The Long History of Taxation

By

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As we commence the new year (2020), we prepare ourselves for what awaits us: spring showers, flowers, and the hand of the tax collector reaching into our pockets. For most persons, tax is an "unpleasant subject" of complex and inexplicable rules, administered with bureaucratic ferocity and, often, resulting in expensive litigation over an extended period. It has always been so. Tax law has a long history and has been reviled since its inception. However, despite its unpleasant nature, tax law is the root of some of our most cherished values of the rule of law in our democracy.

The word "tax" is associated in history with unpleasant events, such as wars, revolutions, expropriations, and looting. The word derives from the Latin "taxare": "to name; to describe; to heap up; to appraise; to tax". Taxes are essentially compulsory expropriations levied on persons, property, or businesses to support expenditures by government, generally, but not always, for the public good.

In an earlier era, taxes even had religious significance, particularly in ancient Greece and in the Roman Empire. We see this in the Brancacci Chapel in Florence, where the fresco "Rendering of the Tribute Money" depicts the gods approving the Florentine income tax.

The religious association of taxes soon disappeared and was replaced by sovereign rights to levy citizens. We see the "newer" forms of taxes in levies in the feudal system of landholding in medieval England, in which the King held all land through a complex web stretching down from the monarch to the rural peasantry at the bottom. Everyone in this hierarchy had allocated feudal rights, which came with obligations regulated by custom.

The King was entitled to many traditional forms of payments. For example, he could demand money from his tenants-in-chief on the marriage of their eldest daughter, or when his tenants' heirs inherited their estates. He had the lucrative right of wardship over tenants' heirs who were minors, and he could control the marriage of his tenants' widows and heirs. To the extent that the payments were compulsory appropriations, they were, in effect, "taxes". The barons also owed 'scutage' to the King, a payment in lieu of military service.

King John (1199-1216) notoriously breached the bounds of traditional practices by exploiting his feudal taxing rights to excess. After many years of unsuccessful foreign policies and heavy taxation demands, he faced a possible rebellion by the country's powerful barons. In May 1215, a group of discontented barons rebelled. Led by Robert fitz Walter (1162-1235), who called himself 'Marshal of the Army of God and Holy Church', the rebel barons captured London on 17 May 1215, and the following month forced the King to sign *Magna Carta* ("the Great Charter").

Under duress, the King agreed to the charter of liberties that would place him and all of England's future sovereigns within the rule of law. The barons then made peace with him and renewed their allegiance. *Magna Carta* contained a clause that provided that 25 barons should oversee the enforcement of its provisions. Over a third of the 63 clauses in the 1215 Magna Carta dealt directly with rights defining and limiting the extent of the King's authority.

Though it was not initially successful, the document was reissued (with alterations) in 1216, 1217 and 1225. Eventually, it became the foundation for the English system of common law and the rule of law.

The early English revenue system relied primarily on customs and excise duties, rather than the medieval system of taxes on property, which contributed a very small proportion of general revenues. However, after England declared war with France in 1793, it needed to increase its revenues.

Pitt the Younger introduced the first income tax in England in 1800 to finance the fight against Napoleon. Following The Battle of Waterloo (June 18, 1815), where the Duke of Wellington (the "Iron Duke") defeated Napoleon, opponents of the income tax forced it to be abolished and demanded the destruction of all documents that referred to the law. Only one copy was saved in the basement of the English tax court and it became the model of the modern-day tax system. It was the income tax that saved Canada from becoming a French colony.

The story of tax in the United States is similarly rooted in revolution. The Boston Tea Party was essentially a political and mercantile protest by the Sons of Liberty in Boston, Massachusetts, on December 16, 1773, a revolution against Britain's Stamp Tax on everything from tea to legal documents. The Tea Act of May 10, 1773 allowed the British East India Company (EIC) to sell tea from China in American colonies without paying taxes.

The EIC was founded in September 1599 at Founders' Hall, off Moorgate Fields in London (see: Henry Stevens, *The Dawn of British Trade to the East Indies*, London, 1866, pp. 1-10). The idea of a joint stock company was one of Tudor England's most brilliant and revolutionary innovations and the precursor to the modern multinational corporation. The idea sprang from the medieval craft guilds, where merchants and manufacturers could pool their resources open to all investors to undertake ventures that none could afford individually. Hence, the concept of the passive investor who had cash to subscribe but not be involved in the management of the enterprise. The Company eventually grew to control almost half the world's trade and become the most powerful corporation in history. As Edmund Burke put it, the EIC was "a state in the guise of a merchant" (see: William Dalrymple, *The Anarchy*: *The Relentless Rise of the East India Company*, Bloomsbury Publishing).

The story is similar in Canada. Before World War I, the principal sources of revenue were customs duties, excise taxes and revenues from postal services. Sir Robert Borden, Prime Minister of Canada, introduced the federal income tax on business profits in 1916 and a tax on personal income on September 20, 1917. Both taxes were tabled as temporary measures to finance World War I. By then, the cost of the war had reached $600 million (1916 dollars).

In introducing the tax, Sir Thomas White - Minister of Finance (Leeds), speaking to the Committee of the Whole in the House of Commons, said:

> "Mr. Chairman, I desire today to lay before this committee proposals for a national measure of income taxation. Hitherto we have relied upon duties of customs and of excise, postal rates and other miscellaneous sources of revenue. Canada has been, and will continue during the lifetime of those present today, to be a country inviting immigration. I have, therefore, thought it desirable that we should not be known to the outside world as a country of heavy individual taxation.

> We are, however, confronted with grave conditions arising out of the war. The time has arrived when we must resort to direct taxation. I am confident, Mr. Chairman, that the people of Canada, whose patriotism during this war has been so often and so nobly proven, will, in light of present conditions, which call for it, cheerfully accept the burden and the sacrifice of this additional taxation.
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> We cannot see very far ahead in these days. We do not know how long this war will last. We do not know what the attitude of the people of this country will be upon the many questions, social, industrial, financial and fiscal.
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> Therefore, I have placed no time limit upon this measure but merely have placed upon Hansard the suggestion that, a year or two after the war is over, the measure should be reviewed by the minister of finance of the day, with a view of judging whether it is suitable to the conditions which then prevail".

His statements were prophetic. There is indeed no time limit on taxation and governments do review our taxes annually. However, it was not until 1949 that Louis St. Laurent finally made income taxes permanent in Canada. Nevertheless, the principle of taxation only through representative government ("No taxation without representation") is incorporated in the Westminster parliamentary system of Canadian tax law.[1]

The *Income War Tax Act* of 1917 was all of ten pages. It has since grown through several reincarnations into the *Act* of today - over 3,500 pages and expanding annually. Of course, the nature of the Canadian income tax system has also changed significantly in the interim. For example, in 1917, the *Income War Tax Act* exempted the first $1,500 of income — about $30,720 in 2020 dollars — from any tax whatsoever. The top rate of 25% applied only to income over $2,048,000 in 2020 dollars. The top federal marginal rate of 33% now kicks in at $214,368 (2020).

Income tax law has also evolved well beyond merely raising money to finance wars. Today, the tax system is used for social, economic, and political objectives. Income redistribution is one of the dominant themes of modern tax legislation. We use tax rules to induce behavioural responses to respond to economic incentives and sanctions. For example, we have special tax rules to encourage Canadian culture and foreign films made in Canada [see: sections 125.4 125.5], discourage advertising in foreign magazines [subsection 19(1)], provide labour credits for journalism organizations [section 125.6] and digital news subscriptions [section 118.02], and promote gender equality [the February 27, 2018 Federal Budget of 362 pages mentioned women 358 times]. We may not agree with all of the incentives, but they dominate the tax system and complicate it.

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[1] The Westminster system is a parliamentary system of government modelled after that which developed in the United Kingdom. The term comes from the Palace of Westminster, the seat of the British Parliament. The system is a series of procedures for operating a legislature.

There have been numerous studies of the tax law with the purported purpose of "reforming" it. The most significant of these studies was the *Carter Commission* (1966), which received widespread acclaim. As Boris I. Bittker, Southmayd Professor of Law, Yale University said of the *Report* in *The University of Chicago Law Review*, Volume 35, 637:

> "The 1966 Report of the Royal Commission on Taxation, established with a sweeping mandate to examine the federal tax laws of Canada and to make recommendations for their improvement, has few peers among modern proposals for income tax reform."

Rare praise indeed from an American for a Canadian proposal.

Regrettably, the acclaim did not capture the imagination of Canadian professionals on Bay Street and the politicians in Ottawa. The *Act* (tabled in the House of Commons June 18, 1971 exactly 156 years later to the day after the Battle of Waterloo) ignored most of the significant proposals of the *Report*, including the concept that "a buck is a buck" and that all income should be treated equally. Indeed, if anything, today's tax structure is firmly rooted in the doctrine that all income must be identified by its source, and that each source of income is subject to its own rules. Hence, the multitude of rules to identify and segregate each source of income.

Since *Carter*, there have been numerous calls for "reform" and "simplification" of the statute. All with minimal success. The statute is now virtually incomprehensible to the average person. As the *Joint Committee on Taxation* of the Canadian Bar Association and the Canadian Institute of Chartered Accountants, in addressing the House of Commons Committee on Finance and Economic Affairs, conceded:

> "For any taxpayer to pick up some of this legislation we are looking at today and understand how these rules are going to impact on him when he sits down to fill out his tax return is almost impossible.
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> There is no quick fix to the complexity issue. It is a very long-term problem, but I fear that the Government's priority for tax simplification has fallen down to the bottom of the various objectives set out for tax reform."

Tax professionals have abandoned any hope of tax simplification. In 1997, for example, the Report of the Technical Committee on Business Taxation reported:[2]

> "[I]n a complex society that is part of a world economy, where the form and processes of business activities are increasingly sophisticated, and where the tax system is also used for purposes other than raising revenue, it is unrealistic to expect our tax system to be simple".

That was in 1997. Today, in 2020, as digital technology crosses national boundaries, the size, scope and complexity of our tax rules is exponentially greater. International tax bureaucrats of the Organisation for Economic Co-operation and Development (OECD), which represents 34 countries seek to accommodate the politics of numerous states.

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[2] Report of the Technical Committee on Business Taxation (December 1997), A Report to the Minister of Finance, at 1.2.

The OECD is working to reach political agreement among its member countries for the *Inclusive Framework* on the development of measures to solve the outstanding issues to settle the tax challenges arising from the digitalisation and globalisation of the economy. For this purpose, in January 2019, the OECD published a policy statement and a document for public consultation which included a proposal whereby all measures to be agreed on should be grouped in two categories (*Pillar One* and *Pillar Two*).

On 8 November 2019, the OECD published for public consultation the document with the proposals for its *Pillar Two*, which is starting point for setting rules for the establishment of a global minimum taxation on corporate income that are intended to help in reducing tax competition between jurisdictions and prevent large groups from organising themselves on the basis of the tax advantages offered by each state. It also proposes a global rule to ensure that the profits of multinational companies are subject to a minimum tax threshold.

OECD “consensus” comes with higher rates and new taxes, which results in even more complex legislation and international tax treaties [See, for example, the latest effort in the *Multilateral Instrument (MLI),* which came into effect in Canada in 2020].

As the income tax law evolves from the industrial to the technological economy, taxpayers must live with the complexity of the statute, pay for professional advice to comply with the law and then pay counsel to resolve their disputes in the courts. Tax litigation is a slow, arduous, and expensive process. It takes the Canada Revenue Agency 12 to 18 months merely to acknowledge receipt of a taxpayer’s objection. It is not unusual for disputes of moderate complexity to extend to ten years in litigation. Complex files can drag on for fifteen to twenty years. Hence, we call it the “unpleasant subject of taxes”.

We hate and cherish it in our democratic system underscoring the rule of law. We would cherish it even more if it was simplified and understood by more Canadians.

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