TAX REFORM IN THE UNITED STATES AND CANADA: A COMPARISON

CHARLES O. GALVIN*

The current national debate on federal budget cuts and income tax reduction raises anew the question of whether the United States can undertake a thorough assessment and overhaul of its taxing system.[1] Our sister democracy, Canada, did undertake a major tax reform effort some years ago[2] and an analysis of the results of that effort may be helpful in predicting the success of such an undertaking in this country.[3] Moreover, the parallel developments in tax reform in the two countries during the last twenty years provide a striking comparison of efforts at serious tax reform in two representative democracies which, although different in size and population, have similar fiscal and economic problems.

I

TAX REFORM IN THE UNITED STATES—A BRIEF HISTORY

Any discussion of the chances of successful tax reform in the present time must necessarily take into account the experiences of the past. The history of tax reform may be divided into four periods: 1913-1939, 1939-1964, 1964-1981, and the Economic Recovery Tax Act of 1981.

A. 1913-1939

It was the practice of the Congress during this period to reenact the tax laws by a series of separate revenue acts. In particular, the Revenue Act of 1928[4] has been noted as a model of simplicity in content and structure; its interstices were filled by regulations, rulings, and the decided cases where necessary. Simplicity in this period, however, was not necessarily attributable to the genius of the lawmakers. Rather, the evolution from simplicity to complexity in the law almost directly correlates with the evolution to a broader tax base and higher tax rates, and during

---

*Professor of Law and Former Dean, School of Law, Southern Methodist University. B.S.C., Southern Methodist University; M.B.A., J.D., Northwestern University; S.J.D., Harvard University.

1. Field, *The Reagan Tax-Cut Proposals,* XII TAX NOTES 3 (1981); Heller & Perry, *U.S. Economic Policy and Outlook,* XII TAX NOTES 851 (1981); Mueller, *Lessons of the Tax-Cuts of Yesteryear,* Wall St. J., Mar. 5, 1981, at 24, col. 3; Musgrave, *The President's Fiscal Program,* XII TAX NOTES 555 (1981); Surrey, *Our Troubled Tax Policy: False Routes and Proper Paths to Change,* XII TAX NOTES 179 (1981); Note, *Reagan Tax Cuts Face Hungry Congress,* XII TAX NOTES 422 (1981).

2. REPORT OF THE ROYAL COMM'N ON TAXATION (Canada 1967) [hereinafter cited as ROYAL COMM'N REPORT]; Bittker, *Income Tax Reform in Canada: The Report of the Royal Commission on Taxation,* 35 U. CHI. L. REV. 637 (1968); Blum, *Progressive Taxation Reconsidered—North of the Border,* 45 TAXES 718 (1967).

3. *See* Bird, *The Tax Kaleidoscope: Perspectives on Tax Reform in Canada,* 18 CANADIAN TAX J. 444 (1970); Drache, *Introduction to Income Tax Policy Formulation: Canada 1972-76,* 16 OSGOODE HALL L. J. 1 (1978); Goodman, *Tax Reform—The Continuing Challenge,* 16 OSGOODE HALL L. J. 147 (1978).

4. Pub. L. No. 562, 45 Stat. 791 (1928).

most of this period exemptions were generous and the rates were low. Therefore, the class of filers was small and within that group the bite was gentle. For example, in 1925 a married couple with two children and a taxable income of $15,000 paid about $280 in tax, and there were no social security deductions or income tax withholding.[5] Corporate income was taxed at a rate of about 12 percent.[6]

The government's need for revenues was minimal; the requirements of the federal fisc in the mid-twenties were incredibly modest. The entire federal budget in 1925 was about $3 billion,[7] as contrasted with projections for the current budget year of amounts in excess of $700 billion.[8] Indeed the government was operating at such a surplus during this period that the Secretary of the Treasury, Andrew W. Mellon, persuaded the Congress to reduce taxes for the year 1925 and to refund certain portions of taxes collected for 1924.[9] Thus, there was no general popular interest to generate research and critical writing about the tax system. To be sure, some economists wrote theoretical treatises, but the few articles in the law, accounting, and business journals were primarily concerned with practical application of the system.

B. 1939-1964

The next period began when the Internal Revenue Code of 1939[10] was enacted. The hearings preceding its enactment involved little probing analysis of the effects of the revenue laws on the economy and of the equity and fairness of the system as it applied to the taxpaying community.[11] Nor was any long range tax policy objective developed. The new Code, therefore, merely reflected the extant law in a more orderly statutory arrangement than had previously existed.

The inauguration of President Roosevelt in 1933 and the New Deal Administration's introduction of Keynesian[12] economics had moved the federal government into an activist role in stimulating the economy through increased taxes and government expenditures. Moreover, World War II and the Korean conflict occurred during this period, creating a need for greatly increased revenues. Exemptions were lowered and sharply progressive rates of 20 percent to 90 percent came into force.[13] Correspondingly, the number of filers increased significantly and the

---

5. [1981 Index Vol.] STAND. FED. TAX REP. (CCH) ¶ 149.

6. *Id.* at ¶ 159.

7. *See* SEC'Y TREAS. ANN. REP. 372-73 [1959] (T1.1); *see also* J. PECHMAN, FEDERAL TAX POLICY 274 (1st ed. 1966).

8. EXEC. OFF. PRES., OMB, THE UNITED STATES BUDGET IN BRIEF, FISCAL YEAR 1982 [1981] (P.Ex. 2.8/2:982).

9. A modest gift tax was enacted as part of the Revenue Act of 1924, ch. 27, § 319, 43 Stat. 313, and repealed in 1926 by the Act of February 26, 1926, ch. 27, § 324, 44 Stat. 86. *See* Mueller, *supra* note 1, at 1.

10. Pub. L. No. 1, 53 Stat. 1 (1939).

11. *See* HOUSE COMM. ON WAYS AND MEANS, 76TH CONG., 1ST SESS., CONSOLIDATE AND CODIFY THE INTERNAL REVENUE LAWS OF THE UNITED STATES (1939) (Rep. No. 6, Serial Set 10296).

12. *See* J. KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY (1936). Keynes has been praised and damned for many things, but in the ravages of the Great Depression governments found that idle plant capacity could be effectively stimulated to use by expenditures to increase demand. *See* P. SAMUELSON, ECONOMICS 205 (9th ed. 1973). Harry Hopkins, one of Roosevelt's advisors, is reported to have said that the way to prosperity was "to tax and tax, and spend and spend."

13. *See* [1981 Index Vol.] STAND. FED. TAX REP. ¶¶ 149, 151.

tax bite became more serious for all. The terms "tax shelter" and "estate planning" entered the vocabulary, and special interest groups began to press the Congress to legislate a variety of special provisions.[14] In time, the 1939 Code became riddled with amendments. This led to a second major recodification: the Internal Revenue Code of 1954,[15] which is the base of the present tax law.

A critical examination of tax policy began in the early 1950s. With regard to the public sector, a subcommittee of the Joint Committee on the Economic Report of the Congress in 1955 summoned academicians and practitioners throughout the country to submit discussion papers on tax policy;[16] and in 1959 and 1960 the House Ways and Means Committee conducted panel discussions based on a series of technical presentations from numerous witnesses which led to the publication of a three-volume Tax Revision Compendium.[17] A cursory reading of those volumes even today reflects an impressive vitality and perception about tax reform for the United States.

In the private sector during this period, various professional organizations moved forward with projects, conferences, institutes and studies to examine particular aspects of the tax laws.[18] As an example, the Section of Taxation of the American Bar Association in 1962 selected a Special Committee on Substantive Tax Reform to study the feasibility of a simplified, broad-based, low rate income tax system to foster economic growth and capital formation and to facilitate compliance and administration.[19] This study was the first undertaken by a private association of lawyers to provide a major critical overview of the tax system. The committee's reports in 1963[20] and 1964[21] became significant American Bar Association publications which compelled the professional and business communities to confront the difficult issues involved in making broad scale tax reform a reality.[22]

---

14. For example, present section 1231 was enacted in 1941 to permit long term capital gains on sales of business assets; losses continued to be treated as ordinary losses. *See generally* J. PECHMAN, FEDERAL TAX POLICY (2d ed. 1971). Surrey, *Complexity and the Internal Revenue Code: the problem of the management of tax detail,* 34 LAW & CONT. PROB. 673 (1969); Surrey, *Congress and the Tax Lobbyist—How Special Tax Provisions Get Enacted,* 70 HARV. L. REV. 1145 (1957).

15. Pub. L. No. 591, 68A Stat. 3 (1954).

16. JOINT COMM. ON ECONOMIC REPORT, 84TH CONG., 1ST SESS., FEDERAL TAX POLICY FOR ECONOMIC GROWTH AND STABILITY: PAPER SUBMITTED BY PANELISTS APPEARING BEFORE THE SUBCOMMITTEE ON TAX POLICY (Comm. Print 1955).

17. HOUSE COMM. ON WAYS AND MEANS, 86TH CONG., 1ST SESS., TAX REVISION COMPENDIUM, COMPENDIUM OF PAPERS ON BROADENING THE TAX BASE, (3 vols.), (Comm. Print 1959); *see* HOUSE COMM. ON WAYS AND MEANS, 86TH CONG., 1ST SESS. PANEL DISCUSSION ON INCOME TAX REVISION, (Comm. Print 1960).

18. The Tax Foundation, Inc., of New York, the Tax Institute, Inc., of Princeton, the Brookings Institution, the American Law Institute, and the National Tax Association, among others, regularly conduct studies and symposia on tax policy.

19. 87 A.B.A. REP. 147, 214, 348 (1962).

20. 88 A.B.A. REP.344 (1963); XVI ABA TAX. SECTION BULL. 4 (July, 1963).

21. XVII ABA TAX. SECTION BULL. 277 (July, 1964).

22. These efforts are described in detail in Galvin, *Progress in Substantive Tax Reform; Work of the American Bar Association; Treasury Studies; What Tax Practitioners Can Do.* U. SO. CALIF. 17TH TAX INST. 1, (1965), 18 ARK. L. REV. 285 (1965); Galvin, *More on Boris Bittker and the Comprehensive Tax Base: The Practicalities of Tax Reform and the ABA's CSTR,* 81 HARV. L. REV. 1016 (1968); Galvin, *Tax Reform and Simplification,* 30 SO. CALIF. 1978 TAX INST. 853; *see also,* C. GALVIN & B. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? (1969); Galvin, *Reflections on Tax Reform, A Tribute to John Chommie,* 29 U. MIAMI L. REV. 21 (1974).

At the close of this period the Revenue Act of 1964[23] was enacted; it amended the 1954 Code and reduced the previously existing progressive rate schedules ranging from 20 percent to 90 percent to a range of 14 percent to 70 percent.[24]

C. 1964-1981

This period has been one of frenetic activity in the federal taxation field in both the public and private sectors. In the public sector, a series of revenue acts,[25] has over-articulated the applicable rules, proliferated complications, and thereby led to further legislative action. This hemorrhaging of legislation, particularly from 1969 onward, has been accompanied by extensive Treasury studies and hearings before the tax-writing committees of the Congress.[26]

An intensification of activities in the private sector has paralleled the work in the public sector, with participation by such organizations as the Brookings Institution, the National Tax Association, the American Law Institute, the American Bar Association, the American Institute of Certified Public Accountants and many others. The project which the Section of Taxation of the American Bar Association began in 1962 was continued jointly by the American Bar Foundation and Southern Methodist University. This joint pilot study demonstrated that legal analysis could be combined with economic analysis, aided by computer technology, to develop a variety of econometric models to test various assumptions relating to a broad-based, low rate tax system. This pilot study was published in 1969,[27] and led to a more comprehensive project published by the Fund for Public Policy Research of Washington in 1973.[28] Both the pilot study and the larger project demonstrated that corporate income taxes could be eliminated from the system and that a single comprehensive individual income tax with a flat rate of 11 percent to 13 percent or a graduated rate of 4 percent to 54 percent could yield the same revenues as the existing law.[29] Some staff members of this project were then employed to develop an important Treasury document entitled *Blueprints for Basic Tax Reform,* released in January 1977.[30]

Blueprints deserves extended comment because it resembles in a primitive way the larger tax reform effort which Canada had undertaken fifteen years earlier:

23. Pub. L. No. 88-272, 78 Stat. 19 (1964).

24. Internal Revenue Code of 1954, ch. 1, § 1, 68A Stat. 3.

25. Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969); Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975); Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976); Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126 (1977); Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763 (1978).

26. *See, e.g.,* HOUSE COMM. ON WAYS AND MEANS, & SENATE COMM. ON FINANCE, 91TH CONG., 1ST SESS, TAX REFORM STUDIES AND PROPOSALS U.S. TREASURY DEPT., PARTS 1-4, JOINT PUBLICATION (Comm. Print 1969).

27. AMERICAN BAR FOUNDATION & SOUTHERN METHODIST UNIVERSITY, STUDIES IN SUBSTANTIVE TAX REFORM (A. Willis ed. 1969).

28. COMMISSION TO REVISE THE TAX STRUCTURE, REFORMING THE FEDERAL TAX STRUCTURE (1973).

29. *Id.* at 192.

30. U.S. DEPT. OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM (1977) [hereinafter cited as BLUEPRINTS].

the *Report of the Royal Commission on Taxation* ("Carter Commission").[31] Published by the outgoing Ford administration, *Blueprints* is a credit to the tenacity of President Ford's Secretary of the Treasury William E. Simon, Assistant Treasury Secretary Charles Walker, and Deputy Assistant Secretaries David Bradford and William Goldstein, because it was the first time that the highest executive level focused on overall tax reform. The *Blueprints* document posed two plans for revision. First, it proposed a comprehensive income tax base which would treat all realized accretions to net worth as income.[32] All realized income, less expenses incurred to produce it, would constitute the taxable base, and all income would be taxed in accordance with the same rate schedule. The corporate income tax would be wholly integrated with the individual income tax so that corporate income passing through the corporate entity and into the hands of shareholders as dividends would be taxed only once.[33] The tax rates under this comprehensive system would range from 8 percent to 38 percent and would be expected to produce the same revenue as under existing law.[34]

The second plan proposed a consumption,[35] or cash flow, tax which would use the same comprehensive base as the first plan, but would allow a deduction for all investments or savings.[36] Under this proposal only the income which taxpayers actually consumed in goods and services would become part of the tax base.[37] The tax rates under this plan would range from 10 percent to 40 percent.[38]

The *Blueprints* proposal was a constructive beginning for tax reform, but, unfortunately, the incoming Carter Administration did not pursue the proposals. Although President Carter in the 1976 presidential campaign described the federal tax system as a national disgrace,[39] he recommended no comprehensive plan for revision. The Revenue Act of 1978[40] and the Windfall Profit Tax Act of 1980[41] reflected a continuation down the path of tinkering and patchwork efforts.

D. The Economic Recovery Tax Act of 1981

On August 13, 1981, President Reagan signed into law a budget which reduced expenditures generally across the board, except for proposed increases in military expenditures. At the same time he signed the Economic Recovery Tax Act of

31. *Supra* note 2.
32. BLUEPRINTS, *supra* note 30, at 3.
33. *Id.* at 4.
34. *Id.* at 159.
35. *Id.* at 9.
36. *Id.* at 113.
37. The concept of a tax on consumption, or expenditures, is not new. An argument for such a tax is that receipts of funds or accretions to wealth are not income until they are enjoyed or consumed, at which point the tax should apply. A basic reference is N. KALDOR, AN EXPENDITURE TAX (1955); *see also,* Andrews, *A Comsumption-Type or Cash Flow Personal Income Tax,* 87 HARV. L. REV. 1113 (1974); Graetz, *Implementing a Progressive Consumption Tax,* 92 HARV. L. REV. 1575 (1979); Warren, *Would a Consumption Tax be Fairer than an Income Tax,* 89 YALE L. J. 1081 (1980); Bradford & Toder, *Consumption vs. Income Base Taxes: The Argument on Grounds of Equity and Simplicity,* 69 NAT'L TAX A. PROC. 25 (1976).
38. BLUEPRINTS, *supra* note 30, at 169.
39. 32 CONG. Q. ALMANAC 851, 852 (1976).
40. Pub. L. No. 95-600, 92 Stat. 2763 (1978).
41. Pub. L. No. 96-223, 94 Stat. 229 (1980).

1981,[42] which is complex and far reaching in its application. Its principal features include a 25 percent reduction in tax rates on individual incomes with such reductions spread over three years,[43] a reduction in the tax on corporate incomes in the lowest two brackets,[44] a new accelerated cost recovery system which will permit new investments in tangible real and personal property to be recovered over shorter life periods.[45] Other provisions include more generous deductions for charitable contributions for individuals and corporations,[46] and liberalized exemptions and credits which will be phased in for the estate and gift tax system to reduce its impact to less than 1 percent of the estates of decedents.[47] Especially important was a new provision for indexing income tax rates and exemptions beginning in 1985; the adjustment will be governed by the Consumer Price Index.

The administration has discarded the Keynesian principle of demand side economics and has opted for a new direction based on supply side economics.[48] This new policy is expected to reduce the role of government in investment and entrepreneurial decision-making and also to reduce the role of government in competing for capital in the money market. By encouraging capital formation through investment incentives, reduced taxes, and liberalized capital cost recoveries the ultimate result is projected to be a healthy, growing economy with emphasis on the function of the free market system. Although the new legislation neither proposes the elimination of the tax on corporate income nor provides an integration of corporate and personal income taxes, the expected effect of the new rules, and, in particular, the new accelerated cost recovery system, would be to reduce the tax on capital intensive industries to a minimum.

It is regrettable that in all the intensive activity leading up to this legislation, neither party's leadership proposed any major reassessment of the general concepts of an income tax system.

E. Summary

A review of the principles enunciated in the past reveals a common theme: the nation's economic well-being will be best served by a broad-based, low rate income tax system that is fair and equitable, understandable by the general taxpaying public, easily administered, and conducive to growth and stability. Of course, different advocates have varied emphases and definitions of these basic desiderata, but the consensus is that the nation's professional, business, and investment skills should be employed to make choices that increase productivity and satisfy human desires rather than those that serve only tax gimmickry, emphasize the tax "angle," or seek the tax shelter. Yet this broad consensus has never reached fruition in legislative enactment. The Tax Reform Act of 1969,[49] the Tax Reduction Act of

42. Pub. L. No. 97-34, 95 Stat. 172 (1981) [hereinafter cited as ERTA].
43. *Id.* § 101 (amending I.R.C. § 1).
44. *Id.* § 231 (amending I.R.C. § 11).
45. *Id.* § 201 (adding I.R.C. § 168).
46. *Id.* § 121 (amending I.R.C. § 170).
47. *Id.* §§ 401-02 (amending I.R.C. §§ 2001, 2010).
48. *See* Musgrave, *supra* note 1.
49. Pub. L. No. 91-172, 83 Stat. 487 (1969).

1975,[50] the Tax Reform Act of 1976,[51] the Tax Reduction and Simplification Act of 1977,[52] the Revenue Act of 1978,[53] and the new Economic Recovery Tax Act of 1981[54] are largely cut-and-paste efforts layered upon already incomprehensible and arcane rules. Has our sister democracy to the north done its tax reform homework better?

II

CANADIAN TAX REFORM

Canada first imposed an income tax in 1917,[55] which continued in force with amendments until 1948 when the rules were recodified.[56] The next major revision was a reordering and renumbering in 1952.[57] Tax rates were generally low in the 1920s and early 1930, but by 1966 ranged from 12.8 percent to 80 percent.[58] Dissatisfaction with the Canadian system developed in a manner similar to that which prevailed in the United States.

A. 1962-1967

In a bold and daring venture into tax reform, Canada began a serious critical analysis of its tax policy. A nonpartisan independent Royal Commission on Taxation (called the Carter Commission after its Chairman, Mr. Kenneth LeM. Carter) was organized in 1962.[59] The Carter Commission operated independently of political or special interest pressure, and was well-funded and well-staffed to accomplish its assignment.[60] The report of the Commission was published in 1966. It was a multivolume document with supporting appendices and working papers which essentially adopted the classic Haig-Simons definition of income.

The Haig-Simons definition may be simply stated: income equals accretions to wealth plus consumption plus transfers by gift.[61] To illustrate: assume that an

---

50. Pub. L. No. 94-12, 89 Stat. 26 (1975).
51. Pub. L. No. 94-455, 90 Stat. 1520 (1976).
52. Pub. L. No. 95-30, 91 Stat. 126 (1977).
53. Pub. L. No. 95-600 92 Stat. 2763 (1978).
54. *Supra* note 42.
55. Income War Tax Act of 1917, c. 28 Can. Stat. 171.
56. Income Tax Act, c. 52 Can. Stat. 475 (1948).
57. CAN. REV. STAT. c. 148 (1952).
58. 3 ROYAL COMM'N REPORT, *supra* note 2, at 169.
59. The Order in Council appointing the Commissioners and setting forth the charge has a familar ring. The Commission was to consider:

(a) the distribution of burdens among taxpayers. . .;
(b) the effects of the tax system on employment, living standards, savings and investment, industrial productivity, and economic stability and growth;
(c) . . .anomalies or inequities . . . loopholes which permit the use of devices to avoid fair taxation;
(d) the effects . . . on . . . international payments. . .;
(e) . . .[how to] encourage Canadian ownership of Canadian industry. . .;
(f) . . .[how to] achieve clarity, simplicity, and effectiveness. . .;
(g) [and] such other related matters as the Commissioners consider[ed] pertinent or relevant. . . .

The Commission was given broad inquiry powers to carry out its mission. P.C. 1962-1334, 1 ROYAL COMM'N REPORT,, *supra* note 2, at v.

60. The Privy Council authorization included full powers of subpoena under the Inquiries Act and power to employ all necessary staff subject to the approval of the Treasury Board. *Id.*
61. H. SIMONS, PERSONAL INCOME TAXATION 61-62 (1938); Haig, *The Concept of Income—Economic and*

individual at birth has no vested property rights or interests, so that his initial power of consumption is zero. Throughout his lifetime he receives net accretions to wealth, or power of consumption, such as wages, rents, interest, royalties, dividends, gifts, bequests, transfer payments from government, and appreciation in the value of property rights. At death he has accumulated a certain amount of wealth. If the individual's transfers of wealth and his consumption of wealth between birth and death are added to this amount the result is his lifetime income.

The government cannot, of course, wait until the taxpayer's death for a final determination of tax liability, so an annual accounting and tax return filing is required. The Haig-Simons definition also requires an annual inventory of the market value of capital investments. The Carter Commission stopped short of adopting this principle, however, and suggested instead an accounting for capital gains at death or on leaving Canada.[62]

The Carter Commission recommended a series of fundamental revisions which were consonant and harmonious with much of the developing tax reform literature in the United States. The recommendations of the Commission released in 1967 and the proposals contained in *Blueprints* released in 1977 are strikingly similar. This is not to suggest that *Blueprints* was cribbed from the Carter Commission Report. Rather, separate and independent critical studies proceeding on similar paths in both countries led to the same general conclusions about tax reform.

The Carter Commission's principal recommendations were as follows:[63]

1. The tax base would be broadened to include income from all sources.[64] Capital gains would be included in the base as realized upon the taxpayer's death or leaving Canada.[65] Estate and gift taxes would be eliminated;[66]
2. The maximum marginal rate would be 50 percent.[67] There would be a zero rate bracket,[68] and deductions for dependents would become credits;[69]
3. Three percent of employment income up to $500 would be allowed for employment expenses;[70]
4. A moving five-year average would relieve the burdens on those with fluctuating income;[71]
5. Taxation would be applied to the family as a unit.[72] Transfers of wealth within the family unit would not be taxable, but all transfers to other family units would be included

Legal Aspects, in THE FEDERAL INCOME TAX 7 (R. Haig ed. 1921); 3 ROYAL COMM'N REPORT *supra* note 2, at 39: "The comprehensive tax base has been defined as the sum of the market value of goods and services consumed or given away in the taxation year by the tax unit, plus the annual change in the market value of the assets held by the unit. . ." Thus, assume that an individual's net worth at the beginning of the year is $100, at the end of the year is $125, and that he consumed or gave away $50. The increase in market value of assets ($25) plus that which was consumed or given away ($50) results in a total income of $75.

62. 3 ROYAL COMM'N REPORT, *supra* note 2, at 51.
63. These are summarized in 1 ROYAL COMM'N REPORT, *supra* note 2, at 3-49. *See* Bucovetsky & Bird, *Tax Reform in Canada: A Progress Report,* XXV NAT'L TAX J. 15 (1972).
64. 1 ROYAL COMM'N REPORT, *supra* note 2, at 9-10.
65. 3 ROYAL COMM'N REPORT, *supra* note 2, at 51.
66. 1 ROYAL COMM'N REPORT, *supra* note 2, at 18-19.
67. *Id.* at 20.
68. 3 ROYAL COMM'N REPORT, *supra* note 2, at 100.
69. *Id.* at 178.
70. *Id.* at 312.
71. *Id.* at 256.
72. 1 ROYAL COMM'N REPORT, *supra* note 2, at 17.

in the taxable base.[73]
6. Working wives would be entitled to a limited credit for each dependent child;[74]
7. Corporate and personal income taxes would be integrated; the corporate tax would continue to be collected for withholding purposes only;[75]
8. Tax preferences for mineral extraction would be significantly reduced;[76]
9. Insurance and banking enterprises would be taxed more nearly like other businesses;[77]
10. Sales and excise taxes would be eventually abolished.[78]
11. Withholding tax on income would be extended to various kinds of receipts;[79]
12. Tax administration would be simplified by various changes, with a proposal for a mandatory system of advance rulings on the tax consequences of intended transactions.[80]

In general the Carter Commission Report adhered faithfully to the principle of a comprehensive tax base. It defended the elimination of various tax preferences and special treatment of different taxpayer groups in favor of a broad base subject to substantially lower progressive rates. The free market system would control investment and business decisions instead of tax gimmickry or the tax angle. Its detailed analysis and voluminous supporting charts and tables provide a model for reformers who seek the same path to tax reform. It was obviously a resource for the U.S. Treasury in the publication of *Blueprints.*

B. 1967 to the Present

The Carter Commission Report was widely distributed, intentionally so in order to elicit response from a broad sector of the Canadian population. In November 1969 the government issued a White Paper on Tax Reform in response to the Commission Report.[81] The "white paper" approach is used by the Canadian government to test the response to executive proposals without risking parliamentary rejection. Thus, if the government were to sponsor measures not commanding a majority vote, this might indicate a want of confidence which would require the government's resignation. The White Paper retreated somewhat from the Carter Report in an effort to find a ground upon which satisfactory compromise legislation could be adopted. The Carter Report and the White Paper thus provided positions on which a vigorous national debate was focused. The parliamentary response was the Income Tax Act of 1971.[82] This legislation did not go so far as the Carter Report, but it did begin to implement the principles of the Report through base broadening, lower rates, and the partial integration of the individual and corporate income tax.[83] The subsequent developments in tax legislation in Canada have been not unlike those in the United States in that patchwork amendatory legislation has tended to blur the model originally proposed in the Report. Nevertheless, Canada did lead the way in achieving tax objectives which the

73. *Id.* at 19.
74. 3 ROYAL COMM'N REPORT, *supra* note 2, at 193.
75. 1 ROYAL COMM'N REPORT, *supra* note 2, at 27.
76. *Id.* at 26.
77. 4 ROYAL COMM'N REPORT, *supra* note 2, at 381-438.
78. 5 ROYAL COMM'N REPORT, *supra* note 2, at 3-10.
79. *Id.* at 131-159.
80. *Id.* at 136.
81. Bucovetsky & Bird, *supra* note 62, at 18.
82. Income Tax Act, c. 63 Can. Stat. 1131 (1971) [hereinafter cited as 1971 Income Tax Act].
83. The legislation is reviewed in detail in Bucovetsky & Bird, *supra* note 63, at 23.

United States has adopted more recently or is still considering. Some of these principal achievements and their American parallels should be noted:

1. *Rate reduction.* The Carter Commission recommended that individual tax rates progress no higher than 50 percent. In fact, they now progress to 43 percent.[84] Effective in 1982 rates in the United States will progress only to 50 percent.[85]

2. *Indexing.* Since 1973 Canada has indexed current year rates and exemptions in accordance with the average Consumer Price Index for the twelve months ending September 30 of the previous year.[86] Effective in 1985 the same system will go into effect in this country.[87]

3. *Fringe benefits.* Canada requires a closer accountability of fringe benefits by requiring employers to place a value on such items.[88] Efforts in this country to promulgate regulations requiring such accountability have been deferred until December 31, 1983.[89]

4. *Capital cost recovery.* Pursuant to the Carter Report recommendations Canada provides generous capital cost allowances on the declining balance method.[90] The new Accelerated Cost Recovery System in the United States under which the cost of tangible property may be recovered over three, five, ten, or fifteen year periods has only recently gone into effect for all post-1980 investments.[91]

5. *Estate and gift tax provisions.* Canada has no estate and gift tax but requires all accounting for appreciation in asset values at death, in certain cases at the time of gift, or on leaving Canada.[92] New estate and gift tax rules in this country which phase-in fully by 1987 will eliminate estate and gift taxes on all but a few estates.[93] Assets passing to estate beneficiaries are entitled to a step up in basis to death time value, irrespective of any estate tax liability.[94]

6. *Integration of corporate and personal income taxes.* Canada recognizes the element of a double tax on corporate dividends at both the corporate and shareholder level. Generally, individual recipients of dividends include 150 percent of the dividend in income and claim a credit against their tax of 75 percent of the "grossed

84. 1971 Income Tax Act, *supra* note 82, ¶ 117, as amended by c. 10 Can. Stat. 348 (1977) (adding subsection 5.1); *See also* [1978] 3 CANADIAN TAX REP. (CCH) 12,030.

85. ERTA, *supra* note 42.

86. 1971 Income Tax Act, *supra* note 82, ¶ 117.1(1)(f), as amended by c. 4 Can. Stat. 96 (1977); *See also* [1979] 3 CANADIAN TAX REP. (CCH), 12,046.

87. ERTA, *supra* note 42, 104(a) (amending I.R.C. § 1).

88. 1971 Income Tax Act, *supra* note 82, § 6(1)(a), as amended by c. 48 Can. Stat. 1275 (1981); *See* [1981] 6 CANADIAN TAX REP. (CCH) 35,504. *See also* INTERPRETATION BULL. no. 1T-71R, *reprinted in* [1981] 5 CANADIAN TAX REP. (CCH) ¶ 52,078; INTERPRETATION BULL. No. 1T-470, *reprinted in* [1981] 5 CANADIAN TAX REP. (CCH) 52,475.

89. ERTA, *supra* note 42, § 801.

90. 1971 Income Tax Act, *supra* note 82, § 20(1)(a); INCOME TAX REGULATIONS 1100-06, *reprinted in* [1981] 6 CANADIAN TAX REP. (CCH) ¶ 37,132-213.

91. ERTA, *supra* note 42, § 201 (adding I.R.C. § 168).

92. 1971 Income Tax Act, *supra* note 82, §§ 48, 70. *See* Bird, *Canada's Vanishing Death Taxes,* 16 OSGOODE HALL L.J. 133 (1978); Carter, *Federal Abandonment of the Estate Tax: The Intergovernmental Fiscal Dimension,* 21 CANADIAN TAX J. 239 (1973).

93. ERTA, *supra* note 42, §§ 401-03 (amending I.R.C. §§ 2001, 2010).

94. I.R.C. § 1014.

up" amount.[95] Although there has been suggestion in the United States of such a system, no such measure has been adopted.[96] Only an exclusion of a minimum amount of dividend income is permitted.[97]

III
OVERVIEW

What may be concluded from the history of tax reform in the two countries? The literature in the United States assumes as a starting point some kind of comprehensive tax base, although to be sure, the writers are not in agreement as to the precise formulation of the definition of such a base.[98] Any effort to move in the direction of a comprehensive base must, however, deal with practical realities. In a complex economic order ingenious advisers will continue to devise ways to avoid the full impact of the tax bite, to which there is a legislative response. New laws, new regulations and rulings, and court decisions further complicate the process.[99] The lofty ideals in the charge to the Carter Commission or in the introduction to *Blueprints* speak to equity, fairness, simplicity, ease of compliance and administration, and promotion of economic growth and stability. Yet these ideals, so efficacious and worthy, inevitably come into collision with the politics of a representative democracy. It has been said that for special interest groups the plea is always "don't tax him and don't tax me, but tax that man behind that tree."

Surely, special interest groups work as hard for their causes in Canada as they do here; yet the Canadians did organize a Carter Commission, publish a White Paper, and conduct a thorough national debate on tax reform, out of which legislative progress was accomplished.[100]

Could not the same be done here? And, as part of the same endeavor, could not other forms of taxation be considered, either as supplements to or as substitutes for the income tax?[101] The value-added tax has been used with some success in

95. 1971 Income Tax Act, *supra* note 82, §§ 82(1), as amended by c. 1 Can. Stat. 58 (1977), 121, as amended by c. 1 Can. Stat. 107 (1977). *See* [1978] 2 CANADIAN TAX REP. (CCH) 7025; [1978] 3 CANADIAN TAX REP. (CCH) ¶ 12,491.

96. The integration of corporate and personal income tax has been recommended in the U.S, but not adopted. *See* BLUEPRINTS, *supra* note 30, at 68; McClure, *Integration of the Personal and Corporate Income Taxes: The Missing Element in Recent Tax Reform Proposals*, 88 HARV. L. REV. 532 (1975); Special Committee on Simplification, Section of Taxation, American Bar Association, *Evaluation of the Proposed Model Comprehensive Income Tax*, 32 TAX LAW 563, 598 (1979).

97. I.R.C. § 116.

98. *See generally*, B. BITTKER, C. GALVIN, R. MUSGRAVE & J. PECHMAN, A COMPREHENSIVE INCOME TAX BASE (1968); G. BREAK & J. PECHMAN, FEDERAL TAX REFORM (1975); J. PECHMAN, COMPREHENSIVE INCOME TAXATION (1977); S. SURREY, PATHWAYS TO TAX REFORM (1973); C. GALVIN & B. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? (1976); Peel, *An Approach to Income Tax Simplification*, 1 U. ARK. LITTLE ROCK L. J. 1 (1978).

99. Bittker, *Reflections on Tax Reform*, 47 U. CIN. L. REV. 185 (1978).

100. *But see* BUCOVETSY & BIRD, *supra* note 63, at 39.

> The fact that Canada has ended up with a reformed tax system which in some key respects looks more like the present U.S. system than it does the pattern set forth in the Royal Commission Report should give pause to reform-mongers everywhere. Instead of U.S. tax policymakers looking to the true North for well-argued logical inspiration, as many prominent American public finance scholars suggested in the post-Carter heyday, Canadian policymakers appear to have ended up looking South for politically acceptable compromises.

101. A recent study on tax burdens demonstrates that the "overall effective rate of federal, state and

Europe; it could provide needed revenues to finance the U.S. defense effort or to restore solvency to the social security system.[102] Such questions and many others bespeak the importance of a long range study under bipartisan auspices. Should such an undertaking be contemplated, the Canadian experience can provide useful insights as to the appropriate organization and the ongoing conduct of the inquiry.

---

local taxes in 1966 averaged nearly the same across most of the range of family incomes." Manvel, *Another Look at Comparative Tax Burdens,* XII TAX NOTES 478 (1981). Interestingly, total tax revenues as a percentage of gross national product were almost identical for Canada and the United States in 1979 (31.2 percent and 31.3 percent respectively). Perry *Fiscal Figures,* 29 CANADIAN TAX J. 99, 101 (1981).

102. Galvin, *The Value-Added Tax—A Proposal for the 80's,* 7 PEPPERDINE L. REV. 505 (1980); *The Value Added Tax—A Symposium* 6 J. CORP. LAW 5 (1980).

The economic, accounting and legal literature is replete with articles on the value-added tax. One of the best analyses with references to many of the extant sources is A.B.A. SECTION OF TAXATION, REPORT OF THE SPECIAL COMMITTEE ON THE VALUE-ADDED TAX (1977), a collection of five committee essays. *See Report of the Special Subcommittee of the Committee on General Income Tax Problems of the Value-Added Tax,* 24 TAX LAW 419 (1971); Subcommittee of the Special Committee on Value-Added Tax' (Should the United States Adopt the Value-Added Tax?—A Survey of the Policy Considerations and the Data Base,) 26 TAX LAW 45 (1972); Special Committee on the Value-Added Tax of the Tax Section of the American Bar Association, *Technical Problems in Designing a Broad-Based Value-Added Tax for the United States,* 28 TAX LAW 193 (1975); Special Committee on the Value-Added Tax of the Section of Taxation, *The Choice Between Value-Added and Sales Taxation at Federal and State Levels in the United States,* 29 TAX LAW 457 (1976); Special Committee on the Value-Added Tax of the Section of Taxation, *Evaluation of an Additive-Method Value-Added Tax in the United States,* 30 TAX LAW 565 (1977). *See also* J. DUE, SALES TAXATION (1957); D. SMITH, J. WEBBER & C. CERF, WHAT YOU SHOULD KNOW ABOUT THE VALUE-ADDED TAX (1973); Cohen, *Foreign Experience with the Value-Added Tax,* 24 NAT'L TAX J. 399 (1971); Smith, *Value-Added Tax: The Case For* 48 HARV. BUS. REV. 77 (Nov.-Dec. 1970); Surrey, *A Value-Added Tax for the United States—A Negative View,* 21 TAX EXEC. 151 (1968).