Tax Reform, Less Talk and More Action, Please

By

Vern Krishna, CM, QC, FCPA

Tax policy should be concerned with the effectiveness and efficiency of compromises between a nation's economic, social, cultural and political values. Canada last considered serious policy analysis in the *Carter Commission Report*, published after thorough and rigorous analysis in 1966. The Liberal government of the day rejected most of the fundamental strictures of that study, most notably the basic tenet that a "buck is a buck". Since then the *Income Tax Ac*t has grown to 3,500 dense pages that fuel the resources of law and accounting firms and empty the pockets of middle income taxpayers. Complex tax law results in prolonged litigation that further drains the economic resources of taxpayers, particularly those in the lower and middle income groups. There is talk about tax simplification, but very little bureaucratic enthusiasm for its implementation.

All tax law is driven by policy. Every rule has an underlying rationale, which is translated into legislative language in the tax statute. However, sloppy drafting or statutory interpretation of rules can distort thwart their policies. Tax policy concerns the efficiency with which we implement transfers of resources from the private to the public sector, and the value and benefit that society derives from such transfers.

Study of tax policy is not new. In 1776, Adam Smith, a Scottish economist and moral philosopher, considered the principles of taxation in the *Wealth of Nations,* where he asked four fundamental questions:[1]

- Who should be taxed?
- How much?
- To what purpose? and
- In what manner?

He responded to these questions with four maxims of what constitutes "good" taxation.

1. As a general principle, taxes should be proportional to how much a person benefits from living in society. There should be proportionality across levels of income and sources of income such as rent, profit, and wages. "The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state." [Notice here the origins of the *Carter Commission's* proposals in 1966 that a "buck is a buck"].

2. Taxes should be clear and predictable. The "tax which each individual is bound to pay

[1] *An Inquiry into the Nature and Causes of the Wealth of Nations*, [1776] W. Strahan and T. Cadell, London.

ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person." He recognized the danger of complex and arbitrary tax laws: "every person subject to the tax is put more or less in the power of the tax-gatherer, who can either aggravate the tax upon any obnoxious contributor, or extort, by the terror of such aggravation, some present or perquisite to himself."

3. Taxes ought to be easy and convenient for the *taxpayer*: "every tax ought to be levied at the time, or in the manner in which it is most likely convenient for the contributor to pay it."
4. Tax law should limit "deadweight loss": "Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the publick treasury of the state."

   "Take out" refers to money taken from people and "keep out" refers to unrealized income due to tax burdens, distortions, and disincentives.

Modern tax laws have all but abandoned the principle of not imposing deadweight loss on taxpayers. Smith described four ways in which taxes create deadweight losses:

- First, the cost of hiring tax collectors [the CRA] to collect and process taxes. The more a country spends collecting taxes, the less additional revenue it has to spend in other areas.
- Second, high taxes on industries with highly elastic demand result in much less production and, maybe, even less tax revenue over time.
- Third, ruinous tax rates encourage tax evasion and black-market activity.
- Fourth, paying taxes requires the services of thousands of tax accountants and tax lawyers to comply with the law and engage in litigation with the tax authorities.

Smith's four principles remain the focus of tax policy debate to this day. The federal government talks up "tax simplification" during elections and delivers complicated reforms. See, for example, the Tax on Split Income (TOSI) rules, which remain a mystery one year after their enactment into law.

Smith's observations on "deadweight costs" on economic efficiency are all but ignored. A tax system should raise sufficient revenue to finance government operations. A good tax system, however, is also concerned with the manner in which we collect the revenue. It should be neutral and efficient, fair and equitable, certain, and importantly, administratively simple to comply with. These are often conflicting goals, and all the more so if we use tax law to implement economic, social, political, and cultural objectives. Ultimately, all tax law is a compromise of competing values.

Tax policy analysis must evaluate the effectiveness and efficiency of these compromises. Smith's four maxims of what is "good" taxation should be compulsory reading for every bureaucrat in the office of the Minister of Finance and the newly appointed Associate Minister of Finance, who is mandated to look after the "middle class". What Canada needs is less talk about tax simplification, more action on implementation and fewer ministers.

Professor Vern Krishna, CM, QC, FCPA is Counsel, Tax Chambers LLP (Toronto) and professor of law, University of Ottawa.

Vern.krishna@taxchambers.ca

www.Vernkrishna.com