



Canadian Tax Foundation
L'Association Canadienne
d'Etudes Fiscales

Thirty-fifth Annual Report

For the year ending December 31, 1980

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TORONTO, CANADA

Thirty-Fifth Annual Report

For the year ending

December 31, 1980

CANADIAN TAX FOUNDATION

L'Association Canadienne d'Etudes Fiscales

THE BOARD OF GOVERNORS

Elected April 14, 1981

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* J. C. Couture, Q.C.	Montreal
J. M. Coyne, Q.C.	Ottawa
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R. F. Lindsay, Q.C.	Toronto
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P. E. McQuillan, F.C.A.	Toronto
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* Executive Committee of the Board of Governors

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J. C. Couture, Q.C. Vice-Chairman and
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Molyneaux L. Gordon, K.C. (deceased)

Gordon R. Munnoch, K.C. (deceased)

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M. Gerald Teed, Q.C. (deceased)

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* Jacques Raymond, C.A., Montreal

* George T. Tamaki, Q.C., Toronto

* William E. Goodlet, F.C.A., Toronto

* Advisory Committee of Past Chairmen

STATEMENT OF FINANCIAL POSITION
AS AT DECEMBER 31, 1980

(With comparative figures for 1979)

ASSETS

CURRENT ASSETS	1980	1979
Cash	\$ 210	\$ 122,254
Investments, at cost (note 2)	2,349,500	1,839,500
Accounts receivable and deposit	25,131	40,479
	<u>2,374,841</u>	<u>2,002,233</u>
FIXED ASSETS		
Furniture and office equipment	72,709	54,414
Leasehold improvements	90,400	14,835
	<u>163,109</u>	<u>69,249</u>
Accumulated depreciation and amortization	17,200	43,919
	<u>145,909</u>	<u>25,330</u>
	<u>2,520,750</u>	<u>2,027,563</u>
TRUST FUND		
Cash	4,450	5,979
	<u>\$2,525,200</u>	<u>\$2,033,542</u>

LIABILITIES AND RESERVE

CURRENT LIABILITIES	1980	1979
Bank indebtedness	\$ 73,995	
Accounts payable	267,653	207,100
Deferred revenue	283,793	234,212
Contributions for publication series, Financing Canadian Federation		32,099
	<u>625,441</u>	<u>473,411</u>

RESERVE

Retained for continuation of the Foundation's activities		
Balance, beginning of year	1,554,152	995,377
Excess of revenue over expense	341,157	558,775
Balance, end of year	<u>1,895,309</u>	<u>1,554,152</u>
	<u>2,520,750</u>	<u>2,027,563</u>

TRUST FUND LIABILITY

Taxation and economic growth study fund, joint project with Queen's University	4,450	5,979
	<u>\$2,525,200</u>	<u>\$2,033,542</u>

Approved on behalf of the Board of Governors:

Stanley E. Edwards
Chairman

Charles Pelletier
Vice-Chairman

STATEMENT OF REVENUE AND EXPENSE
FOR THE YEAR ENDED DECEMBER 31, 1980

(With comparative figures for 1979)

REVENUE	1980	1979
Subscriptions		
Corporate	\$ 187,827	\$ 178,950
Individuals	<u>377,913</u>	<u>349,053</u>
	<u>565,740</u>	<u>528,003</u>
Investment income	235,811	153,817
Conferences	<u>851,101</u>	<u>783,907</u>
	<u>1,652,652</u>	<u>1,465,727</u>
 EXPENSE		
Research salaries	226,271	203,259
Research consulting	5,187	14,231
Publications	150,267	95,788
Special studies	20,394	16,850
Books and periodicals, library	24,667	17,869
Conferences - direct expense	413,717	321,366
Salaries - administration	115,720	105,575
Pension and insurance plans	89,861	34,144
Rent	100,856	39,442
Travelling	18,812	13,806
Telephone and telegraph	7,050	6,452
Postage	29,671	18,534
Office printing, stationery and supplies	18,782	5,835
General office expense	24,177	8,848
Depreciation and amortization expense	16,401	4,953
Loss on disposal of fixed assets	19,053	
Relocation	<u>30,609</u>	
	<u>\$1,311,495</u>	<u>\$ 906,952</u>
Excess of Revenue over Expense	<u>\$ 341,157</u>	<u>\$ 558,775</u>

STATEMENT OF TRUST FUND LIABILITY
FOR THE YEAR ENDED DECEMBER 31, 1980

	1980	1979
Balance, beginning of year	\$ 5,979	\$ 10,035
Interest income	<u>471</u>	<u>944</u>
	<u>6,450</u>	<u>10,979</u>
Expense of special study	<u>\$ 2,000</u>	<u>\$ 5,000</u>
	<u>\$ 4,450</u>	<u>\$ 5,979</u>

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED DECEMBER 31, 1980

(With comparative figures for 1979)

SOURCE OF WORKING CAPITAL	<u>1980</u>	<u>1979</u>
From operations		
Excess of revenue over expense	\$ 341,157	\$ 558,775
Depreciation and amortization not requiring a current outlay of working capital	16,401	4,953
Loss on disposal of fixed assets	<u>19,053</u>	<u></u>
	376,611	563,728
APPLICATION OF WORKING CAPITAL		
Additions to fixed assets	<u>156,033</u>	<u>6,168</u>
INCREASE IN WORKING CAPITAL	220,578	557,560
WORKING CAPITAL, BEGINNING OF YEAR	<u>1,528,822</u>	<u>971,262</u>
WORKING CAPITAL, END OF YEAR	<u>\$1,749,400</u>	<u>\$1,528,822</u>
COMPONENTS OF WORKING CAPITAL		
Current assets	\$2,374,841	\$2,002,233
Current liabilities	625,441	473,411
	<u>\$1,749,400</u>	<u>\$1,528,822</u>

NOTES TO FINANCIAL STATEMENTS

December 31, 1980

(With comparative figures for 1979)

1. Summary of accounting policies

(a) Fixed assets

Fixed assets are stated at cost. Depreciation and amortization are provided over the estimated useful lives of the assets on a straight-line basis at 10% per annum.

(b) Deferred revenue

Subscription revenue applicable to future period is deferred.

2. Investments	1980	1979
Guaranteed investment certificates		
8-1/4% to 8-3/4% due 1982	\$ 100,000	\$ 190,000
Royal Trust Company, M Fund		
10,115.348 units	100,000	100,000
Government of Canada		
\$100,000 10% due June 1, 1984	99,750	99,750
50,000 10-1/4% due February 1, 2004	49,750	49,750
Kinross Mortage Corporation		
Debenture 10% due 1980		100,000
Term Deposits		
Canadian Imperial Bank of Commerce		
11.35% due January 1981	100,000	700,000
Bank of Montreal		
11% to 17.5% due January to		
February, 1981	500,000	600,000
Mercantile Bank		
14.75% to 16.9% due January, 1981	600,000	
Continental Bank		
11.45% to 18.3% due January to		
February 1981	400,000	
Royal Trust		
11.25% to 15.5% due January, 1981	400,000	
	-----	-----
	\$2,349,500	\$1,839,500
	-----	-----
Market value	\$2,334,543	\$1,823,416
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3. Lease commitments

The Foundation rents office space under a lease expiring in 1990. The basic annual rent is \$153,888 until 1985 and \$174,755 thereafter plus an amount representing property tax and operating costs.

AUDITOR'S REPORT

The Board of Governors and the Members,

Canadian Tax Foundation

L'Association Canadienne d'Etudes Fiscales

We have examined the statement of financial position of the Canadian Tax Foundation/L'Association Canadienne d'Etudes Fiscales as at December 31, 1980 and the statement of revenue and expense, trust fund liability and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests and other procedures as we consider necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Canadian Tax Foundation as at December 31, 1980 and the results of its operations and the changes in its financial position for the year then ended, in accordance with generally accepted accounting principles on a basis consistent with that of the preceding year.

Toronto, Ontario
January 21, 1981

Jarrett, Goold & Elliott
Chartered Accountants

REPORT OF THE CHAIRMAN
TO THE THIRTY-FIFTH ANNUAL MEETING OF THE
CANADIAN TAX FOUNDATION

APRIL 15, 1981

In presenting this thirty-fifth annual report of the Chairman, it is my happy privilege to be able to record a busy and productive year in the affairs of the Foundation, marked by the publication of important studies, a significant advance in most of the projects underway, and useful exploration of new tasks considered for assumption in the future. Our conference program continued to attract large numbers of registrants, our membership has increased, our revenues have risen, and we have acquired vastly improved quarters for our office. With all this we have managed to run our affairs with a substantial balance on the credit side of the books.

I propose to discuss the details of certain events of the past year, and the Director will deal with other aspects of our activities in his report.

Membership and Finance

The Foundation relies today, as it has since its inception, on individual and corporate memberships as a principal source of revenue. It is gratifying to be able to report continuing growth in both categories in 1980. There was a net addition to the rolls of 19 new corporate subscribers compared with 5 in 1979 and 439 new individual members compared with 31 in the previous year. Total membership at December 31, 1980 was made up of 8,389 individual members and 405 corporate members. A further 200 companies are represented through association memberships on their behalf. (It should be noted that a careful count recently of the individual memberships revealed that the number reported in previous years had been substantially below the actual number.) To the end of March 1981 we have had a net increase of 28 individual members and 3 corporate subscribers.

When one considers the continuing high level of interest in the field of taxation and the number of practitioners, businessmen, students, and others who would derive real benefit from the Foundation, there seems no reason to doubt that our support will continue to grow. We are constantly seeking to attract new members, both individual and, particularly, corporate. Apart from the financial considerations,

it is important that all regions and interests be adequately represented in a national organization such as ours. Members can assist us by referring to the Foundation or to a governor any company that might subscribe if approached.

Members will have received audited comparative financial statements for 1980 with the Notice of the Annual Meeting. They provide a complete picture of the fiscal aspects of the Foundation's affairs, setting out the assets and liabilities, revenue and expenditures, and investments. It will be apparent to all that while our finances are in good order, we are far from qualifying for the description that was once applied to the Ford Foundation: "a large body of money completely surrounded by people who want some."

To help you translate this array of figures into the practicality of our operations, there are a few matters I bring especially to your attention. Subscription revenues were up appreciably, from \$528,000 in 1979 to \$565,000 in 1980, partly because of new members and also because of the modest increases in membership fees, from \$50 to \$55 in the individual membership rate and from \$200 to \$225 in the minimum corporate subscription. There were also increases totalling \$11,785 in the contributions of 131 corporate members. Their generosity is much appreciated. Conferences and investments have produced income that is indispensable for the support of our operations and that has permitted the expansion of the Foundation's activities during a period of inflation. Our conferences, particularly the Annual Conference, generated net revenue of \$437,000 last year compared with \$462,000 in the previous year. Investment income increased from \$154,000 in 1979 to \$236,000 in 1980.

Expenditures rose by some \$404,000, the main increases being for rent, publications, and salaries. We do not wish the turnover rate for the staff to be unduly high. For this reason as well as the more fundamental desire to be fair to all concerned, we must be properly attentive to matters such as salary comparability and other conditions of employment. In this connection we have recently improved the Foundation's pension plan so that the benefits for employees will not be out of phase with contemporary standards being followed by other nonprofit organizations. The pensions for retired members of the staff were also increased. The year ended with a favourable balance of \$341,157. Let me conclude this portion of my remarks by noting that we make every effort to put our resources to the best possible uses. Our objective is to try to ensure that the Foundation will continue to carry on its present programs with distinction and yet be able to move ahead to a vigorous and useful future.

New Premises

A significant improvement in the Foundation's facilities in the past year resulted from the move to new quarters. The premises occupied on the seventh floor of 100 University Avenue since May 1972 were vacated last September. The new offices, which will be the Foundation's home for the next ten years, are located on the nineteenth floor of the Continental Bank Building and were designed specifically for the needs of the Foundation.

Those of you who have had the opportunity of visiting them will agree with me that they are well planned and spacious and tastefully, if modestly, furnished. Although the rent is considerably higher than we have paid in the past, in light of the rapid escalation in rental rates in downtown Toronto in the few months since we moved, we are pleased to have made the arrangements for new accommodation when we did. We now have adequate space for staff offices and the growing library and we feel well satisfied with the result.

Conferences

There is little doubt that the Foundation's conference program is equal in importance to any other phase of its operations. The Annual Conference last November was attended by nearly 1600 persons, making it the largest Foundation conference ever to be held in Montreal. Some 60 speakers from the professions, business, government, and the universities discussed a wide variety of topical tax issues. We were privileged to have with us two senior ministers of the federal government, the Honourable Allan J. MacEachen, Minister of Finance, who was the guest of honour at the banquet, and the Honourable Marc Lalonde, Minister of Energy, Mines and Resources, who addressed a plenary session on the National Energy Program. As a service to members, over 6,000 copies of papers delivered at the conference have been provided at nominal cost. Every effort is being made to expedite the preparation of the report of the proceedings, which is scheduled for publication late next month.

The two-day Corporate Management Tax Conference, which was devoted to a discussion of "Income Tax Aspects of Corporate Financing," was held in Toronto in June. A second presentation in Calgary in October was nearly cancelled by reason of a labour dispute at the Toronto International Airport, which prevented the Toronto speakers from taking commercial flights to Calgary. Only by chartering an aircraft was it possible for them to arrive in time for the conference.

As for the regional conference program, the Prairie Provinces Tax Conference was held in Winnipeg in January, and the

British Columbia Tax Conference, which is co-sponsored by the Faculty of Law at the University of British Columbia, in Vancouver in May. Our annual French language conference, *Journées d'études fiscales*, was held in Montreal in September. Finally, the Atlantic Provinces Tax Conference, jointly sponsored by the Institute for Public Administration at Dalhousie University, was held in Halifax in October.

The conference program for 1981 will be the most ambitious in our history. In addition to our regular conferences, two special conferences are on the agenda. The first of these was held in Toronto in March and dealt with "Tax Policy Options in the 1980's." Nearly 200 conferees were in attendance to hear and to participate in discussions of a group of papers each of which addressed a specific area of taxation and considered the consequences of policy changes in the structure and role of particular taxes. In addition to providing a comprehensive assessment of the current tax system, the conference was intended to stimulate an exchange of views about possible options and new directions in tax policy over the next decade.

A second special conference will be devoted to an examination and analysis of recent developments in the tax treatment of the petroleum industry, particularly under the National Energy Program. It is tentatively scheduled for June 1-2 in Calgary. However, if the omnibus oil and gas bill and important regulations, which would be the main features of the conference, are not available sufficiently in advance of these dates to permit speakers to prepare papers, the conference will be deferred until the fall.

This year's Corporate Management Tax Conference, the eighteenth in this series of meetings designed for our corporate members, will be devoted to the discussion of a topic of fundamental importance, "Income Tax Aspects of Measuring Business Profits." It will be held in Toronto in June and in Edmonton in October. The timeliness of the conference is underscored by recent administrative, legislative, and judicial developments involving the use of generally accepted accounting principles, inventory valuation, lease options, and the deductibility of expenses.

Finally, as has already been announced, the Annual Conference will be held in Vancouver in November. We devote much thought to the formulation of the program for this major event and certainly we shall welcome suggestions from our members.

Revision of the By-laws

Two amendments to the by-laws will be submitted for your approval at the meeting. The first increases the size of the Board of Governors from 32 to 34 members. The enlargement of the Board will permit increased representation from the West, where burgeoning economic activity has left in its wake a growing interest in taxation and in the work of the Foundation.

The second amendment increases the quorum for a Board Meeting from 6 to 14 governors. Notice of these two amendments was given with the Notice of the Annual Meeting.

Board of Governors

The composition of the Board of Governors will undergo substantial change today. The retiring members are 11 in number:

J. R. Brown, C.A. -- Toronto (formerly Montreal)
P. J. Cloutier, C.A. -- Quebec
G. B. Cooper, Q.C. -- Moncton
G. E. Cronkright, F.C.A. -- Toronto
J. J. A. Dierker -- Saskatoon
G. Drolet -- Quebec
P. N. Geer, C.A. -- Vancouver
W. E. Goodlet, F.C.A. -- Toronto
G. E. Noren, C.A. -- Moose Jaw
J. G. Smith -- Vancouver
D. Y. Timbrell, F.C.A. -- Toronto

On your behalf, and for myself as well, I wish to thank these gentlemen for their valued services to the Foundation and their guidance and encouragement in its work. We shall continue to look for their active interest and support during the years to follow.

A special word of thanks is due to William E. Goodlet, F.C.A., who retires as Past Chairman of the Board of Governors. Mr. Goodlet has served as governor for seven years in all, from 1971 to 1974 and from 1977 to 1981. At all times he gave liberally of his energies and abilities, and we welcome him to membership in the Advisory Committee of Past Chairmen.

I also wish to give special thanks to Doug Sherbaniuk and all the members of the staff of the Foundation. Doug has provided outstanding leadership and we are grateful for his continuing dedication to the work of the Foundation. We have an excellent staff and we are indebted to all of them for making the Foundation the success that it is.

The Presidents of the Canadian Institute of Chartered Accountants and the Canadian Bar Association have nominated the following 11 new governors to fill the vacancies occasioned by the retirements:

D. G. Barry -- Saint John
D. W. Davies, F.C.A. -- Toronto
R. G. Dittmer, C.A. -- Saskatoon
H. R. Germain, C.A. -- Montreal

L. A. Kyle -- Regina
M. A. Leduc -- Montreal
B. G. Levine, C.A. -- Montreal
P. E. McQuillan, F.C.A. -- Toronto
G. W. Riehl, F.C.A. -- Toronto
G. A. Stekl, C.A. -- Vancouver
D. G. Sweet, F.C.A. -- Vancouver

Mr. Riehl and Mr. Sweet are returning for a second tour of duty, Mr. Riehl having served previously from 1972 to 1975 and Mr. Sweet from 1969 to 1972.

Conclusion

There is evidently a high level of interest in our work on the part of the legal and accounting professions, the business and academic communities, and government. Our membership is growing, our publications have higher sales and greater use in universities, and the attendance at our conferences continues to increase. These factors indicate that we are making a useful contribution in the tax field in Canada.

As the activities of the Foundation continue to expand, it is not possible to acknowledge by name and accomplishment in the limited space of this report the many individuals who participated in the work of the Foundation, particularly as participants in our conferences and contributors to our publications. These many individuals are helping to advance knowledge of the tax system and contribute to its improvement. We are very grateful for the many hours, intellectual effort, and other personal resources they commit for the betterment of the tax community.

I now move, seconded by Charles Pelletier, C.A., the following resolution -- namely, that this report of the Foundation for the fiscal year ending December 31, 1980 and the financial statements of the Foundation as of the same date as submitted to this meeting be, and they are hereby, approved and adopted.

S. E. Edwards, Q.C.
Chairman
April 14, 1981

REPORT OF THE DIRECTOR
TO THE THIRTY-FIFTH ANNUAL MEETING OF THE
CANADIAN TAX FOUNDATION
APRIL 14, 1981

Tax Evasion -- Some Random Thoughts on Its
Dimensions and Causes

At the Annual Meeting in 1977, we commented on the apparent increase in income tax evasion in Canada and the threat that this phenomenon posed for the self-assessment system, which is the cornerstone of the Canadian mechanism of tax collection. We noted at the time that lack of data about the form and extent of tax evasion in Canada made it difficult to determine what measures to adopt in order to thwart it. In the intervening four years, perhaps the most significant event in the illumination of the problem of tax cheating has been the attempt in a number of studies, including a recent Canadian one, to quantify the magnitude and rate of growth of the so-called underground economy (also called the subterranean economy, the irregular economy, and the unobserved sector of the economy), which has significant implications for tax collection.

The underground economy has been defined as "that part of the economy which goes largely unmeasured by both GNP statisticians and tax officials." ^{1/} It includes unreported income from legal sources, such as moonlighting and bartering, and also income from illegal sources, such as trafficking in narcotics, illicit gambling, prostitution, and loan sharking.

Although our concern with the underground economy relates to tax evasion, it has other important implications. By concealing economic activity in order to avoid taxes and regulation, individuals also make it more difficult for the federal government to monitor the health of the economy. If the underground sector is growing more rapidly than the rest of the economy, for example, inflation and unemployment may be overestimated and GNP growth underestimated. As a result, policy makers may adopt inappropriate or perverse solutions to misconceived problems.

Until recently there were no estimates of the size of the underground economy in the United States. Within the last four years, however, three different estimates have become available in published papers reflecting three different approaches -- one by Peter Gutmann, another by Edgar L. Feige, and the third by the Internal Revenue Service.

^{1/} Smith and Mirus, "Canada's Irregular Economy" (unpublished, 1981).

In 1977 Professor Guttman wrote a short article ^{2/} estimating that in 1976 the underground economy in the United States equalled \$176 billion. He has recently re-estimated his results and has concluded that, for 1979, the underground economy can be "conservatively" estimated at \$250 billion. For both years the estimates are a little over 10 per cent of legal Gross National Product. He arrived at his estimates essentially by comparing the amount of cash in circulation with the amount of money held in demand deposits (chequing and savings accounts). He found that, since 1961, currency in circulation has been rising more rapidly than demand deposits. This reverses a long-time trend towards the cashless society, a reversal that is especially surprising given the increased use of credit cards. He concluded that the rise in the use of cash was attributable to lubricating the underground economy.

Professor Feige has presented another, and somewhat more startling, estimate of what he describes as the irregular economy. ^{3/} His methodology takes into account the use of cash and cheques. The irregular economy is estimated between \$225 billion and \$369 billion in 1976 and between \$541 billion and \$704 billion in 1978. In relation to GNP these estimates range from 13 to 22 per cent in 1976 and from 25 to 33 per cent in 1978.

The Internal Revenue Service issued a major report on tax evasion in August 1979, ^{4/} producing the first official estimates of the extent of compliance with the demands of reporting for federal income tax purposes. It was not, it should be noted, attempting to measure the irregular economy as Guttman and Feige were. The report estimates that individuals did not report \$75 billion to \$100 billion of 1976 income in the legal sector of the economy, resulting in a revenue loss of approximately \$13 to \$17 billion. In addition, individuals engaged in illegal activities were estimated to earn from \$25 to \$35 billion on which the revenue loss ranged from \$6 to \$9 billion. In summary, in 1976 the federal government failed to collect taxes of up to \$26 billion that were owed on a total of between \$100 and \$135 billion of unreported income.

^{2/} Guttman, "The Subterranean Economy", Financial Analysts Journal, November-December 1977, page 26.

^{3/} Feige, "How Big Is the Irregular Economy?" Challenge, November-December 1979, page 5.

^{4/} United States Department of the Treasury, Internal Revenue Service, Estimates of Income Unreported on Individual Income Tax Returns, Publication 1104 (9-79) (Washington, D.C.: 1979).

The underground economy is not, of course, peculiar to the United States but is rather a world-wide phenomenon. In the United Kingdom, for example, according to Sir William Pile, Chairman of the Board of Inland Revenue, "it is not implausible" that earnings which evade tax might be as much as £10 billion a year, which is equivalent to about 7.5 per cent of the GNP. If taxed, they would yield revenue totalling about £3 to £4 billion. 5/

Canada appears also to be afflicted. In a recent unpublished paper, Professor Roger S. Smith and Rolf Mirus have estimated the magnitude and rate of growth of the irregular economy in Canada, using both the Gutmann and Feige methodologies. First, using the Gutmann approach, they estimate that in 1978 the irregular economy represented 12.44 per cent of total economic activity, amounting to \$33 billion. Using the Feige methodology, they estimate that 19 per cent or \$55 billion of economic activity in Canada was of the irregular variety in 1978. Moreover, it has grown from 5 per cent of the total in 1955 to over 12 per cent in 1978. Their conclusion is that the irregular economy in Canada is large and growing rapidly.

Little information is available from official government sources as to the magnitude of tax evasion in Canada. An officer of Revenue Canada recently estimated that "the government was cheated out of a minimum of \$3.5 billion in taxes last year, or 10 per cent of all the tax money it collected." 6/ It is not clear how the figure was arrived at.

Commentators have been sharply critical of the methodologies of Gutmann and Feige and, in light of the wide divergence in their estimates, understandably so. Nevertheless, while a healthy scepticism of their work is justified, it has served the useful purpose of pointing out a problem serious enough to warrant the expenditure of further time and effort in estimating the size and composition of the underground economy. As one commentator on the IRS study remarked, "What it demonstrates most clearly is how little the government knows about tax evasion." 7/ The same may well be true of Canada.

5/ See Ilersic, "Tax Evasion in the United Kingdom" (November-December 1979), 27 Canadian Tax Journal 693.

6/ Toronto Star, February 9, 1981, page A10, reporting an interview with James L. Gourlay, Director General, Compliance Directorate, Revenue Canada, Taxation.

7/ Reuter, "A Reading on The Irregular Economy," Taxing & Spending, Spring 1980, page 65 at 67.

Causes of Tax Evasion

As a result of the studies of the underground economy, for the first time in recent history the mass evasion of personal taxes in the United States has become a subject of serious policy discussion. In 1979 the Commissioner of Internal Revenue stated that "...the Service contracted with a private sector research firm last fall to develop methods to determine the relative impacts of factors that influence compliance with tax laws. We want to know what makes people comply or not comply with the tax laws." 8 /

Why, indeed, do taxpayers comply with the income tax to the extent they do? An individual taxpayer may have various motives for assessing himself honestly:

- (1) he thinks that the system is relatively fair and therefore he is willing to comply with it;
- (2) even if he is not convinced that the system is fair, he may have personal standards, perhaps influenced by religious and cultural factors, under which he regards it as a duty to comply with the law; and
- (3) he may be fearful of being caught and punished if he cheats.

There appear to be no empirical data for Canada as to taxpayers' motivations with respect to compliance, although studies have been done elsewhere. While this is not an appropriate occasion for an exhaustive review of the literature, perhaps the likely influence of a few important factors is worth mentioning.

1. Tax Equity

In his address at a recent Foundation conference, Professor Richard Musgrave elevated fairness in taxation to its appropriate status: "A proper sense that the tax structure is reasonably equitable is a prerequisite to a sound social structure and the functioning of democracy." 9 /

8 / "Statement of Jerome Kurtz, Commissioner of Internal Revenue, before the Joint Economic Committee, November 15, 1979."

9 / Luncheon address at the conference on "Tax Policy Options in the 1980s," Toronto, March 4-5, 1981.

The Commissioner of Internal Revenue in the United States shared this view when he observed "...voluntary compliance turns not only on enforcement efforts but to a significant but unmeasurable extent on the perception and reality that the system treats taxpayers decently and fairly." 10/ If taxpayers are to be expected voluntarily to comply with the tax laws, they must perceive the system to be fair and they must be satisfied that other taxpayers are paying their appropriate share of the burden. If there is a pervasive feeling that the other fellow is getting away with something and that the wealthy are taking advantage of tax loopholes that are as a practical matter not available to low-income or middle-income taxpayers, they may find it acceptable to engage in self help and do their own tax-minimization planning by not reporting income, or underreporting it, or overstating their deductions.

Another aspect of equity concerns the complexity of the law. As the 1980 Annual Report of the Internal Revenue Service points out,

"In a desire to differentiate carefully among taxpayers with slightly different abilities to pay, we may inadvertently, and with the best of intentions, reduce the perceived fairness of the system, and even its actual fairness, if the nuances of the system become too complex and subtle to be managed by the average taxpayer."

The lesson to be learned may be that, in the interests of promoting compliance, more emphasis should be placed on simplicity rather than on perfect fairness.

2. The Attitude of Taxpayers Toward the Government

A generalized disrespect for the political process and governmental agencies, of which Revenue Canada is one, may result in taxpayer resistance. In a recent unpublished paper, Professor Feige has observed that there has been "a remarkable erosion in 'trust in government' in the United States, related no doubt to the traumatic experiences of Viet Nam and the Watergate debacle." 11/ In his view, the erosion of trust in government and its concomitant effects on co-operation and compliance with existing legal and social norms might be an important determinant of the growth of the underground economy.

10/ Statement of Jerome Kurtz, *supra* footnote 8.

11/ Feige, "A New Perspective on Macroeconomic Phenomena" (unpublished, August 1980).

While we have had no similar convulsions in Canada, one can only speculate on the possibly corrosive effects on taxpayers' attitudes to government of such events as the constitutional debates and the national energy dispute.

3. Economic Considerations

A recent U.K. empirical study of taxpayers' attitudes to income tax evasion revealed that "The most important reason suggested...was the economic motive. This was variously expressed by different respondents as greed, poverty/financial hardship or some other financial pressure." 12/

The high rates of inflation in recent years have doubtless placed many taxpayers in a financial squeeze and, when faced with the alternatives of supporting the government and supporting their families, they have opted for the latter. Indexation of rates and exemptions has, of course, greatly ameliorated the effects of inflation. The elimination of indexation which, according to the last budget, is under consideration of the Minister of Finance, would almost certainly have the result of exacerbating the problem of tax evasion. It is surely a sound impressionistic conclusion that hardly requires affirmation by a sophisticated sociological study that a taxpayer at the low end of the income scale whose burden increases significantly as a result of the elimination of indexation would be sorely tempted to keep a larger share of his earnings by being less than honest in his reckoning with the State. 13/

Other Factors

Other factors that one might have thought would be relevant in the determination of a taxpayer's decision as to whether or not to comply with the tax laws were accorded little weight in the British survey -- for example, dissatisfaction with government's efficiency or expenditure priorities, the low chance of detection, moral considerations, and penalties for evasion. Whether the same result would obtain in Canada is a matter for conjecture.

Conclusion

A U.S. news magazine recently carried an article entitled "Cheating on

12/ Dean, Keenan, and Kenney, "Taxpayers' Attitudes to Income Tax Evasion: An Empirical Study" (1980), no. 1 British Tax Review 26, at 42.

13/ For a discussion of the implications of ending indexing taxpayers at various income levels, see Bossons, "Ending Tax Indexing: Sneaking In Hidden Future Increases," The Globe and Mail, June 6, 1980.

Taxes -- A Worldwide Pursuit," which concluded with the following comments on Canada:

"Canadians say that their nation has nothing to compare with Europe's hidden labor market even though many are known to hold two jobs and to report earnings from only one. Work also is sometimes bartered for goods.

Yet officials in Ottawa claim that the problem is so small that they do not try to calculate the amounts involved. If so, this makes Canada one of the few countries where an underground economy has not become a way of life." 14/

This view seems unduly sanguine, particularly in light of the Smith and Mirus paper on the underground economy in this country. There is a dearth of literature on the level of taxpayer compliance in Canada, the motivations for noncompliance, the success of detection, or the effectiveness of sanctions. Serious studies should be undertaken now to fill this information void.

Let me now continue with the review of our affairs that was begun by the Chairman.

The Foundation in 1980

Publications and Research

Publication is an essential part of the research process. If new information generated through research and analysis is to be of maximum use, it must be widely disseminated to policy makers, practitioners, and the general public.

The Canadian Tax Journal is internationally recognized as a leading periodical in the field of public finance. Its pages attract serious writers on a wide variety of tax and fiscal matters. The contents include not only articles and essays, but also eight features, some of which have been published for a number of years: "Current Cases" by T. E. McDonnell, "International Tax Planning" edited by Robert D. Brown, F.C.A., "Fiscal Figures" by David B. Perry, "Checklist" by Millie Goodman, and "In the Library" compiled by Marjorie Robinson. We were pleased to add three new features last year. First, "Personal Tax Planning," the co-authors of which are W. E. Crawford, C.A., and P. O. Gratias, C.A., both of Clarkson Gordon in Toronto; second, "Selected U.S. Tax Developments,"

14/ U.S. News & World Report, October 22, 1979,
page 53, at 56.

which is edited by Sidney I. Roberts, senior partner in the law firm of Roberts & Holland of New York, Washington, D.C., and Miami; and third, "The Taxation of Corporate Reorganizations," the co-authors of which are David Y. Timbrell, F.C.A., of Coopers & Lybrand, Toronto, and Douglas S. Ewens of McCarthy & McCarthy, Toronto.

The twenty-seventh edition of The National Finances, the Foundation's annual analysis of the federal government's revenues and expenditures, was distributed to members last month. While publication for over a quarter of a century may long since have diminished any novelty about this handbook, it has established its importance as an invaluable reference for those who have an interest in the financial operations of the federal government.

Two issues in the Tax Memo series were published last year: Provincial Finances 1980, which analyses the revenues and expenditures of provincial governments, and 1979 Tax Developments, which is a compilation of tax developments in Canada as reported in the Journal feature, "Checklist." The purpose is to bring together in one place for convenient reference information on federal and provincial budgets, amendments to regulations, and nonbudgetary tax changes. In order to determine whether this publication is serving the needs of members, a questionnaire will be included with 1980 Tax Developments, which will be mailed later this month, requesting readers to indicate its usefulness to them.

Two new issues were added to our series of tax papers. In their comprehensive study, Canadian Tax Policy, Professors Harry Kitchen and Robin Boadway discuss the development of the Canadian tax system and analyse the major taxes imposed by the federal and provincial governments.

Professor Richard M. Bird, in Tax Incentives for Investment: The State of the Art, deals with a subject of growing importance in light of the increasing number and variety of tax incentives to business investment in Canada. The paper surveys the existing literature on the subject and suggests a plan for possible further research in this area.

Two volumes were added to the Foundation's series of studies on Financing Canadian Federation in 1980. In The Acceptable Mean: The Tax Rental Agreements, 1941 - 1962, R. M. Burns presents an analytical history of the tax rental agreements, which draws on Department of Finance files, the archives, privy council office material, and provincial data.

Transfers of funds from higher to lower levels of government have been an important aspect of the Canadian federal system for many years. In Intergovernmental Transfers in Canada, Robin Broaday discusses transfers or grants originating with the federal and provincial governments. This study has been in high demand by universities in all parts of Canada.

Another volume in the series was published early this year, Fiscal Dimensions of Canadian Federalism, which is a report of the proceedings of a small conference of experts convened in October 1979 under the auspices of the Foundation to discuss and analyse present and future fiscal dimensions of Canadian federalism. Prepared for publication by Richard M. Bird, the volume includes the four papers presented, the discussants' remarks, and an introductory chapter.

Other publications distributed to members over the past year include the reports of the proceedings of the 1979 Annual Conference and the 1979 Corporate Management Tax Conference. The reports of proceedings of our regional conferences -- the Prairie Province Tax Conference, the British Columbia Tax Conference, and Journees d'études fiscales -- are distributed to registrants and may be purchased by others from the Publications Department.

Our research and publications program for 1981 contains several major items. Professor Brian J. Arnold is proceeding with his comparative study of the relationship between taxation and accounting concepts, particularly in the measurement of business profits. The project involves an examination of the jurisprudence, the statutory provisions, and administrative practices in Canada, the United Kingdom, and the United States.

The vexing question of the meaning of "cost" in Canadian income taxation is the subject of a study by Professor D. Keith McNair, F.C.A. He is concerned with the meaning of "cost" in various contexts (for example, inventory valuation, capital gains, and capital cost allowance).

A project of great interest to Foundation members is a major study of the taxation of, and planning for, closely held corporations. One of the co-authors left public practice to go into industry and withdrew from the project early this year. We have been most fortunate in being able to replace him with Peter E. McQuillan, F.C.A., national tax partner of Ernst & Whinney. He and his co-author, Howard J. Kellough, look to completion of the manuscript late this year.

The popular Foundation study, which has long been out of print, The Allocation of Taxing Power Under the Canadian Constitution, by Gerard V. LaForest, has been revised by the author and will be published later this month. The study focusses on the role the courts have played in the development and definition of taxing powers in Canada. A number of important decisions have been rendered since the study was published in 1967 and are analysed and examined in the new edition.

Despite the emphasis placed by many on the importance of increasing research and development in Canada, there have been no careful studies of the R and D incentives now provided through the tax system. Professor D. G. McFetridge of Carleton University has undertaken a study of these incentives which, we expect, will constitute a major contribution to the formulation of improved public policy on this subject.

In 1979 Professor Roger S. Smith, Dean of the Faculty of Business Administration and Commerce at the University of Alberta in Edmonton, prepared for the Foundation a monograph on tax expenditures in the Canadian federal income tax system. It is the leading Canadian work on the subject. We are pleased to report that Professor Smith is undertaking another project in this field, a study of the international implications of Canadian tax expenditures.

Members of the Foundation will welcome the news that J. Harvey Perry has agreed to prepare a fourth edition of his well-known book, Taxation in Canada. The third edition, published in 1961, has long since been out of print.

The second volume of the Foundation's consolidated index was published last week. It covers all Foundation publications issued from 1972 to 1977 and contains not only a detailed breakdown of subject matter, but also an author index and an index of cases, and will serve to make the wealth of information contained in our publications considerably more accessible. It is our intention to publish index supplements annually or biennially until the next consolidation.

I am glad to be able to report that the four remaining studies in the Financing Canadian Federation series are proceeding on schedule.

1. The Financing of Canadian Federation. This study is a thorough revision and updating by David Perry of the Foundation's classic 1966 study of the historical evolution of federal-provincial fiscal arrangements. The revision will bring the story up to date through the important changes of 1977.
2. Sharing and Co-Ordinating Taxing Power and Revenues in Canada: The Federal-Provincial Tax Collection Agreements. This study complements the Burns study, providing a detailed and informed account of the origin of the tax collection agreements in 1962 and their evolution to the more flexible structure of 1977. The principal researcher is Ernest H. Smith, formerly a member of the Tax Policy Division of the Department of Finance.
3. Financing Canadian Municipalities. The purpose of this study is to provide a detailed examination of the finances of Canada's third level of government -- the municipalities.

4. Federal Finance — An International Perspective. This project involves the preparation of several brief studies comparing relevant aspects of the fiscal experience of different federal countries -- the United States, West Germany, Australia, and Switzerland. There appears to be little knowledge in Canada of exactly how these different systems function, and an initial consideration of them suggests that some aspects of the experience of each of these countries may be relevant to Canada. Professor Richard M. Bird is organizing this project.

Staff

There were several departures from the Foundation staff and a number of new appointments in 1980 and the early months of this year.

We were sorry to lose the services of Janet Ballentyne, assistant to the research staff, who left in July to return to university.

Last September, Delia Perry resigned as receptionist and secretary for the best of reasons -- to start a family. Since December she and David have been experiencing the joys of parenthood. Her duties have been assumed by Patricia Hunt, who has proved to be such a competent and congenial colleague.

Evelyn Thompson retired in November after 26 years of devoted service. To her fell the responsibility of maintaining the membership records in good order, a responsibility that mounted over the years as membership grew from a few hundred when she came to the Foundation to nearly 10,000 when she left. Her colleagues wish Evelyn many years of good health and happiness.

Ruth Cornish is her successor. She is assisted by Margaret Goldup, who serves on a part-time basis, and also by Anne McAlonen.

Recent additions to the staff are Jane Peeling, who assists the Secretary and the Editor, and Vera Nekrashevicz, who is secretary to the research staff.

I would like to take this opportunity of expressing my gratitude to my associates in the Foundation office for their loyal support at all times. As they have become more expert in their work over the years, their value has increased correspondingly. David Perry has deservedly earned a national reputation for his knowledge of public finance and federal-provincial fiscal relations. He is the author of the Journal feature "Fiscal Figures" and bears major responsibility for the statistical underpinning of much of our work. As I noted earlier, he is in the process of completing a study in our series on Financing Canadian Federation.

Another key member of the research staff is Mary Gurney. She has a remarkable working knowledge of Statistics Canada public finance publications and federal and provincial accounting systems, and a talent for turning statistical tables into prose for The National Finances and Provincial and Municipal Finances.

Millie Goodman also participates in the preparation of these publications and keeps members informed of fresh developments in the field of Canadian fiscal affairs in her Journal feature "Check-list." She carried the primary responsibility for the preparation of the indexes to Foundation publications, including the second volume of the consolidated index that was published last week.

Editorial matters are in the capable hands of Laurel Schwartz. As our publications program has expanded, her duties have grown commensurately. In addition to preparing manuscripts for publication, Mrs. Schwartz has paid close attention to art work, as is apparent from the improved appearance of many of the volumes we produced in the past year.

Marjorie Robinson, the Foundation's Librarian, and Ron MacLeod, Assistant Librarian, had a busier than usual autumn, planning, organizing and supervising the move of the library to our new premises. The library is bright and inviting and well designed to serve the growing number of users, whose diverse requests increasingly require the library staff to become familiar with all facets of taxation.

On the administrative side, John Buckell, the Foundation's Treasurer, keeps our finances in an orderly state.

The duties of Pat Hillmer, the Foundation's Secretary, include the administration of our expanding conference program, and range from reserving accommodation to the sale of conference papers, and a host of other matters. She is fortunate to have the assistance of Marg Brown, who has demonstrated her competence at many Foundation conferences over the years.

Burt Joyner, assistant to the Treasurer, helps all members of the staff in one way or another. His responsibility for the Publications Department has grown more onerous in recent years, with the increase in our output of publications and burgeoning sales.

The work of the secretarial staff is indispensable to the success of our activities, and I am pleased to acknowledge the capable help of Thora Harris, my secretary, who assists me in countless ways, and Anne McAlonen, who serves as secretary to the Treasurer and also assists with membership affairs.

I take this opportunity to record our warmest thanks to Jack MacLeod, who retired as Secretary and Treasurer in 1977, for returning to the Foundation to render invaluable assistance in connection with our move to new premises. He co-ordinated the efforts of the staff, our relocation advisers, and our new landlord to ensure that the move went smoothly, which it did. We are much obliged to him.

Finally, I know I speak for the whole staff in acknowledging gratefully the generous help and encouragement that has been given to the Foundation by the Board of Governors and the members at large. On a more personal note, I want to say how much I have enjoyed a most congenial and co-operative association with Stanley E. Edwards and the other officers and governors. On behalf of the staff, I welcome the new Board and pledge them our best efforts and support.

D. J. Sherbaniuk
Director
April 14, 1981

