes in the conception of the arm’s-length principle from the 1960s to 1995 (that is, the second phase). The authors detail how the US transfer-pricing regulations, which were finalized in 1968, influenced the original OECD guidelines of 1979, and they conclude that these 1979 guidelines “reflect the beginning of a confusion about the arm’s length standard, treating the standard as a determinative of what constitutes a proper allocation, rather than a principle that aids a larger and precedent idea about allocation.” Part III also shows how changes in the US regulations in the 1980s and early 1990s laid the groundwork both for permitting corporations to shift profit

32 For more information on the BEPS project, see Organisation for Economic Co-operation and Development, OECD/G20 Base Erosion and Profit Shifting Project: 2015 Final Reports—Information Brief (Paris: OECD, 2015) (www.oecd.org/ctp/beps-reports-2015-information-brief.pdf); Organisation for Economic Co-operation and Development, Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10—2015 Final Reports (Paris: OECD, October 5, 2015); and Organisation for Economic Co-operation and Development, Transfer Pricing Documentation and Country-by-Country Reporting, Action 13—2015 Final Report (Paris: OECD, October 5, 2015).

33 At 263.

34 At 262.
through contractual allocations and for the divergence between the US approach and the OECD approach reflected in the 1995 OECD guidelines (which still followed the US approach adopted in the 1960s). The authors make the point that the 1995 OECD guidelines still reflected the ideal of value creation, though at times in a distorted way.

Part IV shows the post-1995 OECD thinking as it was manifested in three sets of studies relating to (1) allocations of profit under article 7 of the OECD model convention pursuant to the “authorized OECD approach,” (2) restructuring transactions to address the issue of centralized assets and operations in a central entity or developer, and (3) intangibles. The authors suggest that the OECD showed “growing concerns with—[and] an inclination to depart from—aspects of those [US regulations] which create tension with the ideal of value creation.” The OECD searched for ways to limit taxpayer discretion and contractual allocations of profit for tax purposes. As the authors note, “That search led ultimately to BEPS, and Action 8-10.”

Part V examines actions 8-10 of the BEPS report and shows that they were weak in formulating how to localize value creation and “backed away” from the OECD’s earlier reform impulse, which would have greatly increased the emphasis given to rules based on the objective criteria of business operations and diminished the role of circumstances that were within the control of the taxpayers. Nevertheless, part VI argues that the value creation paradigm not only has ancient roots but also offers the best basis for a fair international tax system in the near and intermediate future.

This article warrants multiple readings; it is quite concentrated in its analysis and penetrates deeply into the layers of complexity and confusion about the arm’s-length principle. It may be of particular interest to Canadian readers, as Canadians courts wrestle with the interpretation of the domestic transfer-pricing rules. Some of the most notable points include the following:

- The arm’s-length principle is not an end in itself but rather a means of determining a proper allocation of profits pursuant to a “larger and precedent idea about allocation”—namely, economic allegiance.
- Value creation is a new nomenclature, but it is not a new ideal or goal with respect to the allocation of taxing rights.
- Value creation represents an “international” paradigm while the pre-BEPS arm’s-length standard was US-centric because the OECD guidelines were heavily influenced by the United States.
- The value creation paradigm is grounded in articles 7 and 9 of the OECD model convention, and thus has a solid legal basis.

35 At 265.
36 At 364.
The situs of value creation remains difficult to establish, but a fixed fractional apportionment method is not appropriate.

Actions 8-10 of the BEPS report represent the beginning, not the end, of an inquiry into how to localize value creation.

The controversy among the major economic powers (for example, China and the United States) concerns the compatibility of value creation with the overall international tax order and the continuing viability of an emphasis on contractual allocations.

J.L.

Canada Revenue Agency, *International Tax Gap and Compliance Results for the Federal Personal Income Tax System* (Ottawa: CRA, 2018) (www.canada.ca/content/dam/cra-arc/corp-info/aboutcra/tax-compliance/intrntltxcmplnc-en.pdf)

Canada Revenue Agency, *Tax Gap and Compliance Results for the Federal Corporate Income Tax System* (Ottawa: CRA, 2019) (www.canada.ca/content/dam/cra-arc/corp-info/aboutcra/tax-gap/txgp2019-en.pdf)

These are the fourth and fifth reports in the Canada Revenue Agency’s (CRA’s) ongoing research project on the tax gap, which is the revenue loss resulting from intentional and unintentional non-compliance with the tax law. The CRA formally defines the tax gap as “the difference between the taxes that would be paid if all obligations were fully met in all instances, and the tax actually paid and collected.”

Measures of the tax gap, according to the CRA, can be derived from either top-down or bottom-up methodologies: “Bottom-up methodology generally uses a tax administrator’s taxpayer data (e.g., audit results, accounting data, assessment data) to estimate the amount of taxes theoretically owing,” whereas “top-down methodology uses independent external data (usually national accounts data) to estimate the tax base, a figure that is then used to calculate a theoretical value of tax that should be paid and collected, by applying the appropriate tax rate to a high level figure.”

The best methodology, as the CRA concedes, would be a bottom-up approach that uses a representative sample of taxpayers, randomly selected from a known population and subject to audit. Even when random samples are not possible, bottom-up approaches are generally much more reliable. Data limitations, however, are especially severe with respect to offshore wealth, and hence the CRA’s study of

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37 See this feature, (2017) 65:3 Canadian Tax Journal 831-48, at 831-836, for discussion of two previous reports in the series: “Tax Assured and Tax Gap for the Federal Personal Income Tax System” and “Estimating and Analyzing the Tax Gap Related to the Goods and Services Tax/Harmonized Sales Tax.”

38 Tax Gap and Compliance Results for the Federal Corporate Income Tax System, at 7.

39 Ibid., at 42.

40 Ibid., at 45.
the international tax gap in the personal income tax largely relies on a top-down approach that was developed by two teams of researchers led by, respectively, Gabriel Zucman of the University of California at Berkeley and Valeria Pelligrini of the Bank of Italy. Broadly speaking, the approach has four steps:

- Determine the global stock of hidden offshore wealth by calculating the difference between the declared assets and liabilities of countries published by national statistical agencies (on the basis that assets and liabilities must be equal on a global basis, and that assets not included in countries’ totals are more likely to be hidden from tax authorities because the owner’s residence has not been tracked).
- Estimate the share of this wealth owned by Canadians—for example, by using Canada’s share of offshore bank deposits, recorded portfolio investments, or world GDP.
- Assume a rate of return for each type of asset.
- Apply the highest marginal federal rate while adjusting for the one-half inclusion rate in the case of capital gains.

The result is that the federal tax gap related to hidden offshore investments is expected to lie between $0.8 billion and $3.0 billion for the 2014 tax year, which is between 0.6 and 2.2 percent of total personal income tax revenues.

Overall, the CRA’s approach seems reasonable, and therefore the estimates are a valuable contribution to knowledge. Still, one would like to know more about why this analysis was not supplemented with work that uses a bottom-up approach. For example, another study that adopted a generally bottom-up approach, by Gabriel Zucman and his co-authors, used leaked data about accounts at HSBC Private Bank Switzerland (the “Falciani list,” or “Lagarde list”) and considered whether the data matched the tax returns from Scandinavian authorities of the accounts’ beneficial owners, in order to determine whether wealth had been properly reported on income tax returns. (In almost all cases, it had not.) This study’s conclusion, based on the assumption that other offshore banks harbour similar amounts of hidden wealth, was that the top 0.01 percent of the richest households ranked by wealth evade about 25 percent of their income tax liability. Clearly, this estimate is quite different from the CRA’s tax gap estimate, which implies a much lower level of evasion.

41 For more details, see International Tax Gap and Compliance Results for the Federal Personal Income Tax System, at 23-27 and at 41-48. Gabriel Zucman has also done pioneering work using the bottom-up approach: in particular, see note 43, below.
42 Ibid., at 4-5.
43 Annette Alstadsæter, Niels Johannesen, and Gabriel Zucman, “Tax Evasion and Inequality” (2019) 109:6 American Economic Review 2073-2103, at 2073-4. Reviewed in this feature, (2019) 67:1 Canadian Tax Journal 263-79, at 265-69. The advantage of this particular leak is that it contained full beneficial owner data for the accounts.
The CRA is known to have access to this same Falciani data, and apparently it undertook a similar matching exercise for audit purposes.\textsuperscript{44} Thus, it would have been interesting for the CRA to have done a study for Canada like the one that Zucman et al. did for Scandinavia—that is, a bottom-up estimate of the tax gap from offshore bank accounts, developed from the HSBC leak. This may not have been possible, but it is impossible to tell because the report makes no mention of this data source.

The report has other data on T1135 forms\textsuperscript{45} and on internationally focused audits,\textsuperscript{46} but this information is not used to determine the tax gap estimate. One noteworthy statistic is that over 10,000 taxpayers were assessed T1135 penalties in 2017-18, with an average penalty of $2,600 (for total penalty revenue of $26.3 million).\textsuperscript{47} Thirty-five percent of the foreign assets reported on T1135 forms were from the United States and 29 percent were from China, with other countries far behind.\textsuperscript{48} There appears to have been more focus on (or at least more success in) enforcing the T1135 obligation than on collecting revenue from internationally based audits: from 2014-15 to 2016-17, only 630 individuals were audited, and only 370 were reassessed, for a total of $82 million more federal tax.\textsuperscript{49}

As noted above, data issues apparently forced the CRA to use a top-down approach for its study of the international tax gap in the personal income tax, and the result is the comparatively low reliability of the estimate produced. In contrast, much more data exist regarding the corporate income tax, which is why the CRA’s study of this topic uses bottom-up approaches and produces much more accurate information.

The ideal approach to measuring the tax gap is the one that the CRA used for small and medium-sized enterprises (SMEs), which are defined as corporations with gross revenues below a threshold of $20 million or $50 million (depending on the industry sector). This approach was based on a (stratified) random sample of corporate tax returns that had been audited for statistical purposes. The returns were for the year 2011, but the results were projected to the 2014 tax year. The resulting tax gap estimate was between $2.7 billion and $3.5 billion.\textsuperscript{50} Federal tax assessed for this group of corporations was $18.7 billion, so the tax gap was between 14 and

\textsuperscript{44} Anthony Sylvain, “The CRA’s Win Against Undisclosed Offshore Accounts” (2018) 8:4 Canadian Tax Focus 12.

\textsuperscript{45} International Tax Gap and Compliance Results for the Federal Personal Income Tax System, at 10-18.

\textsuperscript{46} Ibid., at 19-23.

\textsuperscript{47} Ibid., at 11.

\textsuperscript{48} Ibid., at 14.

\textsuperscript{49} Ibid., at 20-22.

\textsuperscript{50} Tax Gap and Compliance Results for the Federal Corporate Income Tax System, at 21.
19 percent of revenue.\textsuperscript{51} The CRA reports that most of this tax gap arose from unreported or underreported shareholder benefits, such as corporate automobiles and loans to shareholders, although no specific figures are provided. The CRA stresses, using boldface type, that normal CRA audits (conducted not for statistical purposes, but for the purpose of reassessing the taxpayer) recouped much of this money, so the net revenue loss from non-compliance after the impact of CRA activities was between $1.6 billion and $2.4 billion,\textsuperscript{52} which is from 9 to 13 percent of total revenue from this group.

A different bottom-up approach was needed for large corporations (that is, any corporation with gross revenue above the level noted above), because random audits are not done for this group; only risk-based audits are available. The problem was how to extrapolate from the results of these audits to the population as a whole; the simple extrapolation that one would use from a random sample would not work, because the audited corporations might not be representative. To solve this problem, the CRA used two different methods to produce tax gap estimates: an “extreme values” method (derived from the method used in the United States and advanced through academic research) and a “cluster analysis” method (developed by the Italian Revenue Agency, but extended by the CRA through its own “unsupervised machine learning technique”).\textsuperscript{53} The result is a tax gap estimate of between $1.7 billion and $2.9 billion for large corporations for the 2014 tax year.\textsuperscript{54} Total revenue from this group was $22.3 billion,\textsuperscript{55} so the tax gap is between 8 and 11 percent of revenue. Once again, the actual revenue loss is significantly reduced by CRA activities.

A key thing to understand about these corporate tax gap estimates is what they do not take into account: (1) non-compliance that has not been detected by the CRA;\textsuperscript{56} (2) corporations that do not file returns when they are required to do so; (3) non-compliance by non-resident corporations in general, beyond their failure to file (since the report focuses on corporations that are incorporated and filing in Canada); and (4) corporations that do not fully pay their tax by the deadline. A direction for future study is to address the last of these items (that is, payment non-compliance).

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A.M.

\textsuperscript{51} Ibid., at 14. For some reason, the report chooses to express the tax gap as a percentage of federal tax assessed for all corporations regardless of size, deriving a range of 7 percent to 9 percent (\textit{Tax Gap and Compliance Results for the Federal Corporate Income Tax System}, at 21), which would appear to underestimate the significance of the tax gap for this group.

\textsuperscript{52} \textit{Tax Gap and Compliance Results for the Federal Corporate Income Tax System}, at 19.

\textsuperscript{53} Ibid., at 24; more broadly, see supra, at 22-25 and 37-41. The CRA deserves to be commended for this original research and for providing an unusually detailed disclosure of its methods.

\textsuperscript{54} Ibid., at 23.

\textsuperscript{55} Ibid., at 14.

\textsuperscript{56} Tax authorities in other countries have often included this in the tax gap through an uplift factor, but the CRA suggests that additional research would be required to determine an appropriate factor for Canada.
Third-party reporting is well known to be highly effective in ensuring high rates of compliance with the personal income tax, especially for employment income. This article shows that third-party reporting can also be highly effective in ensuring compliance with value-added taxes (VATs), whose Canadian version is goods and services tax/harmonized sales tax (GST/HST). In this case, the specific compliance problem addressed is the “last mile” problem, which arises from the fact that businesses selling to consumers have an opportunity to evade tax by understating sales, because the purchasers are not seeking to claim input tax credits and therefore are not looking for receipts to show that VAT has been paid.

Sao Paulo, Brazil created an incentive for consumers to request receipts showing their social security number (SSN). (In Brazil, unlike Canada, this is not considered private information.) Firms were required to send all receipts (with or without an SSN) to the government electronically. Consumers then created online accounts that provided them with a small rebate on each purchase (on average, 1 percent of the value) registered to their SSN and reported by the firm to the government. Consumers also received lottery tickets on the basis of such purchases, with prizes ranging from small amounts to US $500,000. A consumer can also blow the whistle on a firm that has failed to issue a proper receipt (including the SSN) on request or has supplied improper data to the government; the reward to the consumer is a percentage of the fine paid by the firm.

This article studies the effect of this measure, using a difference-in-differences research design that compares the time pattern of sales reported by retail firms (which are expected to be affected by the measure, because they sell to consumers) to wholesaling firms (which are not expected to be affected, because they sell to VAT registrants). The study shows that, as a result of this measure, retail firms increased reported revenue by at least 21 percent over four years. Although there was a loss of revenue because of the payment of rewards and firms’ increased reporting of expenses, tax revenue net of rewards increased by 9 percent. The compliance effect was stronger for firms that face a high volume of consumers. Also, after the first instance of “whistleblowing,” firms reported 14 percent more receipts and 6 percent more revenue.57

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57 For analysis of other such consumer-rewards programs in Bolivia and North Cyprus, see Bahro A. Berhan and Glenn P. Jenkins, “The High Costs of Controlling GST and VAT Evasion” (2005) 53:3 Canadian Tax Journal 720-36.
It is often suggested that VAT exemptions should be replaced by income-tested transfer payments from government. For example, the zero-rating of basic groceries under Canada’s GST could be replaced by an enhancement of the GST credit. However, there is a difference in timing between the two systems: VAT exemptions have effect immediately, while income-tested transfers are not received until after the filing of the tax return for that year. Thus, credit-constrained consumers, who either cannot borrow or face high interest rates for borrowing, may prefer the immediacy of the VAT exemption. This article formalizes this argument in terms of optimal income taxation theory.

A.M.

Stephen Gordon, “The Incidence of Income Taxes on High Earners in Canada,” Canadian Journal of Economics (forthcoming)

For many years, the literature on tax economics examined workers’ response to taxation in terms of taxation’s effect on the labour-leisure choice: workers facing high tax rates might find meagre incentive to put in long hours, because they kept so little of the money. This approach was ultimately considered to be unsatisfactory when applied to high-income workers because few such workers actually changed their hours of work. That did not mean there was no response to taxation—merely that the response might be occurring in other dimensions.

One such dimension is cross-border migration. This article examines the theory that there exists a continental (Canada-US) market for high-skill, high-income workers. According to this theory, the existence of such a market, with its implied threat that workers in either country can move across the border, might be expected to cause the after-tax incomes of such workers in Canada to be related to (perhaps even equal to) the after-tax incomes that they could earn in the United States. This theory is challenging to test because data on income by occupation is hard to come by, but the article circumvents this problem by examining incomes at borderlines in Canada and the United States, defined by the following fractiles of the income distribution: top 10 percent; top 5 percent; top 0.5 percent; top 0.1 percent; and top 0.01 percent.

In the article, a regression equation relates Canadian after-tax incomes at these income-distribution points to the similar US after-tax incomes at these points, with a measure of bargaining power as the key parameter to be estimated: if this parameter equals one, Canadian after-tax incomes will move in lockstep with those in the United States; as the parameter moves away from one, the connection between the two sets of incomes becomes looser and looser.

A key problem in statistical work is identification issues: it can be impossible to make any inferences if there is not enough variation in the variables of interest. In
this case, the variation is provided by variations in the Canada-US exchange rate. Thus, for example, the depreciation of the Canadian dollar in the 1980s and 1990s pushed up the value of any given US salary in terms of Canadian dollars, which increased the gains available from migrating to the United States. According to the article’s model of a North American labour market, this trend would push up top incomes in Canada as Canadian employers sought to keep their workers.

The parameter values derived from the statistical estimation support the theory that after-tax incomes of top income earners in Canada are closely tied to those in the United States. Thus, an increase in income taxes on top earners in Canada may merely cause their pretax incomes to go up, leaving after-tax incomes the same. In other words, an increase in the top marginal tax rate can, paradoxically, lead to an increase in inequality in Canada (as measured by pretax incomes).

Ross Hickey, Bradley Minaker, and A. Abigail Payne, “The Sensitivity of Charitable Giving to the Timing and Salience of Tax Credits” (2019) 72:1 National Tax Journal 79-110 (http://dx.doi.org/10.17310/ntj.2019.1.03)

Although an individual’s charitable donations for a given taxation year produce a non-refundable tax credit, the cash flow effect of the credit is realized only on the filing of a tax return for that year. In particular, charitable tax credits are not included on the CRA’s TD1 form and therefore do not affect tax withholding from employment income. Many people have hypothesized that if this delay of from 4 to 16 months in receiving the cash flow benefit could be reduced—perhaps by allowing donations made in the first 60 days of the next year to qualify, as in the case of RRSP contributions—people would make more charitable donations.

This article uses a natural experiment to estimate the magnitude of this response. Donors contributing to the relief efforts for the Haitian earthquake of January 12, 2010 were allowed to claim their donations on the 2009 return for Quebec provincial income tax, but the normal rule—that donors had to wait until the 2010 return to make this claim—applied for federal income tax and for provincial income tax in other provinces.58 Thus, differences between charitable donations given by Quebec residents and those given by residents of other provinces can plausibly be attributed to this tax change, at least if one is comparing groups of people in Quebec with those in the rest of Canada who would seem equally likely to give to this cause.

The analysis was done at the neighbourhood level, with neighbourhoods defined according to forward sortation areas used by Canada Post (7,000 households per neighbourhood, on average).59 There were two dependent variables to explain: the change in the proportion of donating households (the extensive margin) and the change in the donation per donating household (the intensive margin), with

58 Only donations made before March 1, 2010 were eligible (at 84).
59 At 88.
the change being measured from a time before the earthquake (2007-8) to the time of the earthquake (2009-10). (It appears that donations in 2007 and 2008 combined are being compared with those in 2009 and 2010 combined.) The authors had access only to federal tax return data, not to Quebec tax return data, so any Haitian relief donations by Quebec taxpayers induced by the Quebec tax change may be appearing either correctly on the 2010 federal tax return or incorrectly on the 2009 federal tax return.

The independent variables (control variables), which were essentially used to identify similar neighbourhoods in Quebec versus those in the rest of Canada, were characteristics of the neighbourhood that would influence either the overall level of charitable giving or the neighbourhood’s donation response to the Haitian earthquake. For example, a prominent variable that was relevant to the latter concept was the share of residents in the neighbourhood whose primary language was French, given that Quebec and Haiti have this language in common.

The result of this statistical analysis is that the Quebec policy intervention increased the share of households reporting donations by 2 percentage points, and it increased the average donation per donating household by 9 percentage points.\(^{60}\) These figures imply that if donors are fully informed about charitable tax credits and have low discount rates, the responsiveness of charitable donations to the after-tax price of giving will be implausibly high (relative to previous findings in the literature). The article suggests, as a possible explanation for these findings, that many people lacked awareness of the tax credits until this Quebec measure.

The article uses these findings to suggest that policy makers consider moving the period for reporting a charitable donation closer to the filing of the tax return. However, two disadvantages of this proposal are not discussed. First, if charitable donations are ever to become part of the CRA’s “auto-fill my return” initiative,\(^{61}\) lead time will be needed between the end of the donation-reporting period and the time when the auto-fill information becomes available, and the suggested policy measure could interfere with that. Second, RRSP contributions are promoted in the press and in advertising 60 days after the end of the year; sharing this period with charitable donations might dilute the promotion of RRSPs and exacerbate the trend toward declining RRSP contributions.\(^{62}\)

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\(^{60}\) At 103.

\(^{61}\) More information is available on the CRA’s website: Canada Revenue Agency, “Auto-Fill My Return” (www.canada.ca/en/revenue-agency/services/e-services/about-auto-fill-return.html).

\(^{62}\) See Derek Messacar, “Economic Insights: Trends in RRSP Contributions and Pre-Retirement Withdrawals, 2000 to 2013,” Statistics Canada, revised February 13, 2017 (www150.statcan.gc.ca/n1/pub/11-626-x/11-626-x2016064-eng.htm).
George K. Yin, “Who Speaks for Tax Equity and Tax Fairness?”: Stanley Surrey and the Tax Legislative Process, Virginia Public Law and Legal Theory Research Paper no. 2019-25 and Virginia Law and Economics Research Paper no. 2019-09 (Charlottesville, VA: University of Virginia, School of Law, August 2019), 71 pages

Stanley Surrey is best known today for his views on equity in taxation and his development of the concept of tax expenditures. However, Surrey served for many years in government and wrote extensively on the tax legislative process in the United States. As described in this paper, Surrey was an advocate for the primacy of the Treasury in this process, as opposed to the elected politicians serving in Congress. He believed that the Treasury was likely to bring a more principled, knowledgeable approach than politicians would, and that the Treasury would give an appropriately high priority to achieving equity. This paper points out that such a “top-down” approach may not always be ideal, since good ideas can come from Congress (and the public). The paper cites the 2017 US tax reform (the Tax Cuts and Jobs Act) as an example of an extreme version of the top-down approach that could have produced a better result had there been more input from outside the Treasury.

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