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Evolution of the Canadian Tax Reform

John G. Head*

Introduction

The passage of the Tax Reform Bill in December 1971 marked the end of an extraordinary decade of inquiry and debate on federal tax reform in Canada. Minor (and some major) changes are still being made, and a further instalment of reform is to be expected in the area of sales taxation. The more controversial issues of tax reform in the field of income taxation have, however, been finally settled, at least for the next few years and probably for a much longer period. While business firms, families and the government wrestle with the complexities of the new system, it is therefore time to sit back and review this remarkable episode in Canadian public finance history.

Three main stages can be distinguished in the evolution of the reform to 1971. The first began with the appointment of the Carter Royal Commission in 1962 and ended with the presentation of the Carter Report in February, 1967.[1] The second began when the Minister of Finance invited public submissions and discussion on the Carter Report and ended after a lively public debate and prolonged government study with the publication of the Benson White Paper in November, 1969.[2] The third and final stage was the "White Paper process" of public and parliamentary discussion of the Benson White Paper ending with the introduction of the detailed legislation in June 1971 and its eventual passage in December 1971.[3] In the following sections we shall consider the development at each of these three stages in turn.

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1 *Report of the Royal Commission on Taxation*, 6 Vol., Ottawa, 1966. (Hereafter cited as *Report.*)

2 *Proposals for Tax Reform*, Ottawa, 1969. (Hereafter cited as *White Paper.*)

3 For a useful tabular summary of the proposals made in the later stages of the debate from the White Paper to Bill C-259, see *Summary of 1971 Tax Reform Legislation*, Ottawa, 1971.

Stage I — The Carter Royal Commission

The Royal Commission was appointed by the Diefenbaker government in September 1962, in response to a number of specific problems and also some general misgivings about the federal tax system. Notable amongst the former were the treatment of the undistributed corporate surplus of closely-held corporations and the problem of associated corporations. The tax-free treatment of capital gains was the subject both of general misgivings and of specific problems as the courts struggled to draw a clear distinction between taxable income and capital gain with increasingly arbitrary and unsatisfactory resutls. It was also recognised that the various difficulties were interrelated. A fundamental change in the existing tax structure might therefore be required for a satisfactory solution. In the absence of any great enthusiasm for any particular programme of reform on the part of the government, the device of a far-reaching inquiry into the existing system was adopted.

The device of a Royal Commission on taxation was new to Canada. The U.K. Royal Commission of the early 1950's had produced a thorough and interesting study of the British income tax system but recommended few fundamental changes and had little impact on existing legislation.[4] This and other precedents were not therefore especially encouraging. Even in principle the problem of political implementation is especially great, as the government is entirely free to ignore politically unpopular recommendations; and, in the case of a prolonged and far-reaching investigation of the sort proposed, there is also no guarantee that the government setting up the inquiry will still be in power to receive the resulting report.

The Carter Commission laboured for four years and spent some $4 million to produce a truly monumental six volume report with 27 supporting staff studies. The report is recognised throughout the world as a landmark in the annals of taxation, and set the stage for a debate on tax reform in Canada of unprecedented intensity and duration.

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4 *Royal Commission on the Taxation of Profits and Income,* especially *Second Report,* 1954 and *Final Report,* 1955.

The Carter Blueprint

In contrast to the U.K. Royal Commission, the Carter Commission chose to approach the problems of the existing tax system not individually and "on their merits", but in terms of a unifying vision of an ideal tax system, derived from the modern public finance literature and in particular from Henry Simons' classic theory of tax reform.[5] In accordance with this approach the Commission places major emphasis on the equity objective: "The first and most essential purpose of taxation is to share the burden of the state fairly among all individuals and families".[6] For this purpose taxation should be based on ability to pay, which requires the application of progressive rates of tax to a comprehensive income tax base.

Following Simons, the Commission argues that the ideal tax base is provided by the concept of "net additions to economic power" 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".[7] All net gains should therefore be included in the tax base of the unit (family or single individual) regardless of source, form or use: "If economic power is increased it does not matter in principle whether it was earned or unearned, from domestic or foreign sources, in money or in kind, anticipated or unanticipated, intended or inadvertent, recurrent or non-recurrent, realized or unrealized".[8] Some of the more striking implications of this approach would include full taxation of bequests and gifts, accrued as well as realized capital gains and the imputed rent of owner-occupied dwellings on the same basis as wages, salaries, interest and dividends. Moreover the taxation of corporations, trusts and other intermediaries would be abandoned along with a variety of other taxes such as sales, property and excise taxes.

The Commission similarly proceeds to derive an appropriate structure of progressive tax rates to apply to the comprehensive tax base. For this purpose they employ a

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5 H. C. Simons, *Personal Income Taxation,* Chicago, 1938.

6 *Report,* Vol. 1, p. 4.

7 *Report,* Vol. 3, p. 39.

8 *Report,* Vol. 3, p. 25.

subjective and very unsatisfactory concept of "non-discretionary expenses" defined as those required "to maintain the members of the unit".[9] These expenses are assumed to be a function of income and of family responsibilities, and a wholly arbitrary set of assumptions is made regarding these functional relationships to yield separate progressive rate schedules for a family and for a single taxpayer and a system of tax credits for dependants.[10] To complete the ideal vision, liberal averaging provisions are required to avoid the discriminatory impact of progressive tax rates on tax units with lumpy or fluctuating incomes, a particularly important problem with the inclusion of items such as bequests, gifts and capital gains in the ideal tax base.

Like Simons, the Commission recognises that some modifications of the ideal may be necessary to take account of administrative and political problems and other policy objectives. Thus, for example, it is argued that, because of valuation and liquidity problems, capital gains should, at least initially, be taxed on a realization rather than an accrual basis. To limit the possibility of wholesale tax avoidance by the transfer of assets at death or by gift, Simons' constructive realization proposal is advocated under which such transers are deemed to be realizations for tax purposes. Tax postponement is, however, still possible under the Simons scheme, notably through the retention of income in intermediaries such as corporations. The possibility of accrual taxation of share gains in the case of public corporations is recognised but not recommended.

In contrast to Simons, the continued taxation of organisations is therefore proposed. Such taxes should, however, be regarded as withholding taxes collected on behalf of resident families and individuals. In particular the corporate income tax should be retained as a withholding tax on dividends and on those capital gains which result from retained earnings. For this purpose the corporate income tax must be fully integrated with the personal income tax by giving the shareholder full credit for the corporate tax against his personal income tax liability.[11]

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9 *Report*, Vol. 3, p. 5.

10. For details, see *Report* Vol. 3, Ch. 7.

11 For details, see *Report*, Vol. 4, Ch. 19.

Certain other modifications are proposed on administrative grounds, including the exemption of imputed rent of owner-occupied dwellings, the services of housewives and consumption of own products (such as furniture built by a carpenter for his own use). Except perhaps for the case of imputed rent, most of the adjustments proposed have a clear justification. Administrative difficulties are not used simply as a convenient excuse for arbitrary and politically expedient departures from the ideal. Indeed the Commission rightly emphasizes the very considerable administrative advantages of the comprehensive tax base. Thus, for example, under the prevailing system the intention or purpose of the taxpayer was an important criterion in determining the taxability of gains from the purchase or sale of property. Such a test can only be applied in a very arbitrary and/or unpredictable way. By contrast, under the comprehensive tax base, all property gains are to be included regardless of the original intentions or expectations of the taxpayer.

Some further modifications are, however, proposed on account of certain political constraints. In particular the Commission's terms of reference did not include the area of federal-provincial-municipal relations. The abolition of sales and property taxes could not therefore be recommended as these taxes constitute the main independent revenue sources of the provinces and municipalities respectively. A far-reaching reform of the federal sales tax is, however, proposed under which the present manufacturers sales tax would be replaced by a retail sales tax collected if possible by the provinces which would levy tax on the same base. It is also recognized that in the long run these other non-income taxes should, like the corporate tax, be integrated as far as possible with the personal income tax by means of a system of credits.

The modifications discussed so far take no explicit account of other public policy objectives, such as an efficient allocation of resources, economic stability and economic growth. These other objectives are not, however, neglected. The general position taken by the Commission is that the (then) existing tax system is grossly inefficient in the broad sense that a substantial increase in equity can be achieved without sacrificing other objectives.[12]

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12 *Report,* Vol. 6, pp. 164-5.

Thus, for example, it is a major thesis of the Report that the adoption of the comprehensive tax base would serve to eliminate the distortions in private sector resource allocation produced by a variety of discriminatory provisions or "non-neutralities" in the existing tax system. Some of these provisions might, however, be justified as an offset to existing market imperfections. For instance, the "small business incentive" provided by the low 21% rate on the first $35,000 of taxable corporate profits might serve to offset the capital market bias against the small corporation. Similarly the percentage depletion allowances for the mining and petroleum industries and the three-year exemption for new mines may in part be justified by the special risks involved. The same might even be said of the exemption for capital gains. The Commission argues very persuasively, however, that the existing provisions are vastly excessive in relation to any market imperfections which they may be intended to offset and/or very inefficient per dollar of revenue cost.[13] Moreover other important non-neutralities such as the double taxation of dividends have no justification whatever as incentive provisions. Certain specific and limited departures from the strict neutrality of the comprehensive tax base are therefore recommended to compensate for existing market imperfections. Examples include immediate write-off of capital costs for small new businesses, immediate write-off for the exploration expenses of mining and petroleum companies and immediate write-off for research and development expenditures. The overall role of such provisions in the system would, however, be dramatically reduced, with favourable implications for resource allocation.

The Commission shows somewhat less concern for neutrality in relation to international income flows. The major proposal for an arbitrary 30% gross-up and credit system for foreign taxes paid by resident individuals and corporations would nevertheless constitute a significant improvement in both equity and neutrality.

The possible effects of the new system on the rate of economic growth are likewise considered carefully and in great

13 For a brief summary of the Commission's views, see *Report*, Vol. 6, pp. 88-90.

detail.[14] However, only very limited changes in the equity ideal are proposed on account of growth effects, notably an arbitrary ceiling of 50% to the structure of progressive rates applied to the comprehensive tax base. This limit is accepted primarily in order to minimize disincentive effects on effort, saving and investment, and, in combination with a corporate tax rate of 50%, to remove any discrimination against dividends and in favour of retained earnings. Even with this modification it might reasonably be feared that full taxation of capital gains and the increased weight of tax on certain industries, such as mining and petroleum, could have markedly unfavourable implications for economic growth. The Commission's detailed analysis suggests, however, that although there would be significant changes in the allocation of capital between different industries, there should be little change in the overall volume of saving and capital formation. Indeed they would expect a modest increase in the rate of growth as a result of the improved allocation of capital and the more effective application of fiscal and other stabilization policies. Even allowing for the many uncertainties in the Commission's detailed calculations, it seem clear that any adverse effects would be small and could easily be offset by other measures. The possibility of pursuing a more positively growth-oriented tax policy is considered but rejected in accordance with the Commission's primary emphasis on the equity objectives.

Other effects of the reforms are also expected to be favourable. Canadian ownership of Canadian industry would, for example, be strongly encouraged by restricting the benefits of integration to resident shareholders. Similarly the Commission finds no evidence that economic stability or the balance of payments position would be unfavourably affected by the proposed reforms either in the short run or in the long run.

Although the effects on other economic policy objectives are therefore expected to be favourable or at least neutral, equity remains the overriding objective of the proposed reform programme. Even after taking account of administrative and political restrictions and other policy objectives, the proposed system remains remarkably close to the Simons equity ideal and

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14 *Report*, Vol. 6, Ch. 37.

would offer a dramatic improvement in tax equity. The substantial broadening of the income tax base to include capital gains, bequests and gifts and many other untaxed or undertaxed items would eliminate a multitude of "horizontal" inequities between people in similar economic circumstances. Moreover, since items such as capital gains and bequests and gifts are heavily concentrated in the higher income brackets, the effective progressiveness of the system would be much greater, in spite of the reduction in marginal rates to a maximum of 50%, with a consequent improvement in "vertical" equity. Studies by the Commission had shown that, as a result of gaps in the tax base, the existing system of direct taxation was little better than proportional in higher income ranges.[15] Further, though somewhat less spectacular, improvements would also result from the adoption of the family as the tax unit.

Stage II — The Carter Debate

The Carter Report was presented to parliament in February, 1967 and in April the Minister of Finance announced a tax reform schedule. Submissions were invited from the public by the end of September on the major income tax recommendations in the Report, and it was hoped that the government would be in a position to reveal its own proposals in the form of a White Paper by the end of the year. It was envisaged that the White Paper would be studied by a parliamentary committee and that a draft bill would then be produced incorporating any changes which might be made as a result of the views received in parliament, from the public and from the provincial governments. It was hoped that the relevant legislation could be passed in 1968.

The reaction to the Report as reflected in about one thousand submissions received during 1967 and in public discussion was extremely hostile. The proposals for full income taxation of capital gains and bequests and gifts, complete integration of the corporate and personal income tax and the removal of the special concessions for the mining and petroleum industry were particularly strongly criticized, and the whole Report was branded as a recipe for stagnation. These criticisms

15 *Report*, Vol. 6, Table 36-5, p. 58.

were for the most part articulated by representatives of the more affluent and better organized sections of the community and particularly by business interests. This opposition is not difficult to explain since these were precisely the groups who stood to lose as a result of the strong equity thrust of the Carter reforms. It is also hardly surprising that criticism was focussed largely on those features of the Carter package which involved tax increases, whilst those which involved tax reductions were generally welcomed.

Somewhat more difficult to understand perhaps was the opposition aroused by the proposal to integrate the personal and corporate income tax, which, in itself, would substantially reduce the weight of tax on corporate source income by completely eliminating the double taxation of dividends. This is no doubt to be explained in large part by the "package" character of the Carter proposals, under which the integration credit was firmly tied to the proposal for full taxation of capital gains. The possible blunting of provincial tax incentives also made the integration proposal very unpopular with the provinces as well as with the business community.

Against the very vocal and articulate opposition of the business community to most of the major proposals, there was a conspicuous absence of enthusiastic popular support from the vast majority who stood to gain. Compared with the obvious burdens on the more affluent sections of the population the benefits at the lower income levels were widely dispersed and significant in percentage terms only for the unorganised mass of taxpayers with comprehensive income of less than $5,000.[16]

It would, however, be very misleading to imply that no valid criticisms of the Carter proposals emerged in the course of the debate, or even that the general approach adopted is above criticism. Indeed to a large extent the unfavourable response to the Report reflects fundamental weaknesses of the modern theory of tax reform and the ability-to-pay tradition on which it is based. In this general approach, as we have seen, equity is the overriding objective; but of all the objectives that might have been chosen this is intrinsically the most controversial. People's conceptions of equity vary widely, and there is no

16 See, for example, *Report,* Vol. 6, p. 56.

guarantee that the particular formulation of the equity objective to be found in the modern tax reform literature will necessarily command widespread acceptance.

Like Simons, the Commission recognises that both the horizontal and vertical equity aspects of this approach require ethical judgements: "These are questions of belief rather than of fact. We can do no more than recommend what *we* believe to be fair."[17] Problems of general acceptability and political implementation are not completely ignored, but are essentially glossed over with the hopeful assertion that there is a "consensus among Canadians" on these extremely controversial distributional questions.[18] Thus, like Simons, the Commission probably greatly overrates the equity appeal of the comprehensive tax base. Many people simply do not agree that capital gains, bequests and gifts should be taxed as income in the same way as wages and salaries. Similarly the particular structure of progressive tax rates chosen may or may not fall within Canadian conceptions of what is "fair and reasonable".[19]

Related, but in some respects conceptually quite distinct, is the obvious but fundamental problem that those who stand to lose as a result of particular proposals must in general be expected to oppose them. This is true even where agreement might in principle be obtained that the proposal is "fair". Redistribution of income is the essence of the proposed reform, and those who stand to lose cannot generally be expected to abstract in altruistic fashion from their vested interest in the status quo. This accounts to some extent for the fact that the equity aspects of the various proposals were seldom attacked directly but rather by emphasizing their unfavourable implications for economic growth.

Somewhat different problems arise in the treatment of other policy objectives. Thus, for example, in the case of the neutrality objective it is always possible to argue that the existence of market distortions or special social benefits justifies continuing preferential treatment. These alleged social benefits or market distortions are often very difficult to quantify precisely, and as a result the economic case for eliminating or

17 *Report*, Vol. 1, p. 5 (italics added).
18 See, for example, *Report*, Vol. 2, p. 10 and Vol. 3, p. 5.
19 *Report*, Vol. 3, p. 8.

even substantially reducing preferential treatment is seldom completely conclusive even though it may be very strong.

The Commission's general strategy in relation to other objectives had been to try to minimize conflict by ensuring that the programme as a whole would involve no sacrifice of other goals, and notably of economic growth. Conflict cannot, however, be completely avoided in this way since there may be no agreement that the primary emphasis should be placed on the equity objective.

In view of the overwhelmingly unfavourable "public" response to the Report and the critical attitude of most of the provinces and also of the Conservative opposition, it is hardly surprising that the government preferred to delay taking a firm position on such a controversial issue with the likely prospect of an election in 1968. The new Minister of Finance, Mr. Benson, announced the change in the government's tax reform schedule in April 1968, indicating that, if the government was reelected, some changes could be expected in the fall budget, but that the major reforms would be presented some time in 1969, probably in the form of a Bill rather than the promised White Paper.

Important changes in the taxation of bequests and gifts and also of the life insurance industry were duly announced in the budget of October 1968. These changes can, however, be properly appreciated only in the general context of the government's major income tax proposals which were finally revealed in the Benson White Paper "Proposals for Tax Reform" in November, 1969.

The White Paper Proposals

Although the government's priorities are not explicitly stated, the far-reaching programme of reforms proposed in the White Paper is based primarily on considerations of equity and efficiency.

The main equity thrust of the reforms and the significant divergences from the Carter blueprint are simultaneously evident from the major proposals. Thus, for example, it is proposed to tax capital gains under the personal income tax. It is, however, precisely in this context that the Carter concept of the comprehensive tax base is explicitly rejected: "The government rejects the proposition that every increase in economic power, no matter what its source, should be treated the same for tax purposes."[20] The major breach in equal treatment concerns gains on the shares of widely-held Canadian corporations, only half of which would be included in taxable income. In partial justification it is argued that half inclusion ". . .would put Canadians in approximately the same tax position regarding capital gains and losses on these shares as most of the non-residents who invest in Canada."[21] By contrast, most other capital gains, including the gains on closely-held shares, would be taxed at full personal rates on realization.

This is not, however, quite such a striking departure from equal treatment as it might at first appear, as it is largely offset by a number of other proposals, notably in the corporate tax field. Thus, in contrast to the Commission, the government attempts to draw a very sharp distinction between the small closely-held corporation and the large widely-held corporation. For the profits of closely-held corporations full integration with the personal income tax is proposed under which shareholders would in effect receive full credit at the personal level for corporate income tax paid, as suggested by the Carter Commission. The intention here is to put small corporations in much the same tax position as the unincorporated firms which they closely resemble and with which they "usually compete."[22] Combined with the full taxation of closely-held share gains, this proposal would also solve the special problems posed by the undistributed surplus of these corporations without the need for the existing arbitrary anti-avoidance provisions.

By contrast, in the case of widely-held corporations a separate corporate tax is held to be justified by the effective separation of ownership from control and by the fact that such corporations compete with foreign public corporations subject to similar taxes. It is also suggested that part of the tax is probably passed on to consumers in higher prices. In contrast to the Commission, it is not therefore proposed to give Canadian shareholders of these corporations full credit at the personal level for corporate income tax paid. Instead Canadian share-

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20 *White Paper*, para. 3.3.
21 *White Paper*, para. 3.34.
22 *White Paper*, paras. 1.40, 4.19, 4.32.

holders would receive credit for half the corporate tax paid on cash or stock dividends to replace the existing 20% dividend tax credit as a more equitable incentive to Canadian ownership of Canadian industry.[23]

The benefits of half inclusion for capital gains on widely-held shares are therefore roughly balanced by the half credit for corporate tax paid. Further compensation is provided by the pioneering proposal to tax the accrued gains on shares of widely-held corporations every five years. By contrast, significant tax postponement would be possible on most other capital gains, as there would be no deemed realization but rather a carry-over of cost basis at death. Like the Carter approach, the government's proposals in this area represent a carefully integrated package. Indeed if we could assume that the tax on widely-held corporations is one-third shifted to consumers whilst that on closely-held corporations is not subject to shifting, quite a strong case could be made for the White Paper modifications of the Carter proposals even by the exacting standards of the Carter Commission.[24]

Another area in which the government had already departed sharply from the Commission's concept of the comprehensive tax base is in the treatment of bequests and gifts. The proposal to tax these items as ordinary income was completely rejected at an early stage in the government's deliberations. The Commission's rather shaky argument that interspousal transfers should be completely exempt from tax was, however, accepted and embodied in a far-reaching reform of the estate and gift taxes early in 1969.

Other proposals to tax a variety of items previously excluded from the income base are more consistent with the Commission's approach. Examples would include the more stringent treatment of expense account benefits, taxation of unemployment insurance benefits (with a deduction for employee contributions), accrual taxation for the professions and the broadening of the business income tax base to provide more adequate taxation of cooperatives, credit unions, trusts,

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23 *White Paper*, paras. 4.34 – 4.36.

24 For details, see my paper "An Economic Appraisal of the Capital Gains Proposals", *Report of Proceedings of the Twenty-Second Tax Conference*, Canadian Tax Foundation, 1970, p. 95.

and (to a lesser degree) the extractive industries. Measures to tax the life insurance industry had already been introduced on the basis of the Commission's recommendations in 1969. Proposals for a more rational system of deductions for medical expenses, new deductions for employment expenses and moving expenses, and a general averaging scheme to reduce discrimination against those with fluctuating incomes were also inspired by the Carter recommendations, though the averaging scheme is much less generous.

Even though they are generally less far-reaching than the Carter proposals, the many changes in the income tax base which we have so far discussed would cumulatively represent a substantial movement towards equal treatment of people in similar economic circumstances, the Carter objective of horizontal equity. The taxation of capital gains would also greatly increase the effective progressiveness of the system by increasing the burden on high-income taxpayers. Like the Commission, however, the government would simultaneously reduce the top rate of the personal income tax to about 50% to minimize disincentive effects on effort, saving and investment and (in combination with a corporate tax rate of 50%) to close off the possibility of tax avoidance through retained earnings. In spite of this modification the tax system would still be substantially more progressive at the upper end of the income scale.

At the bottom of the income scale the White Paper proposals go somewhat beyond those of the Carter Commission, which would have left the existing tax-exemption level essentially unchanged. By contrast, under the White Paper the personal exemption for a single taxpayer would rise from \$1,000 to \$1,400 and for a married taxpayer from \$2,000 to \$2,800. This would free some 750,000 current taxpayers from income tax liability and would reduce the burden on 3,000,000 other low-income taxpayers. (The benefits that would otherwise accrue at higher income levels would be offset by higher tax rates.)

Along with the comprehensive tax base and the principle of greater effective progression the Commission had also strongly advocated the adoption of the family (and single individual) as the tax unit. This proposal was in effect shelved for the present in the White Paper, although the new and very liberal deduction recommended for child-care expenses depends very heavily for its equity rationale on the family unit concept.

Whilst the primary emphasis in the White Paper proposals, as in the Carter Report, is on equity, other public policy objectives are not forgotten. Like the Commission the government expects favourable effects on private sector resource allocation to result from the removal of many discriminatory provisions in the existing law. Thus, for example, the taxation of capital gains and the integration proposals, combined with more consistent treatment of different types of business, should substantially reduce an array of existing non-neutralities variously affecting different firms and industries and distorting debt-equity ratios and pay-out policies.

The need for certain specific departures from strict neutrality is also recognised to encourage risky ventures. There are, however, some interesting differences in the relevant proposals from those of the Commission. Thus, for example, no general incentive for small business is proposed. In contrast to the Commission, the government interprets the existing low 21% rate on the first $35,000 of corporate income (combined with the 20% dividend tax credit) as a very inefficient attempt to eliminate the competitive disadvantage suffered by small corporations relative to unincorporated businesses which pay no corporate tax.[25] The White Paper proposal for full integration of the personal and corporate taxes and full taxation of capital gains for the shareholders of closely-held corporations is therefore precisely designed to put small corporations in the same tax position as their unincorporated competitors, without the loopholes and distortions associated with the low 21% rate. This line of argument would suggest that no special incentive to small business is required, and none is recommended.

The White Paper approach to the mining and petroleum industries also differs significantly from that of the Commission, which would have limited the long-run concession to an immediate write-off for exploration expenses. In response to fierce opposition from the industries and the major provinces involved, it is conceded in the White Paper that substantial concessions are still required in recognition of the extra risks

25 *White Paper*, paras. 4.9 – 4.11.

involved and the industries' contribution to regional development. The existing incentives are, however, excessively generous and inefficient and would be replaced by concessions more directly related to exploration and development activity. Thus the percentage depletion allowances would be transformed into a "tax subsidy" on exploration and development. For every $3 of exploration and development outlays the taxpayer would earn the right to $1 of depletion allowance up to the previous maximum of one-third of production profits. The three-year exemption for new mines would likewise be replaced by an accelerated write-off for mining machinery and buildings. The immediate write-off for exploration and development expenses would be continued.

A somewhat reduced concern for neutrality is also to be observed in the proposals for taxing international income. The existing differences between the tax treatment of foreign-source income derived from the operations of a branch, a subsidiary or portfolio investment would by and large continue. The changes proposed had the more limited aims of reducing tax avoidance through the use of controlled foreign corporations in tax haven jurisdictions and of strengthening the hand of the Canadian government in negotiating a much-needed extension of the existing network of tax treaties.

On the sensitive issue of economic growth the government argues that the proposed reforms should have no significantly unfavourable effects. The main effects anticipated include a moderate reduction in aggregate private saving of some $525m. (or somewhat less than 4%), due mainly to an expected increase of about $560m. in corporate tax revenue by the fifth year of the new system. Some reduction in capital spending, especially by closely-held corporations and the extractive industries, is also expected. The net effect on private saving and capital formation is, however, impossible to estimate in the absence of any indication in the White Paper as to how the government would plan to use the substantial increase in revenues expected. Assuming that some part of the increased revenue would be used to finance public capital outlays or to reduce tax rates, the net unfavourable effect could be reduced to minimal proportions. The White Paper nevertheless remains much less reassuring on growth effects than the Carter Report.

On the whole the White Paper proposals go a very long way towards meeting the challenge of Carter. In spite of fierce opposition in the Carter debate, equity remains the foundation of a far-reaching programme of reform which would reduce or eliminate a multitude of loopholes and discriminatory provisions in the income tax system.

Stage III – The White Paper Process

When the White Paper was presented it was announced that the government would welcome public discussion of the proposals. Detailed legislation would be introduced only after parliament, the public and the provinces had been given full opportunity to comment on the changes proposed, and possible modifications would be considered in the light of the views expressed. At the parliamentary level the White Paper was referred to the Commons Committee on Finance, Trade and Economic Affairs and to the Senate Committee on Banking, Trade and Commerce. Both committees held extensive public hearings and received hundreds of briefs and other submissions. Their reports, and particularly that of the Commons Committee, had a very considerable influence on the final legislation. The government held numerous discussions with the provinces which were also of crucial importance in shaping the final proposals. Finally there was a vigorous public debate led by the Conservative opposition and representatives of the business community.

As we have seen, the White Paper proposals retain much of the strong equity thrust of the Carter Report. It is not therefore surprising that the public reaction was once again extremely hostile. It had perhaps been hoped that the various concessions which had already been made would serve to produce that "consensus of informed Canadians" which had escaped the Carter Commission. It was found, however, that those who stood to pay more as a result of particular proposals remained unshakeably opposed, and the discussion was dominated once again by representatives of the business community and other more affluent sections of the population.

In some respects the White Paper was in fact more vulnerable to criticism than the Carter Report. This is true, for example, of the large long-run revenue increase estimated at \$630m. (based on 1969 incomes) by the fifth year of the new system. As a result the rates of tax proposed were significantly higher than under the existing system, especially in the middle-income ranges. These rates would be necessary to ensure that there would be no reduction in revenue in the first year of the new system, but could be reduced as various transitional concessions expire and revenue begins to build up. Completely unnecessary opposition was therefore created by the failure to provide explicitly for future tax reductions. As we have already seen, this expected revenue increase is also the source of much uncertainty regarding the growth effects of the proposed changes, and it contributed greatly to the success of the business community in presenting the White Paper as a recipe for economic stagnation. As a result, the Minister finally announced in June, 1970 that the final legislation would include a schedule of rate reductions to absorb the expected revenue increase.

As in the case of the Carter Report the most important proposals in the White Paper from the point of view of equity are those relating to capital gains. As we have seen, the White Paper proposals in this area constitute a carefully integrated and reasonably equitable package, but the individual components of the package appear to involve strikingly inconsistent treatment of capital gains on different types of assets. As a result the proposals were particularly vulnerable to criticism.

Thus, for example, there was very strong criticism of the differential treatment proposed for gains on closely-held and widely-held shares. If, for various reasons, half inclusion is appropriate for widely-held share gains, it is surely impossible to justify full inclusion for closely-held share gains or, for that matter, personal property gains. This superficially plausible argument was accepted by both parliamentary committees, even though it completely overlooks offsetting provisions in the reform package as a whole and even within the capital gains area. The compensating proposal to tax the accrued gains on widely-held shares every five years fared even less well and was almost unanimously condemned as inequitable and economically dangerous.[26]

26 For a recent discussion of the many advantages of an accrual tax, see C. S. Shoup, "The White Paper: Accrual Accounting for Capital Gains and Losses", *Canadian Tax Journal*, Vol. XV111, No. 2, 1970.

The related corporate tax provisions were also fiercely criticized as discriminatory and inconsistent. It was argued that half integration for widely-held corporations and full integration for closely-held corporations would inevitably create serious competitive distortions. The Ford Company of Canada (widely-held) and General Motors of Canada (closely-held) was one widely-quoted example. It was claimed, with some justification, that no conceivable redefinition of the basic White Paper categories could avoid creating numerous problems of this sort. As in the Carter debate there was in fact strong opposition to any form of integration, partly because of the associated implications for capital gains taxation and partly because the integration credit would not apply to tax-sheltered or foreign-source income where no Canadian corporate tax had been paid.

Another major weakness in the corporate tax proposals was the absence of any concession to small business to compensate for the withdrawal of the low 21% rate on the first $35,000 of corporate profits. As recognised by the Commission, some compensating tax incentive is justified as an offset to capital market bias against small, new fast-growing firms. The failure to provide some such concession produced a storm of opposition much of which might well have been avoided. As a result the Minister soon conceded that some incentive should be provided, and a special departmental committee was established to look into the problem.

As the Carter debate clearly showed, it would, however, be very misleading to attribute the hostile reaction to the White Paper solely or even mainly to these flaws and apparent inconsistencies in some of the major proposals. The Carter Report was a model of consistency, but was bitterly attacked. In both cases the fundamental problem lies in the essentially redistributive character of the proposals. Like the Carter Report, the White Paper provisions would impose obvious and substantial new burdens on a relatively small but affluent, articulate and well organised section of the community which could hardly be expected to stand idly by. The futility, from this point of view, of the various compromise provisions embodied in the White Paper is well illustrated by the strong opposition of the mining and petroleum interests to the new incentive scheme proposed for these industries.

As in the case of the Carter reforms, the benefits from the White Paper proposals would be widely dispersed over the relatively unorganised mass of taxpayers at the bottom of the income scale. The substantial increase proposed in the personal exemptions should no doubt be interpreted as an attempt to make these benefits more dramatically obvious and politically more effective. This and other concessions at the lower income levels were not, however, clearly linked in the public mind with the important reforms proposed further up the income scale. As a result the considerable popular support for the exemption increase (and the new deductions for employment expenses and child care expenses) did not carry over into articulate popular support for other aspects of the programme.

If the White Paper experiment in participatory democracy was not to be exposed as a sham or a failure some further concessions to the opposition were therefore unavoidable.

Reports of the Parliamentary Committees

The reports of the parliamentary committees were presented in the fall of 1970 and reflect in varying degrees the overwhelmingly hostile reaction of representatives of the business and professional organisations from whom the bulk of the briefs and other submissions were received.

The Commons Committee would retain most of the White Paper proposals, though with some significant modifications.[27] The most important change proposed is in the crucial area of capital gains and corporate income where the Committee recommends a uniform system of half inclusion in personal income for all realised capital gains and half integration for all corporations whether closely-held or widely-held. An exception would, however, be made for the first $50,000 of corporate income of closely-held corporations where full integration would be allowed. In place of the quinquennial tax on accrued capital gains, the Simons-Carter system of a deemed realization of accrued gains at death and on gifts is proposed in order to limit tax postponement and lock-in effects. Some reduction in

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27 *Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs Respecting the White Paper on Tax Reform*, Ottawa, October 1970.

estate taxes would at the same time be made to limit the double impact of capital gains and estate tax at death, which had been fiercely criticized as discussions turned to this alternative.[28] The top rate of the personal income tax would, however, be reduced to 60% rather than 50% as in the White Paper.

Other important changes proposed include a significant liberalisation of the new incentive scheme for the mining and petroleum industries. In particular the categories of expenditure which would be eligible for the new accelerated write-off and earned depletion provisions would be considerably broadened. These changes would supplement a number of concessions already announced by the Minister in August, 1970.

The need for an adequate incentive for small business is also strongly stressed, but it is agreed that the existing dual rate system has created serious problems and should be abolished. Some broad principles but no detailed proposals are offered regarding the form of the new incentive.

The Committee concludes that these changes should remove any cause for concern that the White Paper proposals would adversely affect Canada's rate of growth. At the same time it is noted rather revealingly that "...a number of the Committee's suggestions for modifying White Paper proposals stem not from a belief that those proposals are inequitable or detrimental to economic growth, but from a concern for taxpayer understanding and acceptance."[29]

The Senate Committee was much more impressed by the arguments put forward by the business community and would either reject or entirely revamp the major White Paper proposals.[30] On capital gains the Committee recommends a variant of the U.S. system with the troublesome U.S. distinction between short-term and long-term gains and a rate of tax on long-term gains limited to 25% or half the marginal income tax rate of the taxpayer, whichever is less. Instead of a deemed realization at death or on gift, a carry-over of cost basis is proposed which would allow unlimited tax postponement. This effect would be further increased by an extended system of

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28 *Ibid.*, pp. 33-4.

29 *Ibid.*, p. 11.

30 *Report on the White Paper Proposals for Tax Reform Presented to the Senate of Canada*, Ottawa, September 1970.

roll-over provisions. Although the deemed realization at death is rejected, the Committee still felt able to suggest that the government ". .might well consider abandoning the estate tax field to the provinces. . ."[31] The top rate of the personal income tax would moreover be reduced to 50% as proposed in the White Paper.

The White Paper integration proposals are also completely rejected, and the existing system of corporate income taxation would be retained with relatively minor modifications. In a rather unsatisfactory attempt to meet the White Paper objection that the 20% dividend tax credit favours high-income shareholders, the credit would be graduated in three broad steps to provide a higher percentage credit to shareholder with a smaller volume of dividends.

Similarly in the case of the incentives to the mining and petroleum industries the Committee recommends in effect that the existing system of incentives be retained with only minor adjustments. The three-year 100% exemption for new mines would be reduced to 75%, but supplemented by the accelerated write-off proposed in the White Paper. The 33 1/3% depletion allowances would similarly be reduced to a minimum of 20%, but supplemented by a liberalised version of the government's earned depletion provisions.

The Committee would also retain the low 21% rate on the first $35,000 of corporate income as an incentive to small business. In an attempt to meet some of the major criticisms, use of the low rate would, however, be restricted to the business income of private corporations with net profits not exceeding $100,000.

The White Paper proposals for the treatment of international income, entertainment expenses and a variety of other items are either completely rejected or would be substantially watered down. Reflecting the general tenor of the public debate, only the new deductions and concessions are really welcomed. Even here a significant change is proposed which would replace the politically very popular exemption increase by a form of vanishing exemption thus avoiding the need for rate increases to offset the benefits further up the income scale.

31 *Ibid.*, p. 45.

Provincial Reaction

Provincial support for the proposals was also essential in order to preserve the considerable economic, administrative and compliance advantages of the system under which the provincial governments[32] levy personal and corporate income tax on the same base as the federal government which collects the tax on their behalf. Provincial reaction to the major provisions for capital gains and corporate taxation and to the proposed changes in the incentives for the mineral industries and small business was, however, extremely unfavourable. As a result there was a strong possibility that a number of provinces would refuse to harmonize with the federal system if the White Paper proposals were implemented. It is not therefore surprising that, both in general and on particular points of detail, provincial attitudes exercised a crucial influence on the shape of the final legislation.

The differences between the federal and provincial positions are clearly illustrated in the critique of the White Paper and the set of counter-proposals published by the Ontario government in June 1970.[33] On capital gains the Ontario government would favour a completely separate tax at a flat rate of 25% with a distinction between short-term and long-term gains and a deemed realization at death or upon emigration. Like the Senate Committee, they recommend a simultaneous and "drastic" reduction in death and gift taxes. The top rate of the personal income tax would, however, be "at least" 65%.

In the corporate tax field the existing system would be retained though with a graduated dividend tax credit along the lines subsequently recommended by the Senate Committee. The proposals for the mineral industries also foreshadow the Senate recommendations, and a substantial incentive for small business is strongly advocated.

Other significant differences from the White Paper include the proposal for a low income allowance to replace the exemption increase, and a tax credit for working mothers to replace the proposed deduction for child care expenses. On the

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32 Except Quebec and, in the case of the corporate tax, Ontario.

33 *Ontario Proposals for Tax Reform in Canada*, Toronto, 1970.

basis of a detailed computer study it is also suggested that the White Paper estimate of the expected long-run revenue increase is much too low; and the need to provide explicitly for compensating rate reductions is particularly stressed.

The Final Legislation

In the light of public reaction, the reports of the parliamentary committees and the views of the provinces, the White Paper proposals were substantially revised, and the government finally presented its detailed proposals in Bill C–259 on June 18, 1971.[34] A large number of relatively minor and mostly technical amendments were subsequently approved in the fall, and the legislation was eventually passed just in time to take effect in 1972.

Since the opposition to the White Paper had focussed on the tax increases proposed, including those for middle-income wage and salary earners to finance the increased personal exemptions, the government finally had resort to the classic tax reform strategy of combining the reforms with a tax cut. The method chosen was to remove the 3% surtaxes on personal and corporate income which had been imposed as an anti-inflationary measure in 1968. As a result it was possible to ensure that taxes would either be reduced or substantially unchanged on wage and salary incomes. Rate reductions were also scheduled for the following four years to absorb the expected revenue increase which had been such a controversial and confusing issue in the White Paper debate.

On capital gains the new legislation closely follows the recommendations of the Commons Committee for a general system of half inclusion of realized capital gains in personal income with a deduction for one-half of capital losses. The system applies to all capital assets with very limited exceptions such as (1) complete exemption for a principal residence (plus up to one acre of surrounding land), (2) an exemption for personal property where sale proceeds do not exceed $1,000. Losses are generally deductible first against gains and then, up to a limited amount of $1,000 against other income. Any excess

34 For a general description of the proposals, see *Summary of 1971 Tax Reform Legislation.*

can be carried back one year and forward indefinitely. Losses are not, however, deductible in the case of personal property which depreciates through use, and in other cases losses are deductible only from gains on other personal property with a limited one-year carry-back and five-year carry-forward. Similar provisions apply to corporate as to individual capital gains, except that there is no deduction for losses against other income. As recommended by the Carter Commission and the Commons Committee, there is a deemed realization of accrued gains on assets transferred by bequest or gift with an exemption for inter-spousal transfers. This latter provision is, however, at least partly offset by the extraordinary decision to abolish the recently reformed federal estate and gift tax as suggested by the Senate Committee. The top rate of the personal income tax is also reduced, but only to 61% as recommended by the Commons Committee.

From the point of view of equity the new system of capital gains taxation undoubtedly represents a significant retreat from the more far-reaching proposals of the Carter Commission and the White Paper. The degree of preferential treatment is, however, greatly reduced and the tax is perhaps the most equitable to be found in any advanced country. To be set against this achievement is the fact that the government chose to pay a disastrously heavy price for the deemed realization at death, going far beyond the recommendations of the Commons Committee to the complete repeal of the federal estate and gift tax. As a result the plugging of the death loophole in the tax on realized capital gains has been made the occasion for the abandonment to interprovincial competition of another tax with an equally important but quite different equity rationale.

Compromise is evident once again in the new corporate tax provisions. Abstracting for the moment from the special treatment of private corporations, the new legislation provides for what amounts in effect to approximately a 33 1/3% gross-up and credit on dividends. Like the dividend tax credit which it replaces, the new gross-up and credit is available regardless of whether Canadian corporate tax has been paid. Like the half integration proposal of the White Paper and the Commons Committee, and in contrast to the dividend tax credit, the new credit would, however, reduce "double taxation" by about the same proportion for shareholders in all income brackets (except those below 25%, since no refund will be paid where the credit exceeds personal income tax liability).

This compromise provision thus successfully achieves the government's objective of eliminating a possible inequity in the dividend tax credit, whilst satisfying those who were alarmed that the credit might be withdrawn for tax-sheltered or foreign-source income. The scrapping of the integration proposals and the resulting lack of coordination between the new credit and the capital gains provisions ensures, however, that the important objective of reducing discrimination against dividends and in favour of retained earnings is much less fully achieved. As a result, a variety of inequities and associated tax-induced distortions of corporate pay-out policies, debt-equity ratios and the allocation of capital between different firms and industries will remain. These effects are further reinforced by the reduced concessions at the top of the income scale.

For small business the low rate of corporate tax is to continue but in an ingeniously modified and restricted form which will effectively limit the benefits to small private Canadian-controlled corporations which actually use the resulting tax savings for direct business purposes. Under the new scheme, a Canadian-controlled private corporation pays a concessional 25% rate on the first $50,000 of business income each year until it has accumulated a total income of $400,000. As recommended by the Senate Committee, investment income is excluded from the concession, and special provisions have been introduced to ensure approximately full integration with the personal income tax for the investment income of private corporations, thus eliminating the intractable tax avoidance problem of the "incorporated pocketbook". Full integration is also provided in effect for dividends paid out of business income which has been taxed at the low rate. Combined with a provision which excludes income paid out in dividends from accumulated taxable income in determining eligibility for the low rate, this ensures that small static corporations which distribute most of their income are effectively placed in the same tax position as an unincorporated business. A true concession is therefore involved only where the tax savings resulting from the low rate are used for purposes of business expansion.

The new small business incentive is likely to be considerably more efficient per dollar of revenue cost than the system it replaces. Combined with the new tax on capital gains, the scope for tax avoidance through the small corporation is also greatly reduced. Unfortunately the remaining imperfections are sufficiently serious to require the continuation of some of the arbitrary anti-avoidance provisions of the previous law. These problems could have been completely solved only by the Carter and White Paper proposals for full integration and full taxation of capital gains for private corporations. It is also most unfortunate that no way was found to extend a corresponding tax incentive to small unincorporated businesses.

In contrast to the major provisions so far discussed, the new system of tax incentives for the mining and petroleum industries follows, in form at least, the general approach laid down in the White Paper, though with some further liberalisation along the lines suggested by the Commons Committee. The most significant changes include the extension of the new system of accelerated depreciation for mining machinery and buildings to a variety of associated outlays on roads, railways, refineries, townsites, airports and docks. A similar but more restricted allowance will also apply in the case of a major expansion of an existing mine. The definition of exploration and development outlays for purposes of the new earned depletion provisions is likewise extended to include all the above items with the exception of social capital outlays such as townsites. Also included is the significant reduction, previously announced, in the rate of tax on mining profits from 40% to 25% in order to make additional tax room available to the provinces.

Although the form of the White Paper proposals has thus been preserved in the new legislation, most of the substance has unfortunately disappeared. The new concessions which have been granted ensure that the degree of preferential treatment of these industries has been little if at all reduced. Generous transitional provisions along the lines of the White Paper further ensure that it will be many years before even these limited effects are felt.

A variety of other less important changes in exemptions, inclusions, deductions and other adjustments in the tax base closely follow the White Paper proposals. Amongst the politically more popular proposals, the new legislation goes somewhat beyond the White Paper and raises the personal exemptions to $1,500 for a single taxpayer and $2,850 for a married taxpayer. At the lower end of the income scale the government therefore recognises in effect those economies of living together which had led it to condemn the Carter proposals for a family unit as a "tax on marriage".[35] The new deductions for employment and moving expenses and for child care expenses are virtually the same as the corresponding White Paper proposals, and this is also true of the new system for taxing unemployment insurance, fellowships, research grants and training allowances. The new general averaging scheme involves a somewhat more liberal application of the White Paper proposal for backwards averaging and moves on towards Carter with a useful forward averaging provision for a variety of "unusual receipts".

Other relatively minor changes involve some watering-down of the White Paper scheme. This is especially true where strong opposition was encountered, as, for example, in the case of expense account benefits and the income of cooperatives, credit unions and the professions. The degree of preferential treatment is, however, generally reduced, and significant loopholes in the tax treatment of rental buildings and the income of controlled foreign corporations have been closed in spite of strong opposition. An actual reduction in equity is to be observed only in the increased deductions for retirement savings and for charitable contributions which were evidently added in a further attempt to sweeten the package and, in the case of retirement savings, to help counter the argument that the reforms will reduce savings and growth.

Although falling far short of the equity ideals of the Carter Report, and even of the White Paper, the cumulative effect of all these changes is undoubtedly to create a somewhat more equitable tax system. The considerable broadening of the tax base, and, in particular, the taxation of capital gains, will

35 *White Paper,* para. 2.5.

significantly reduce tax discrimination between people in substantially similar economic circumstances. At the bottom of the income scale the increased exemptions provide useful relief. The new system of capital gains taxation will also help to ensure that effective rates of tax rise smoothly at higher income levels instead of flattening out behind a facade of ostentatiously progressive nominal rates. These effects are admittedly offset to some degree by the disastrous decision to abolish the federal estate tax. Taking all the various changes together, there nevertheless seems little doubt that a modest overall gain in tax equity has been achieved.

Another major objective of the Carter and White Paper proposals was to improve private sector resources allocation by reducing or eliminating a variety of discriminatory or non-neutral provisions in the tax system. Here again some small gains can be claimed, though an extremely complicated array of non-neutralities remains. The attempt to reform the incentives to the extractive industries failed almost completely, and the new incentive to small business is in some respects disappointing and adds greatly to the complexity of the system.

In the light of these relatively limited achivements in the areas of equity and efficiency, it might perhaps be expected that the growth effects should be significantly more favourable. As the Carter Commission had emphasized, however, an equitable system of taxation is not necessarily growth-inhibiting, and the less vigorous equity thrust of the new legislation does not automatically guarantee that it will have more favourable growth effects. The abolition of the estate tax, for example, is extremely costly from the point of view of equity, but provides only a very weak and indirect incentive to saving and capital formation to offset the effects of taxing capital gains. On balance the most that can be said is that the new system should not much affect the rate of economic growth.

Finally it should be noted that the modest equity and neutrality achievements of the new legislation are already threatened with substantial further erosion as a result of the corporate tax changes announced in the pre-election budget of May, 1972. Although ostensibly designed to offset the effects of recent U.S. export incentives and in particular the so-called DISC legislation, the proposed changes are excessively generous and must be interpreted in part as a final concession to the views of the business community.[36]

Conclusion

In retrospect the evolution of the Canadian tax reform debate is not difficult to understand. Starting with the Royal Commission, the attractions of the modern theory of tax reform based on the twin objectives of equity and neutrality are considerable and have been cogently argued in the public finance literature for over thirty years. The fundamental political weaknesses of this approach have, however, been largely ignored. It would have been a remarkable coincidence indeed if the government in power had happened to share the detailed equity conceptions of the Carter Report and also had the courage to implement the necessary legislation in the face of powerful opposition by those who stood to pay.

The Carter emphasis on equity and neutrality nevertheless set the stage for the subsequent debate. The White Paper accordingly offered a set of compromise proposals involving dilution of the major Carter recommendations but still representing a carefully integrated package of reforms with a strong equity thrust. With the laudable aim of involving parliament, the public and the provinces in the making of major

36. Some further if relatively minor concessions are contained in the budget of February, 1973, notably in relation to the small business incentive and the deemed realization of capital gains at death (in the case of a farm passing to the children).

Somewhat wider questions are raised by the interesting new budget proposal to index the rate brackets and exemptions for the personal income tax to eliminate the effects of inflation. This would tend to reduce the built-in stabilizing effects of the tax system and also the volume of public expenditure. Some improvement in equity could also be expected, for example, between people with very different time patterns of income. It was only very late in the tax reform debate that the possibility of an inflation adjustment began to be seriously discussed with particular reference to capital gains. See especially J. Helliwell, "The Taxation of Capital Gains", Canadian Journal of Economics, Vol. II, No. 2, 1969. It should be noted that the general inflation adjustment proposed in the 1973 budget would involve no special concession for capital gains, and rightly so as they already enjoy the special benefits of half inclusion under the new legislation.

tax reform, the White Paper process of participatory democracy then gave the various interest groups a final opportunity to defend their tax privileges. Because of widespread ignorance and organisational difficulties there was no countervailing campaign on behalf of the lower income groups who stood to gain. Further compromise was therefore inevitable, bringing with it additional complications and inconsistencies. In the final result, with the help of some seriously misguided and excessively generous concessions, notably in the death tax area and the extractive industries (and subsequently in the 1972 budget), the original equity and neutrality emphasis of the ten-year tax reform process was largely lost.

In view of the very limited results achieved from the enormous outlay of money, time and effort, it is tempting to ask whether much the same results could not have been achieved more economically in some other way. The capital gains tax stands out as the major achievement of the ten-year reform process; but a similar tax had been introduced (without death tax concessions) in the United Kingdom shortly after the Labour Party came to power in 1964, while the Carter Commission was still engrossed in its work. Such a major change requires, however, either broad popular support or strong ideological commitment on the part of the government. In the Canadian context both prerequisites were lacking, and it was only as a result of the radically new perspective provided by the Carter Report that general capital gains taxation came finally to be viewed as desirable or at least inevitable. Most of the other changes were admittedly less controversial or even positively popular (like the exemption increase) and could have been legislated at any time without the need for a far-reaching inquiry or prolonged public debate.