Draft of June 15/22.

**The Carter Commission and The Corporate Income Tax in Canada**

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Most Canadian tax practitioners, if asked about the origin of the modern Income Tax Act, would refer to the report of the Royal Commission on Taxation (the “Carter Commission” and the “Report”) which recommended, among other things, a radical reform of the corporation income tax.[[1]](#footnote-2) Those recommendations – abolition of the low rate of tax on the first $35,000 of taxable income, full integration of corporate and shareholder income and full taxation of capital gains realized on shares were all designed to address surplus stripping, deferral and double taxation of corporate income. They were also essential for the wider aims of the Report – neutrality between different forms of business enterprise and a more equitable distribution of the tax burden. The initial response to the Report, the 1969 White Paper, accepted the first and third of those recommendations but proposed limiting integration to closely-held corporations. When the *Income Tax Act[[2]](#footnote-3)* was substantially amended in 1971, however, its corporate tax provisions diverged markedly from the Report. The dual rate was retained with some modification, full integration rejected outright and capital gains on shares half taxed. The incentive for surplus stripping and deferral remained largely unchanged.[[3]](#footnote-4). As Mitchell Sharp observed,” … the results, while useful, bore little resemblance to the fundamental reforms recommended by Carter and his associates.”[[4]](#footnote-5) This paper explores that result, focussing on the architecture of the Carter Commission’s proposal rather than its more granular comment on the computation of business income and the taxation of specific industries (notably in the resource and financial sectors).

***The Origins of the Commission***

The Commission was promised by Prime Minister John Diefenbaker during the 1962 election campaign, apparently at the urging of Wallace McCutcheon[[5]](#footnote-6), a prominent Toronto businessman, as a response to business concerns including high levels of tax, restrictive rules for computing income and as discussed below, aggressive tax avoidance. Kenneth Carter, the eponymous chair, added the difficulties in distinguishing income from capital gains.[[6]](#footnote-7) After the election (which returned the Diefenbaker administration to power in a hung Parliament), the cabinet considered its establishment, terms of reference and membership in September of 1962; discussion focussing primarily on membership.[[7]](#footnote-8) Its terms of reference were extremely broad, extending to virtually any aspect of taxation, other than tariffs and federal-provincial tax arrangements. Diefenbaker announced they were to “investigate the whole situation, “with a view to “amelioration” and the removal of “anomalies”. [[8]](#footnote-9) The terms of reference were introduced to the cabinet by the new Minister of Finance, George Nowlan[[9]](#footnote-10), but it is uncertain whether they reflected concerns of the Department of Finance or simply Diefenbaker’s promise of a wide-ranging enquiry. Kenneth LeM. Carter, the chairman of the Commission and a prominent accountant, had considerable experience in tax matters, including involvement with the Canadian Tax Foundation from its inception in the late 1940s. Douglas Hartle, his choice of research director was an academic economist at the University of Toronto. Carter and Hartle were to dominate the work of the commission.

The Commission’s report was initially expected in 1964. The Liberals, in opposition in 1962, insisted reform could not await the report – Edgar Benson, who, as Finance Minister, was later to introduce the 1971 tax reform, argued that Canada “cannot wait two years” for reform. “Bold changes” were needed.[[10]](#footnote-11) Walter Gordon, who was to become Finance minister after the 1963 election returned the Liberals to power, suggested a complete revision of the Act was “overdue” and “[hated] to think that it is going to be postponed for several years”. A “small group of lawyers and chartered accountants”, Gordon suggested, could draft a new act in a “relatively short time” without waiting for the report.[[11]](#footnote-12) In 1963, Gordon, now Finance minister, disclosed that the Commission had not planned to report until 1965 but because of the “pressing nature” of the problem had agreed to report by the end of 1964. There was no mention of the “new act” of the previous year.

Pending the Report, interim measures in 1963 were designed to address the “justifiable sense of inequity and frustration” taxpayers felt in the face of tax avoidance (and in particular, dividend or surplus stripping addressed by new section 138A (to some extent inspired by a surplus stripping rule in the IWTA) discussed further below).[[12]](#footnote-13) George Nowlan, now the Opposition finance critic, predictably echoed Gordon’s comments of the year before that reform of the Act could not wait for the Commission. In particular, Nowlan was critical of the discretion section 138A gave the minister and suggested that there were other ways of “clearing up this great reserve of undistributed income” which was the root cause of surplus stripping.[[13]](#footnote-14)

In the 1964 budget debate, Gordon said it would be “premature and unwise” to make major changes before the Commission reported, still expected later that year and he deferred consideration of deductions for tuition fees and other school expenses, charitable deductions, employment expenses, union dues and logging equipment.[[14]](#footnote-15) He also referred, presciently, to the” extremely difficult task of rewriting the tax laws "and warned that the process might not be any more successful than those in the past to produce” simple, workmanlike, understandable” legislation and that achieving simplicity was” easier said than done”.[[15]](#footnote-16) In late August, Carter advised Gordon there would be a further delay of six months; in April of 1965, the report was expected in the summer. In the 1965 budget, sales tax and corporate income tax were added to the list of matters to be deferred pending Carter and Prime Minister Pearson added mining tax issues a little later in the session.

After the November 1965 election, Gordon was replaced as finance minister by Mitchell Sharp, an experienced civil servant whose experience in fiscal matters went back to the early 1940s.. Early in 1966, Sharp disclosed that draft chapters of the report had been made available to officials in the Department of Finance, but not to the minister. He confirmed that this would not affect the 1966 budget and the report would be studied for “some time” before the government “makes up its mind” how to react.[[16]](#footnote-17) For the remainder of 1966, Sharp faced repeated questions about the timing of the report and pleaded delays in preparing the French language translation. Both Sharp and the opposition looked to the report for fundamental change. The Conservative Opposition looked for the reduction of” incentive-destroying levies”, Sharp promised change based on” equity and efficiency”; the New Democratic Party wanted exemption from tax for low-income persons and more government control of business investments.[[17]](#footnote-18). In debate on the income tax amendments flowing from the 1966 budget, Sharp expressed hope that the Commission would recommend” fundamental changes both in methods of imposing taxes and in the structure of the taxes themselves”.[[18]](#footnote-19) The Commission did not disappoint Sharp or his political opponents. Its proposals for the corporate income tax were far-reaching; to understand how far-reaching, we need to examine the tax as the Commission found it.

***The Corporate Income Tax in 1966***

*Canadian-Source Income*

When the Carter Commission released its report, Canada had a partially modified “classical” corporate tax system. Corporations paid tax at a rate of between 21% and 23% on the first $35,000 of taxable income and a rate of between 50% and 52% on the balance.[[19]](#footnote-20) Dividends[[20]](#footnote-21) were taxed in the hands of individual shareholders at progressive rates up to 80% but entitled the shareholder to a dividend tax credit equal to 20% of the dividend[[21]](#footnote-22), deductible in computing tax payable designed to address criticism of double taxation. In addition, since 1949 a corporation had the option of paying an additional 15% tax under s. 105(2) on a dividend paid out of its accumulated after-tax surplus (Undistributed Income on Hand or “UIOH”). In that case, the dividend was not subject to tax in the hands of the individual shareholder and did not give rise to a dividend tax credit. At the 21% corporate tax level, this produced over-integration - that is, combined corporation and shareholder tax less than the tax an individual shareholder would have paid had they earned the income directly or through a partnership – in respect of the initial $35,000 of income. The over-integration was increased further for shareholders at the higher marginal brackets if the 15% tax was paid. [[22]](#footnote-23)

 For corporate income taxed at the higher rate, the system generally produced under- integration, particularly marked at the lower tax brackets, so that a portion of the corporate income was arguably taxed twice. Payment of tax under s. 105(2) reduced that level somewhat at the higher tax brackets.[[23]](#footnote-24) Intercorporate dividends passed tax free between Canadian corporations. Capital gains were not taxed, creating further surplus where a corporation realized a gain. Because the corporate tax rates were substantially less than the highest marginal rates for an individual, there was an obvious incentive to defer tax by accumulating income in the corporation. There was an equally strong incentive to attempt to withdraw corporate after-tax income, or surplus, without paying tax at the individual level.[[24]](#footnote-25) Deferral and surplus stripping were inherent in the tax system from its inception in 1917 and had been the focus of repeated, specifically targeted anti-avoidance measures.[[25]](#footnote-26) While they enjoyed some success, they led to a seemingly endless battle between the tax authority and the inventive advisors of taxpayers. The courts, committed generally to a strict construction of the taxing statute, afforded little aid to the government. In response, from the late 1930s a series of targeted anti-avoidance measures directed at surplus stripping and driven by reliance on ministerial discretion were enacted[[26]](#footnote-27) and enforced with varying enthusiasm. The most recent, section 138A, enacted in 1963, was a “general and arbitrary measure”, had been widely criticized, in principle because of its reliance on administrative discretion not law; in practice because it produced uncertainty and impacted “ordinary business transactions”.[[27]](#footnote-28)

 Richard Bird, a member of the Commission’s research staff argued that the Commission was primarily appointed to address surplus stripping: “There is good reason to believe that the principal force impelling the government of the day to appoint the Royal Commission on Taxation in 1962 was that the problem of surplus stripping had reached the proportions of a scandal among responsible tax practitioners.”[[28]](#footnote-29) This view was shared by Douglas Hartle, the Commission’s director of research, who wrote that Wallace McCutcheon championed the commission because of “the cries of outrage emanating from the most conservative members of the accounting and legal professions engaged in tax practice”, who had advised their clients not to engage in surplus stripping. When the “blatantly transparent” schemes devised by their more adventurous colleagues succeeded, their clients attacked them, hurting “their personal reputations and, more importantly, … their future incomes.”[[29]](#footnote-30) While this may overstate the case, there is no doubt that tax practitioners were unhappy with the surplus stripping situation. In a well-known article in 1961[[30]](#footnote-31), Heward Stikeman, perhaps the leading tax lawyer in Canada at the time, set out twelve ways in which, under the existing law, corporate surplus could be legally stripped. This was not, we would suggest, a form of advertising or even display of his legal skills, but a statement that reform of some kind was needed. Confirmation came the following year when his law partner, George Tamaki, followed with an explicit plea for reform.[[31]](#footnote-32) Tamaki described the various technical issues facing the tax advisor whose client wished to strip corporate surplus, including problems of sham and substance and the” special care” needed to ensure there was no” missing link in the chain of events”. While taxpayers (and their advisors” should not be criticized for taking advantage of the technical rules of law”, the” glaring deficiencies” he and Stikeman had identified, a” complete review” of the provisions of the Act was needed. In his view, the solution lay not in a” blanket anti-avoidance provision” but a new approach based on a” clear and consistent principle of taxation”.[[32]](#footnote-33) This approach, based on a new statutory scheme rather than targeted or general anti-avoidance measures, was in fact what the Commission set out to do.

Inappropriate deferral in the Act was also addressed by the personal corporation rules, which required accrual of passive investment income in a closely held family corporation where such income exceeded 25% of its total income[[33]](#footnote-34). In one sense, surplus stripping could also be said to exist when the holder of a share in a public company sold the share, without tax in the absence of capital gains taxation, when a significant portion of its value was attributable to retained after-tax earnings. In the context of the Report, however, the term was used to describe the more complex schemes used in closely held corporations where the value in its shares could otherwise only be realized in a tax-free capital gain by parting with control. This, the research staff concluded,” explains why surplus-stripping schemes have ordinarily related to controlling interests in closely-held corporations.”[[34]](#footnote-35) The element of double taxation[[35]](#footnote-36) was reduced but by no means eliminated by the introduction of the dividend tax credit and double taxation joined deferral and surplus stripping as a target for the Report. A final incentive for the Commission to question the existing corporate tax arrangements was one of equity – taxpayers in the lower tax brackets bore effective tax on corporate income at rates significantly higher than their nominal marginal rate.

*Income from Outbound Investment*

Prior to 1971, a Canadian corporation recognized foreign-source income when received and claimed a foreign tax credit (up to the Canadian tax paid) in respect of either foreign withholding tax on passive investment income or foreign direct tax on business income realized in a branch, subject to two exceptions. Under paragraph 28(1)(d) of the Act*,* dividends from a foreign corporation in which a Canadian corporation held 25% or more of the voting shares was fully deductible in computing taxable income, regardless of the activity in the foreign corporation which gave rise to the income, the jurisdiction in which it was earned or the foreign tax paid. Under s. 71 a “foreign business corporation” - a Canadian resident corporation in existence before 1959 whose activities and investment were wholly outside Canada - was exempt from tax.[[36]](#footnote-37)

***Federal-Provincial Relations***

Federal-provincial fiscal relations were outside the remit of the Commission, but it could not avoid their effect given the importance of the shared income tax. In 1967 the federal personal income tax (PIT) was reduced by 28% to provide “tax room” for provincial PIT. Outside Quebec, the provinces imposed tax on the federal tax base, which was collected by the federal tax authority. In Quebec the abatement was 48%[[37]](#footnote-38) and the province imposed and collected its own tax but on a substantially identical base. A corporation’s federal corporate income tax (CIT) was reduced by 10% of its taxable income to provide provincial “tax room”. Quebec and Ontario imposed and collected their own CIT; the other provinces imposed CIT on the federal tax base and collected by the federal tax authority. [[38]](#footnote-39) The arrangements also involved” equalization” payments by the federal government to the poorer provinces, calculated by reference to their tax revenues, also potentially affected by changes in the federal tax system.

***The Commission’s Proposals – Haig-Simons and “A Buck is a Buck is a Buck”***

 *General Provisions*

The Commission’s overall analysis and recommendations were driven by its adoption of the Haig-Simons model for measuring income – that is, income included whatever increased the economic power of the recipient – or what some commentators at the time called the “buck is a buck is a buck” approach. R.A. Musgrave, a well-known Harvard tax expert, described the Report as exhibiting the “unity of Simonesque design.”[[39]](#footnote-40) Carter himself described it as the “widest possible tax base to include every form of economic gain. “ [[40]](#footnote-41) The general recommendation was for what would now be characterized as “base broadening” and consequent rate reduction. In particular, the Commission recommended the full taxation of capital gains and the inclusion in income of a variety of amounts, including gifts, inheritances, employment insurance payments, scholarships, and amounts from various employee benefit arrangements. The treatment of life insurance companies and financial businesses was to be brought closer to that of other corporations with consequent increases in taxable income.[[41]](#footnote-42) The Commission found that about half of all taxpayers were overtaxed by 15% or more and about a tenth were undertaxed by 15% or more. This base broadening and rate reduction required to rectify this lack of” progressiveness”[[42]](#footnote-43) in turn opened the door for the Commission’s approach to the corporate income tax.

 *The Corporate Income Tax*

 The Commission’s recommendation was arguably its “second best” solution. The ideal theoretical prescription was the abolition of the CIT entirely, on the basis that its ultimate incidence could not be determined,[[43]](#footnote-44) and almost certainly violated principles of equity and neutrality. The theoretically desirable alternative was a combination of taxing dividends received, the increase in value of the shares of the corporation (on an accrual basis if unrealized) and the gains realized on the disposition of shares. For practical reasons, principally the loss of revenue from indirect taxation of non-resident shareholders and the valuation difficulties inherent in taxing unrealized gains on shares, it was somewhat reluctantly rejected: “Although we can see no grounds in principle for taxing corporations and other organizations, we have reluctantly reached the conclusion that there are good and sufficient reasons for continuing to collect a tax from them.”[[44]](#footnote-45) The recommendation also echoed (though in greater detail) the conclusions twenty-five years earlier of the Rowell-Sirois Commission on federal-provincial relations. While concerned principally with the division of revenue and taxing powers between the two levels of government its report devoted a chapter to issues of efficiency and equity in taxation. Its recommendation that the provinces and municipalities withdraw from all corporate taxation was partly justified as a first step in eventually replacing corporate income taxation for essentially the same reasons as considered.[[45]](#footnote-46)

The Report’s proposal simultaneously addressed all three issues – deferral, surplus stripping, and double taxation - in a theoretically satisfying and elegant manner by fully integrating[[46]](#footnote-47) the taxation of the corporation and its resident shareholders. As a result of its base broadening proposals, it proposed a substantially reduced maximum individual marginal rate of 50% and maintenance of the existing 50% corporate tax rate.[[47]](#footnote-48) If a corporation had paid tax at less than that rate, it would be required to pay sufficient additional tax to make up the shortfall so that the dividend credit proposed would reflect tax actually paid.[[48]](#footnote-49) A corporate tax rate equal to the highest marginal rate for individuals would simultaneously eliminate both inappropriate deferral and the need for surplus stripping. Dividends would be “grossed up”[[49]](#footnote-50) to reflect the underlying corporate tax paid and full credit would be given for the corporate tax. Taxpayers subject to the highest rate of tax would pay no more, all others[[50]](#footnote-51) would receive refundable credits.[[51]](#footnote-52) This eliminated double taxation.

 Where corporate surplus was not distributed by way of a cash dividend or dividend in kind, three other “eligible” methods of distribution were to be available. A corporation could pay a stock dividend, the amount of which would be subject to the gross-up and credit and added to the cost of the share. It could similarly capitalize surplus with the same result. Finally, a corporation could “allocate” surplus to a shareholder without distribution or capitalization. The shareholder would recognize the allocation in the same manner as an actual distribution; the “allocated” income could be distributed later without tax as a return of capital (and reduction in the cost base of the share).[[52]](#footnote-53)

 The Commission also recommended abandonment of the dual rate system, stressing the administrative difficulties posed by the continuing battle to restrict inappropriate access to the low rate[[53]](#footnote-54) and the opportunity it provided for deferral including planning to avoid the associated corporation rules associated with the split rate arrangement.[[54]](#footnote-55) The Report recommended that a small, closely held corporation, subject to several conditions, have the option to elect to be treated as a partnership on a flow-through basis. As some compensation for the loss of the low rate, such a corporation was to be allowed to fully deduct capital expenditures as incurred up to a $250,000 cumulative limit.

Intercorporate dividends were to be treated on the same basis – inclusion in income, grossing-up and dividend tax credit, with a refund to a recipient corporation which had incurred losses. This effectively continued the tax-free treatment of intercorporate dividends while allowing a form of consolidation. When dividends were paid to an individual the regime described above would apply. The recommendations applied only in respect of resident shareholders; non-residents would continue to be subject to non-resident withholding tax on dividends (but not allocations of income).

One necessary corollary of the proposals was full taxation on gains on the disposition of shares, to prevent “unwarranted benefits” that a shareholder of a corporation that had not paid dividends would reap from the elimination of double taxation and the anticipated increase in the value of Canadian equities. Conversely, taxation of capital gains on shares in accordance with the Commission’s general recommendations without eliminating double taxation was equally unfair: “The two proposals are part of a package. Neither can be recommended in isolation.”[[55]](#footnote-56) The proposals solved the problems raised by the accumulation of retained corporate earnings, but at the immediate cost of decreased revenue.[[56]](#footnote-57) The decreased revenue would not be immediately offset by taxation of capital gains[[57]](#footnote-58) and elimination of various corporate preferences. If “economic conditions” required immediate replacement of the lost revenue, the Report offered two alternatives.[[58]](#footnote-59) The first (and preferred) was to temporarily raise the general level of taxes. The second was a temporary tax on corporate surplus.[[59]](#footnote-60)

*Income from Outbound Investment*

The Commission recommended distinguishing between portfolio and “direct” outbound investments. An investment by a Canadian resident or associated group of 10% or more in a foreign corporation, property or business was a direct investment; any other was a portfolio investment. In either case, the calculation of income from the investment was to be as reported for foreign purposes but subject to the “general principles” of Canadian income calculation (for example, the treatment of capital gains).

Income from portfolio investments was to be treated under the existing rules. Where a Canadian corporation had a direct investment in a foreign property or business, the income was to be accrued, that is, recognized as it was earned rather than received. Dividends from shares constituting a direct investment would continue to be taxed on a received basis. The foreign income was not, however, to be fully taxable until distributed to a shareholder. Instead, the income was to be taxed at a 30% rate in the hands of the corporation, taking into account foreign tax eligible for the foreign tax credit. If the latter was 30% or more, there was no additional tax. If the foreign tax was less than 30%, the Canadian corporation would pay tax equal to the shortfall.

The Commission proposed the upper limit of 30% on the foreign tax credit, notwithstanding that Canadian tax otherwise payable might, and likely would, exceed 30%. The rationale offered for this proposal was that some Canadian tax should be paid – “… we believe that every resident of Canada enjoys some public benefits and should bear some of the Canadian tax burden of providing these benefits”[[60]](#footnote-61) – and the “net economic benefit” derived by Canada for Canadians’ foreign investments is “uncertain”. The 30% rate was also less than actual corporate tax rates in the United States and the United Kingdom, the principal locations for Canadian foreign investing at the time, so that a 30% rate could be assumed without complicated administrative requirements (and perhaps administered by regulation specifying eligible foreign states).

The Commission considered and rejected what it called a “full gross-up and credit” system which would have given the Canadian investor full credit for all underlying foreign tax relating to the direct investment (apparently without the limiting factor of Canadian tax payable) and withholding tax. That would involve “a whole new range of administrative complexities”, including “completely recalculating” the foreign subsidiary’s income on the Canadian basis and extending the procedure to lower-tier subsidiaries.[[61]](#footnote-62) It would also involve a revenue loss in Canada and potentially undermine tax sparing arrangements in respect of developing countries (though the Commission eventually recommended protecting them by treaty provisions). The Commission also suggested that the limited gross-up and credit regime it proposed would replicate the administrative simplicity of the s. 28(1)(d) arrangements.

The final element was to mesh these provisions with the proposed domestic arrangements for full integration. Accordingly, when a Canadian corporation which had received foreign source income from a direct investment paid a dividend to its shareholders, it was to pay an additional 20% tax on the amount of the dividend, to bring the aggregate tax paid at the corporate level to 50%, the rate contemplated under the proposed gross up and credit rules[[62]](#footnote-63). It followed from these recommendations that the partial “territorial’ system set up in s. 28(1)(d) was to be repealed. The Report does not appear to have considered the foreign business corporation rules.[[63]](#footnote-64)

*Federal-Provincial Relations*

The Commission’s proposals for integration contemplated that the gross-up and dividend tax credit would be limited to tax actually paid. The varying provincial tax rates existing under the tax sharing arrangements would make this considerably more complex to administer and, for the sake of administrative efficiency and uniformity of treatment, the Commission recommended that the corporate tax field be occupied solely by the federal government[[64]](#footnote-65) and the provinces compensated with either a share of the tax collected or more sales tax room. The Report noted that this “might be unacceptable to the provinces on doctrinal grounds”[[65]](#footnote-66), a curious use of language likely designed to mask the widely held view of most anglophone academics at the time that advocacy of provincial rights was regressive and regrettable. This recommendation, of course, had no more chance of acceptance than the similar recommendation of the Rowell-Sirois Commission in 1940. Failing that, the Commission proposed that the federal government give “full credit” for the federal tax and for a “standard” rate of provincial tax (presumably the abatement level).

*The Minority Reports*

Two of the Commissioners, Emile Beauvais and Donald Grant, submitted minority reports. Grant’s was brief[[66]](#footnote-67) and did not refer to the corporate income tax proposals. Beauvais’ was considerably more substantial[[67]](#footnote-68) and took the form of a series of comments to each chapter of the Report, principally on the corporate tax proposals in chapter 19. His principal argument was that full integration would provide a “windfall” gain to wealthy investors if the general tax rate was increased to offset lost revenue. The proposed transition tax would be “discriminatory” because it would only affect shareholders of corporations with large surpluses. Beauvais’ solution was to adopt the proposals of the so-called “Committee of Four”,[[68]](#footnote-69) principally replacing taxation of distributions in the hands of shareholders with a flat 15% withholding tax at the corporate level. The Commission had considered a revised version of this proposal and rejected it, principally on grounds of equity.[[69]](#footnote-70) The Commission concluded it would make equities less attractive to lower income taxpayers and would make full taxation of capital gains in shares unworkable. Beauvais also proposed half taxation of capital gains, similar to the U.S. treatment, a position also inconsistent with full integration. He rejected eliminating the dual rate as being “to the detriment” of many small business shareholders. Some would be unable to elect partnership treatment; others would have few assets eligible for accelerated capital cost allowance.[[70]](#footnote-71)

***The Initial Response to the Report***

Robert Bryce, the deputy minister of Finance, had arranged for officials to meet with Kenneth Carter and several senior Commission staff members beginning in 1965 to discuss potential recommendations but admitted that the department was not “adequately staffed” to deal with the reaction to the final Report[[71]](#footnote-72). The Commission delivered the Report on December 22, 1966.[[72]](#footnote-73) The government had no advance warning of its contents - officials in the Department had taken an oath of secrecy before conferring with the Commission staff - and for Mitchell Sharp it was an” unexpected source” of challenge. [[73]](#footnote-74) Bryce recommended, because of the “highly technical and complex nature of the subject”, that no decisions be taken before it had been available to the public for at least six months and, in what turned out be a wildly optimistic guess, the “legislation could not be prepared before the end of 1967.”[[74]](#footnote-75) The English text was made available to the departments concerned immediately; public release was delayed pending the French translation. In early January of 1967, Sharp reported that most of the Report (five volumes in English; four in French) would be ready by mid-February. On February 9, 1967, the cabinet discussed the release of the Report at some length. Walter Gordon, the former Finance minister (who doubtless was aware of its contents) said it would “undoubtedly be disturbing” to the financial community and should be released on a weekend to allow briefing of the press. Other ministers felt the recommendations of the Commission might be “explosive” and, to avoid “pressure … to accept responsibility for its recommendations”, should be kept away from ministers until publication (which would also minimize the chance of leaks).[[75]](#footnote-76) In time-honoured fashion, the Report was released at 6 p.m. on Friday, February 24th, after the close of the markets and after the House had risen for the weekend. The cabinet was briefed on its contents earlier that day, agreeing that it should be made clear the Commission had been appointed by the previous government and did not “at this stage” represent government policy.[[76]](#footnote-77) When Sharp was questioned about the government’s response, he gave the” customary answer, that it would be studied by the government”[[77]](#footnote-78), and invited representations.

The Report dashed any expectations of the business community. As Robert Bryce remarked, “As soon as the Report was published, all hell broke loose in the Canadian business world” and the dual rate proposal “spread consternation throughout the constituencies of most Members of Parliament.”[[78]](#footnote-79) Initial favourable comment in the press was transitory; criticism in the “business pages” as Hartle put it, was permanent. In the June 1, 1967, budget speech Sharp said that” we can properly aim at a white paper late this year” with a draft bill to follow after public comment.[[79]](#footnote-80) in early June a special committee of the cabinet was established under Sharp’s chairmanship to consider the Report.[[80]](#footnote-81) That hope persisted at least until September when the deadline for the public to make submissions was extended to the end of October, with a white paper to follow “as close to the end of the year as possible”.[[81]](#footnote-82)

 It did not happen. Hartle’s explanation was that wider political events preoccupied the government. Mitchell Sharp contested the Liberal leadership in the wake of Lester Pearson’s announced retirement and became the foreign minister when Pierre Trudeau became prime minister in April of 1968. Well before Pearson announced his intention to resign, in December of 1967, the cabinet rejected the Report “as a whole”. At a meeting on October 10, Sharp reported that “it was now clear that the government could not adopt the recommendations of the Royal Commission on Taxation as a package”. Pearson said that, while it was “unfortunate that public reaction had resulted in the whole of the Carter Report being criticized whereas some aspects of it might be well worth implementing”, it was “essential that the government dissociate itself from the Report as such”. The special committee of the cabinet was tasked with articulating the reasons for this decision. Edgar Benson, who was to succeed Sharp as Finance minister in April of 1968, and Walter Gordon both suggested that specific measures flowing from the Report should be prepared by the Finance minister and that the cabinet committee should confine itself to the “public presentation” of the decision not to accept the Report’s recommendations “as a package”.[[82]](#footnote-83)

Sharp returned to cabinet on November 9th, 1967,with a proposal for a statement thanking the public for their comments, emphasizing “the sweeping extent that sudden changes of such magnitude might have on the economy”, the fact that the Commission’s proposals would result in a tax system “quite different” from that of the United States and their” regional” impact, particularly on resource industries. The proposals need not be adopted “as a package” and “meaningful” tax reform could occur outside the proposals in the Report. The cabinet “noted with approval” the statement.[[83]](#footnote-84) On November 30th, Sharp told the House that, while tax reform was necessary and the Commission’s report was of” great value”, the changes to be proposed, though” undoubtedly ... influenced by the monumental report of the royal commission”, will be” more in the nature of reforms in the existing tax structure rather than the adoption of a radically different approach.” Sharp advanced four reasons: the unpredictability of the” sweeping” changes, the divergence they would create from the American tax system, the lack of” adequate weight” given to the need to generate capital and the” regional impact” of the recommendations regarding resource industries.[[84]](#footnote-85) In early 1968, the cabinet, at Pearson’s suggestion, agreed that no white paper be issued before the end of April.[[85]](#footnote-86) Shortly after, the Liberal leadership convention was called for April 4-6, and on April 20, Sharp was replaced by Edgar Benson, an accountant from Kingston and previously the minister of national revenue. An election was called shortly afterwards which returned a Liberal majority.

In the October 22, 1968, budget speech, Benson stated that he had made “certain decisions” about tax reform and had instructed his officials to prepare a draft bill. He also announced rejection of the Commission’s proposal that gifts and inheritances be included in income, “while respecting the intellectual coherence and elegance” of the commission’s analysis because the “overwhelming weight of Canadian opinion” was against it. [[86]](#footnote-87) there was no mention of corporate taxation. In March of 1969, he anticipated a white paper early in June. In the event, Benson presented detailed proposals for a white paper to the cabinet in July 1969, to be released later in the year with implementation in 1970, effective for the 1971 taxation year. The new Prime Minister, Pierre Trudeau, questioned the political advisability of proceeding with tax reform, but the cabinet consensus was to proceed. Trudeau also questioned the timing, given that an election was expected in 1972. Benson’s reply was that deduction tables were designed to give refunds to two-thirds of taxpayers and a 1971 effective date would produce refunds close to the election. Trudeau also speculated on the possibility of an “administration mess” in 1972. Benson doubted that this would happen but reassured cabinet that “it would only become apparent after the election.”[[87]](#footnote-88) The proposals relating to corporations did not come before cabinet until September 23rd. They received little debate, mostly on the degree to which they would encourage Canadian ownership.[[88]](#footnote-89) The draft White Paper itself was considered at an all-day cabinet meeting on October 10th. The cabinet conclusions do not disclose any discussion relating to the corporate income tax. What is most surprising is that there was no mention either of the potential backlash from small business owners to the abolition of the dual rate of tax or the proposed changes in mining taxation (both of which Opposition members had repeatedly raised in in the House).

***The 1969 White Paper***

*Corporate Tax Provisions*

The White Paper[[89]](#footnote-90) was released on November 7, 1969, and notwithstanding the Pearson cabinet’s apparent disavowal of the Report, adopted a significant part of the Commission’s recommendations respecting corporate taxation.[[90]](#footnote-91) It proposed a maximum marginal rate for individuals of 50%, both to avoid “some slackening” in the efforts of highly paid professionals and executives but also to combat deferral and surplus stripping. A substantial difference between the top rate of personal tax and the corporate tax rate “provides an incentive for wealthy people to accumulate income in the corporation …. Means may be found of converting those surpluses into forms that will benefit the owners without attracting personal tax at excessive rates”.[[91]](#footnote-92) Consistent with this position, the corporate tax rate would remain at 50%, equal to the proposed top personal rate.

The White Paper also followed the Report in rejecting the dual rate[[92]](#footnote-93) – all corporations were to be subject to the 50% rate – but proposed differences in the treatment afforded to shareholders, to be based on the size and status of the corporation. Corporations would be classified either as “closely-held” or “widely-held”. The latter were Canadian-incorporated public corporations, corporations which elected to be such (based on tests concerning number and distribution of shareholdings) and corporations designated by the Minister (based on somewhat similar criteria). Once classified as widely held, a corporation would always remain so. All other corporations would be classified as closely held. The latter, in some circumstances,[[93]](#footnote-94) could elect to be treated as partnerships, as the Report had suggested, where taxation of corporate income at progressive personal rates would be beneficial.

At this point, the White Paper diverged from the Report. For closely held corporations, corporate and personal tax would be fully integrated by means of a 100% gross-up of dividends paid[[94]](#footnote-95) and full credit for the underlying tax[[95]](#footnote-96). This addressed surplus stripping by ensuring that income would be taxed at the same rate regardless of the form through which it was earned and addressed concerns about double taxation of corporate income. For widely held corporations, however, the gross-up and corresponding dividend tax credit were to be limited to 50% of the underlying corporate tax.[[96]](#footnote-97) The White Paper described this as “reasonable and competitive”, apparently on the basis that “some level” of the corporate tax was passed on to consumers.[[97]](#footnote-98) This approach also reflected the conclusion of the Commission’s research staff that surplus stripping was only a real issue in closely held corporations. It ignored, however, the argument put forward in the study of surplus stripping that elimination of surplus stripping in closely held corporations would give an “advantage” to shareholders of widely held corporations because of their ability to realize surplus tax-free by selling their shares without having to part with control.[[98]](#footnote-99)

Consistent with the White Paper’s approach, capital gains realized on the shares of closely held corporations were to be fully taxable. Capital gains on the shares of widely held corporations were to be half taxed (consistent with the lower dividend tax credit for their shareholders) but would re-valued every five years and accrued gains or losses taxed. There was no mention of the possible transition tax; the proposed phasing of some personal tax changes and rejection of full integration apparently addressed revenue concerns. Intercorporate dividends were treated in a similar fashion – a closely-held corporation receiving a dividend from another Canadian corporation would gross it up by the tax paid by the paying corporation, 100% of the tax where the latter was closely-held, 50% if widely-held. Tax would be paid, and the dividend tax credit deducted in the normal manner. Dividends between widely held corporations would be grossed up by 50% of the underlying tax but only taxed at the rate of 33 1/3% to avoid eventual tax at an overall rate greater than 50%.[[99]](#footnote-100)

In substance then, the White Paper was aligned with the Report’s recommendations in respect of the corporate tax to a significant degree. This is somewhat surprising, given the initial warnings by both Sharp and Gordon of “explosive” reaction in the business community and “consternation” at the small business proposals. By the time work on the White Paper began again after the 1968 election, Sharp and Gordon, by far the two most experienced ministers in financial and economic matters, had moved on. In return for throwing his support to Trudeau, Sharp became the foreign minister. Gordon, though encouraged by Trudeau to remain in cabinet, retired from political life. Trudeau himself was not interested in tax reform and was preoccupied with constitutional and foreign policy matters. His principal concern was the effect of tax reform on the 1972 election, and he received assurance from Edgar Benson that it would be minimal. Benson, the new minister of Finance, an accountant from a small city in eastern Ontario, was relatively inexperienced – first elected in 1962, he had served as Gordon’s parliamentary secretary for a year before becoming Minister of National Revenue in mid-1964. He was to leave Finance immediately after the 1971 reforms went into effect in January 1972 and left political life entirely eight months later.

*Income from Outbound Investment*

The principal divergence in the White Paper from the Report in this area was its acceptance of the complexity involved in full accrual of investment income in certain circumstances, which the Report had rejected. This conceptually followed the American controlled foreign corporation rules adopted in 1962. The Report’s distinction between foreign corporations based on a 10% votes threshold was to be replaced with the existing 25% threshold used for s. 28(1)(d). The Canadian parent of the “controlled” foreign corporation would continue to enjoy an exemption regime, but only in respect of dividends from such a corporation resident in a country with which Canada had entered a tax treaty and derived from active business income. Passive investment income by contrast would be accrued as earned and fully taxed on a current basis. As the Report had indicated, this involved “complicated and difficult law but the problem is serious and defies easy solution.”[[100]](#footnote-101) This was the genesis of the modern foreign affiliate/FAPI rules and was a significant divergence from the Commission proposals.

The White Paper was silent on most situations outside the controlled foreign corporation proposal and presumably assumed partial or full integration on dividends paid by the Canadian parent, depending on its status. The Canadian individual shareholder of a foreign corporation would presumably pay tax only when dividends were paid with credit only for foreign withholding tax on the dividend. Because the normal treaty withholding rate did not exceed 15%, the White Paper proposed limiting the tax credit to that amount.[[101]](#footnote-102) The special status of a foreign business corporation was both “repugnant in principle” and inconsistent with the proposed treatment of controlled foreign corporations and would be phased out over a five year period.

*Federal-Provincial Relations*

Predictably, the White Paper summarily rejected the recommendation that the provinces vacate the corporate tax field: “It is the government’s view that both jurisdictions should retain access to wide powers of taxation. Constitutional taxing powers should not be allocated between the provinces and Canada according to some prediction of fiscal requirements.”[[102]](#footnote-103) It adopted the Report’s alternate recommendation to “construct the system of credits … on the basis of a national tax rate of 50 per cent.”[[103]](#footnote-104) Although the White Paper did not provide further detail, presumably this meant a uniform gross-up rate for all taxpayers. Under the on-going federal proposal to abandon the “tax on tax” system, each province would have chosen what portion of the gross-up to recognize as representing provincial tax paid.[[104]](#footnote-105)

***Reaction to the White Paper***

The White Paper was referred to the House of Commons Standing Committee on Finance, Trade and Economic Affairs on December 19, 1969, and to the Senate Standing Committee on Banking, Trade and Commerce on November 19, 1969.

 *House of Commons Standing Committee on Finance, Trade and Economic Affairs*

The Committee’s hearings on the White Paper elicited massive public response.[[105]](#footnote-106) It sat for 146 days, including hearings outside Ottawa, heard from over 800 witnesses and over 200 or the more than 500 briefs submitted. The briefs were almost uniformly hostile to the corporate tax proposals.[[106]](#footnote-107) Ron Robertson, a prominent tax practitioner, described the reaction to the proposal to remove the dual rate for small businesses as “a torrent of abuse”. Benson, Robertson wrote,” recognized defeat early on and started to figure out how to handle the small business problem.” Integration was a “perplexing issue” and the response was less hostile, though practical difficulties were cited, particularly the requirement to distribute surplus within 2 ½ years and the administrative difficulties in limiting the dividend tax credit to tax actually paid.[[107]](#footnote-108) Some briefs also pointed out that the requirement for a 50% corporate tax rate in the integration scheme appeared to negate the benefit of any tax incentives which had the effect of reducing the tax paid by the corporation below that level. These were overshadowed by the opposition to full taxation of capital gains (which was an essential part of the Report’s “package deal”) with limited relief for gains on personal residences.

The Committee recommended retention of the dual rate on the first $35,000 of income but to be phased out when income exceeded $105,000, and with a maximum benefit of $10,000 annually. Public corporations and their subsidiaries and foreign-controlled corporations would not be eligible. The Committee approved the partnership option and full integration for the first $50,000 of income earned in a closely held corporation. This essentially continued the existing system while excluding widely held corporations from its benefits. For the latter, half integration was recommended, again roughly approximating the status quo. The Committee also recommended that corporate level tax incentives flow through to shareholders. Finally, all capital gains were to be half taxed. The Committee thus substantially rejected the White Paper (and Commission) proposals for the corporate income tax.

 *Senate Standing Committee on Banking, Trade and Commerce*

The Senate Committee’s report[[108]](#footnote-109), as Bryce remarked, was “not so important politically”, but “whose expert cross-examination of the government witnesses was an experience I shall never forget”.[[109]](#footnote-110) It was assumed that the senators would be generally hostile to the Report and they did not disappoint, recommending retention of the existing corporate tax arrangements though with a sliding scale for the dividend tax credit, ranging from 15% to 25%.

The Committee report somewhat surprisingly accepted full taxation of short-term (less than one year) gains and taxation of other capital gains at a maximum rate of 25% (implying half taxation of gains). It also proposed retaining the dual rate of tax for but limiting it to business income of private corporations with income of less than $100,000, a proposal largely adopted by the government. The Committee objected to the White Paper integration proposals on several grounds – the requirement to pay dividends within 2 ½ years of earning income would force corporations to make distributions when funds should be retained for re-investment; they would deny corporate level incentives to shareholders and creditable tax would be difficult to determine. There was also generalized hostility to full integration, thought to flow from suspicion that base-broadening would eventually tempt governments to increase the rates of tax initially lowered.

***The 1971 Amending Bill***

Before the House and Senate Committees completed their hearings the special cabinet committee on tax reform had begun to back away from the White Paper. On June 11th, 1970 Benson sought and received cabinet approval to write to the Chairman of the House Committee making it clear that the tax reform exercise was not intended to increase revenue and that the White Paper tax rates would be reduced if necessary to achieve this.[[110]](#footnote-111) More significantly, Benson also said it would be “extremely helpful” if he could share with the Committee “fundamental changes in the proposals in the White Paper which the government would be making”. Trudeau opposed disclosing changes in “a piecemeal fashion” and cabinet instructed Benson not to refer to any proposed change in policy. On July 9th, Benson reported to the cabinet that he would be appearing before the House Committee in the first week of August. The special committee on tax reform was asked to consider whether Benson should announce any changes to the White Paper proposals then.[[111]](#footnote-112)

The special committee produced an interim report on July 29th which was discussed at a cabinet meeting on July. 31st. The principal recommendation was to abandon full taxation of capital gains in favour of the “general principle of a half gains tax with complete exemption of principal residences and to “discard” the proposal for the revaluation and tax of accrued gains on shares of widely-held corporations every five years. Benson said that the proposals for integration had been “widely misunderstood” and had produced proposals which would have increased tax. He therefore proposed half integration for all corporations subject to providing full integration for closely held corporations for up to $100,000. At least one of his colleagues demurred. Ron Basford, the Minister of Consumer and Corporate Affairs, argued that the revisions would be a “substantial falling away” from the original plan, as a result of “pressure from industry”. This would have “serious political implications” and it would be preferable to concentrate on removing “minor irritants”. His position elicited no support. Ministers also disagreed about immediate partial disclosure of changes in policy[[112]](#footnote-113). In the end, the cabinet approved “in principle” the changes Benson proposed, authorized him to meet with the Liberal members of the Committee to inform them of the “possible trend of changes” to the White Paper and, in his meeting with the full Committee, to “respond in general terms which would reflect his personal view rather than a previously agreed position by government”.[[113]](#footnote-114) Notwithstanding the circumlocution about the government’s position, it was the death knell of the Commission’s corporate tax proposals. Benson raised the metaphorical white flag at the House Committee on August 4th.[[114]](#footnote-115)

***The Final Proposals***

On March 18, 1971, Benson reported to cabinet the report of the cabinet committee on tax reform. It described integration as “counter-productive” because it allowed the flow-through of tax concessions (such as super-depreciation for anti-pollution equipment) to shareholders, without reference to the Commission’s proposal to top-up corporate tax to a 50% rate. Perhaps more significant was a “basic political problem … those who would lose from it would attack it vigorously while those who would gain would not defend it.” It also noted that abandoning integration would increase revenue, offsetting at least in part the estimated cost of $300 million for the low corporate rate. Reflecting the government’s retreat from its “previous commitment to integration”, the position was to be presented “in such a way as not to appear to be giving in to criticisms by the opposition and others.” It also argued that what it described as the “modified dividend tax credit” would assist the resource industries. The cabinet authorized drafting of the amending legislation on this basis.[[115]](#footnote-116) The final timetable for completing the reform process by the end of the year was approved in a meeting on April 29th and a memorandum from Benson summarizing the reform package was approved on May 11th. The memorandum confirmed the final shape of the corporate tax provisions:

1. Small businesses were to be taxed at the rate of 25% on the first $50,000 of active business income, limited to a cumulative total of $400,000.
2. All dividends were to be grossed up at a rate of 33 1/3%; the dividend tax credit to equal the gross-up and to be available regardless of tax actually paid by the corporation; and
3. Half taxation of capital gains, including shares, on a realization not accrual basis, and exemption of principal residences.

It also noted that tax incentives for mining would be placed on “a more rational and ultimately less expensive” method and that the proposals reflected “in large part” comments of the provincial governments. The cabinet discussion of the reform proposals continued on May 13th and 18th but the only substantive discussion on the corporate tax proposals related to the decision to reduce the general corporate tax rate over 5 years to 46%.[[116]](#footnote-117)

***The 1971 Amendments***

*Corporate Income Tax*

 The provisions enacted in 1971 diverged significantly from both the Report and the White Paper,[[117]](#footnote-118) creating a gap between the reduced corporate tax rate of 46% and the maximum personal marginal rate of 61%. The distinction proposed in the White Paper between widely held and closely held corporations was replaced by distinctions based on the type of corporation, the location of control and the type of income earned. The dual rate system for small corporations was retained in revised form. A closely held Canadian-controlled corporation was subject to a rate of 25% [[118]](#footnote-119)on the first $50,000 of annual income from an active business, subject to a lifetime cap of $400,000 in income. For all corporations, the gross-up and dividend tax credit rate was 33 1/3% of dividends paid. This yielded full integration only in respect of income subject to the low, 25% tax rate[[119]](#footnote-120). The requirement in the Report and White Paper that the credit be limited to tax paid was dropped, allowing tax expenditures to pass through to shareholders. The requirement that the credit be claimed with 30 months of the end of the year in which income was earned was also abandoned. Withdrawal of corporate surplus attracted significant additional tax in respect of income not subject to the low rate and capital gains were to be only half-taxed. In those circumstances, there was no possibility of withdrawing any of the existing surplus stripping provisions. The corporate tax measures were, complained Bird and Bucovetsky, a “set of complex and petty provisions”.[[120]](#footnote-121)

 Relief was given in respect of surpluses accumulated before 1971 by allowing a corporation to distribute such surplus on payment of a 15% tax, effectively continuing the option under s. 105(2). Once the surplus had been subject to the tax and distributed, the corporation could distribute tax-free the portion of any capital gains realized or accrued before 1972. These distributions were deemed to be returns of capital, reducing the cost of the recipient’s shares in the corporation.

 The object of the White Paper provisions applying to closely held corporations was partially maintained where the corporation earned passive investment income, albeit in a more complicated manner. Such income was to be taxed at the rate of 50% when earned[[121]](#footnote-122), to prevent deferral, but 25 percentage points of the tax were refunded to the corporation on payment of sufficient dividends.[[122]](#footnote-123) The 33 1/3% gross-up and dividend tax credit would then fully integrate the tax on the investment income. To address the additional deferral arising from the re-investment of active business earnings taxed at the low rate, a special tax was imposed on “ineligible investments”, essentially passive investments unrelated to the corporation’s active business. [[123]](#footnote-124) The amendments also integrated the taxation of capital gains realized in a private corporation by allowing the corporation to distribute the non-taxable half of capital gains tax-free to shareholders as a “capital dividend”.

*Income from Outbound Investment*

 The amendments generally followed the proposals in the White Paper. The “controlled foreign corporation”, now renamed a “foreign affiliate”, was a foreign corporation which satisfied one of three conditions: it was either controlled by the Canadian taxpayer, alone or by a related group; 25% of its voting shares or 50% of any class of shares was owned by the Canadian taxpayer; or the taxpayer owned 10% of its voting shares and elected to qualify it as a foreign affiliate. Following a transition period ending in 1975, dividends paid by a foreign affiliate to a Canadian corporation out of active business income would be exempt from tax if the income was earned in a country with which Canada had a tax treaty. Dividends paid out of active business income earned in a non-treaty country would be taxable but with full credit for foreign tax, both underlying tax and withholding tax on the dividend. Where the foreign affiliate earned passive investment income or capital gains after 1975, the Canadian shareholder was required to accrue the income as earned regardless of whether it was distributed, with recognition both for foreign withholding tax on dividends and underlying foreign tax in the foreign affiliate. The dual nature of the treatment of international income thus lived on, albeit under different rules. A full territorial, exemption system for active business income earned in a treaty country reflected capital import neutrality, the accrual regime, capital export neutrality. Capital gains realized on the disposition of business assets were subjected to the accrual regime, no allowance being provided for re-investment in the active business operations.

 *Federal-Provincial Relations*

The 1971 amendments had virtually no impact on federal-provincial relations. The one concession made by the federal government was in the refundable tax regime for investment income. In effect, no provincial corporate income tax was required to be refunded, the federal government agreeing to bear the full cost. The provinces thus realized a higher proportion of the total tax paid on passive investment income in private corporations than the proportion of tax paid on active business income.

***Conclusion***

Why did the eventual result fall so far short of the Commission’s recommendations? The obvious reason was the political backlash – the proposed abolition of the dual rate produced a tsunami of opposition from small business groups, small business taxation arguably being the “third rail” of Canadian tax politics. There was also widespread public criticism of the capital gains proposal and business opposition to full integration.[[124]](#footnote-125) The nearly three-year delay between submission of the Report and release of the White Paper allowed its opponents ample time to prepare. What is surprising is that the Trudeau government apparently did not anticipate the public reaction (though it was a government which came very close to losing the 1972 election, so perhaps not so surprising). Mitchell Sharp, who had left Finance before it began to grapple with the White Paper, accurately summarized the political situation:” There was too much inertia in the existing system of taxation, and there were too many uncertainties in shifting from known to unfamiliar and untested systems for the politicians to take risks inherent in radical reform.”[[125]](#footnote-126)

The insulation of the Commission from the department, not to mention the government – Bryce and departmental officials were required to take oaths of secrecy before talking to the Commissioners – arguably contributed. It may be asked whether maintaining the “purity” of the Commission was unrealistic and, indeed, counter-productive where major public policy decisions were in issue which inevitably were intertwined with politics. The Commissioners evidently rejected any such suggestion – “The Commission and Douglas Hartle, the Commission’s director of research, quite properly took the position that the Commission’s job was to provide the framework. How it was or could be implemented was up to the technicians and politicians.”[[126]](#footnote-127) A contributing factor may have been the extremely broad scope given the Commission. Like the Rowell-Sirois Commission in the late 1930s, the Commission had been appointed to provide an immediate response to a political problem and an open-ended mandate fitted that requirement. Consequently, the Commission was given no practical boundaries, notwithstanding the significant political obstacles to radical change. By contrast, two royal commissions had been appointed in 1944[[127]](#footnote-128) to deal with discrete and limited income tax issues. Their recommendations were adopted with little controversy.

Another factor, which most commentators passed over, was, as Richard Bird put it, “money”. The key Commission proposals were linked financially as well as logically. Full integration involved a substantial revenue loss in and of itself, of about 5% of the annual tax revenue of the government. Other proposals of the Report, including the full taxation of all capital gains, removal of the low rate, taxation of gifts and inheritances as income and increased taxation of resource industries compensated for the reduction. It was a “package deal” in money as well as technical terms. Retention of the dual rate, half taxation of capital gains with exemption of principal residences, rejection of the inclusion in income of gifts and inheritances and of part of the proposed tax increases for resource industries unravelled the fiscal basis for the Report’s plan. Bryce had harsh words for the latter: “… I have believed ever since that the mining industry was successful in exerting pressure on the provincial governments to get them to oppose very strongly this central recommendation [full integration]”[[128]](#footnote-129)

 The Commission also rejected, apparently out of hand, recourse to more effective anti-avoidance legislation and limited itself to a brief plea to the courts to be more active in approaching tax avoidance. The Commission’s solution – a statutory scheme which removed even the possibility of surplus stripping – offered escape from the uncertainty of litigation and the apparent lack of sympathy in the courts. Unfortunately, it did not offer escape from attack by powerful interest groups. Ironically, a robust general anti-avoidance rule could likely have been enacted at the time with relatively little political cost. The only anti- tax avoidance measures in the past which had elicited meaningful political opposition were measures employing ministerial discretion, absent which they were passed often with little discussion, let alone significant opposition.

Despite the fate of the Commission’s principal recommendations, its work provided a focus and impetus for generalized support for tax reform in the 1960s. Whether the substantial amendments made in 1971 would have happened without it is a matter of speculation. Some of its recommendations and the technical improvements it proposed[[129]](#footnote-130) with respect to the corporate income tax were adopted in 1971. Its overall vision of an income tax based on abstract economic principles of equity and neutrality has been more influential in the design of academic papers and conferences[[130]](#footnote-131) than in the making of income tax law.[[131]](#footnote-132) It can be said with some confidence that few innovations in the Canadian income tax after 1971 owe anything to the Report, notwithstanding invocation of its name.

1. *Report of the Royal Commission on Taxation*, Ottawa: Queen’s Printer, 1966, volume 4, chapter 19. [↑](#footnote-ref-2)
2. S.C. 1952, c. 148, as amended (the “Act”). The “modern” Act was the product of extensive amendments in 1971 in S.C.1970-71, c. XXX. The Act was consolidated in the 1985 revised statutes; references here to the Act are to the Act as it was after 1971 but prior to the consolidation. [↑](#footnote-ref-3)
3. To modern observers, the Report said relatively little about tax avoidance, beyond urging judges to loosen the generally prevalent strict construction approach to statutory interpretation (and in a study specifically dealing with surplus stripping, noted that in the U.S. “specific or general anti-avoidance provisions do not seem to be necessary because of the role played by the courts in frustrating attempts to avoid taxes.” (Surplus Stripping, fn. 27 below, at p. 49) . The study described in detail anti-avoidance legislation both specific and general in a number of countries. Based on the experience in the U.S. and the U.K., the study concluded “that there is reason to doubt that such legislation is the final answer to the surplus-stripping problem” (at p. 50). [↑](#footnote-ref-4)
4. Sharp at p. 134 [↑](#footnote-ref-5)
5. Appointed to the Senate and made Minister without Portfolio after the election. Donald Fleming, then Minister of Justice, who had just been replaced as Minister of Finance, ascribed the suggestion to Oakley Dalgliesh, publisher of the Toronto *Globe and Mail.* Fleming claimed he was “lukewarm’ to the idea and concerned that the commission’s report might be “unseasoned by political experience”. See Donald Fleming, *So Very Near: The Political Memoirs of the Honourable Donald Fleming, Volume 2: The Summit Years,* Toronto: McClelland and Stewart, 1985, pp. 561-2. [↑](#footnote-ref-6)
6. Kenneth Carter, “Canadian Tax Reform and Henry Simons”, *The Journal of Law and Economics,* 11:2, (Oct. 1968), pp. 231-242 t p. 231 [Carter, Canadian Tax Reform]. This is the text of the Fourth Henry Simons Lecture, delivered by Carter at the University of Chicago on April 18, 1968. Carter died In 1969 and thus played no ongoing role in the consideration or implementation of the Commission’s recommendations. [↑](#footnote-ref-7)
7. See Cabinet Conclusions [the term used to describe cabinet minutes] Library and Archives Canada (“LAC”) RG2, Series A-5-a, volume 6193. An unnamed minister hoped it would include others than “businessmen and tax lawyers”. At the last minute, it was suggested there should be a woman on the Commission because women’s organizations had begun raising tax issues. A choice was quickly made, and the Commission was appointed on September 25, 1962 (P.C. 1962-1334). [↑](#footnote-ref-8)
8. See Debates of the House of Commons (“Debates”), October 2, 1962, p. 91 [↑](#footnote-ref-9)
9. Nowlan was an experienced politician but had not particular fiscal experience or expertise. See Margaret Conrad, George Nowlan, Maritime Conservative in National Politics (Toronto, Buffalo: University of Toronto Press, 1986). [↑](#footnote-ref-10)
10. Debates, October 22, 1962, p. 863 [↑](#footnote-ref-11)
11. Debates, November 15, 1962, p. 1654 [↑](#footnote-ref-12)
12. Debates, June 15, 1963, pp. 1004-5 [↑](#footnote-ref-13)
13. Debates, June 19, 1963, p. 1355. Gordon, later in the debate, suggested that s. 138A would not be a “permanent fixture” but that the Commission would suggest a “more suitable fashion” of addressing the issue. In the debate, Gordon Fisher, the NDP finance critic, referred at some length to the papers on surplus stripping delivered at the 1961 CTF Conference by Heward Stikeman and Peter Thorsteinsson (Debates, July 22, 1963, at p. 2490ff.). Gordon replied that the existing provisions were “less than successful” and that his was the only “practical approach” pending the Commission report. [↑](#footnote-ref-14)
14. Debates, pp.977, 2625, 3284, 3371 in April and May of 1964. [↑](#footnote-ref-15)
15. Debates, May 14, 1964, p. 3284 [↑](#footnote-ref-16)
16. Debates, January 24, 1966, pp. 146-7. Sharp later disclosed that draft chapters had been provided to officials at various times from May of 1965, either at the request of the Commission (to determine the feasibility of some alternatives) or of the department. The department had also established a tax analysis unit, largely staffed by outside experts, to consider the report. See Debates, February 2, 1966, at p. 593 and February 9, 1966 at p. 957. [↑](#footnote-ref-17)
17. Debates, pp. 4182, 3375, 6145 respectively. [↑](#footnote-ref-18)
18. Debates, June 9, 1966, p. 6198 [↑](#footnote-ref-19)
19. This included provincial income tax, in all provinces imposed on a tax base identical or nearly identical to that at the federal level and in 8 of the 10 provinces administered by the federal tax authority. The federal corporate income tax was imposed at a rate of 50%, but with an “abatement” or reduction of 9 percentage points (at the time the Report was issued; 10 percentage points by 1969) in respect of income earned in a province. The provinces then imposed tax at rates, by the mid-1960s, of from 10% to 13%. [↑](#footnote-ref-20)
20. Including distributions (other than formal returns of capital) which were deemed to be dividends. [↑](#footnote-ref-21)
21. The dividend tax credit was introduced first in 1949 at the rate of 10% and increased to 20% in 1953. The credit was deductible in computing tax payable but was not refundable. The dividend tax credit was effectively financed in part by the provincial governments because, by reducing personal income tax payable, it generally reduced their tax rental payments, up to 1962, and their tax receipts after 1962 (which were calculated as a percentage of federal tax payable). [↑](#footnote-ref-22)
22. For an example, see Wolfe Goodman, “Integration” in *Report of Proceedings of the Twentieth Tax Conference,* Toronto: Canadian Tax Foundation, 1968 at pp. 73-4. The 15% tax was imposed under subsection 105(2) of the Act. [↑](#footnote-ref-23)
23. A corporation realizing $100 of taxable income would pay $50 in corporate tax; a $50 dividend by the corporation, taxable in the hands of an individual shareholder at a marginal rate of 50%, bore tax of $25 less the 20% ($10) dividend tax credit, for total tax of $65 (as opposed to the $50 payable if the income had been earned directly). Where the 15% tax was paid on half of the dividend, total tax was reduced to $61.25. Where the recipient’s marginal rate was 40% or more, it was generally advantageous for a resident individual shareholder for the corporation to pay the 15% flat tax in respect all or part of the dividend. This reduced the degree of under-integration but was of no benefit to shareholders in the lower tax brackets. Recourse to s. 105(2) in practice was likely limited to closely-held corporations. This was reinforced by the presence of non-resident shareholders in public companies who received no benefit from payment of the 15% tax. [↑](#footnote-ref-24)
24. To the extent that accumulated surplus was reflected in the value of the corporation’s shares, the surplus could be accessed without tax by selling the shares but in closely-held corporations shareholders wanted to retin their interest in the corporation. [↑](#footnote-ref-25)
25. See Colin Campbell and Robert Raizenne, *A History of Canadian Income Tax. Volume I: the Income War Tax Act 1917-1948,* Toronto: Canadian Tax Foundation/Osgoode Society for Legal History, 2022, pp. 138-179; 309-320. [↑](#footnote-ref-26)
26. See R. Raizenne and C, Campbell, “Countering Tax Avoidance in Canada before the General Anti-Avoidance Rule”, in Harris and deCogan, eds., *Studies in the History of Tax Law,* vol. 10 at pp. xx=xx, London: Hart 2021. [↑](#footnote-ref-27)
27. Ch. 19 at p. 14. The Commission’s staff study of surplus stripping (see fn. 27 below) downplayed the effect of administrative discretion, on the basis that the Minister’s determination of a tax avoidance purpose could be appealed, and reversed, by the court. The discussion can be read as representing a view that anti-avoidance rules were not the appropriate response because of the uncertainty of the judicial response. The Report is notable for the brief treatment of tax avoidance and its reliance on specific “bright line” statutory measures. [↑](#footnote-ref-28)
28. Meyer Bucovetsky and Richard Bird, “Tax Reform in Canada: A Progress Report”, *National Tax Journal,* 25:1, 15- 40 at 29. They also noted that the Department of Finance had requested, as the “first order of business” for the Commission, a study of surplus stripping. In mid-1963, Walter Gordon reported that he had spoken to Carter, suggesting that” this was one of the things on which we would like an early study and an early recommendation" (Debates, July 22, 1963, p. 2496) and repeated it in October of 1963 (Debates, October 22, 1963, p. 3637). , The Preface to the Commission’s study of surplus stripping (*Studies of the Royal Commission on Taxation. Number 15 – Stripping of Corporate Surplus,* November 1963) referred to the “grave concern” which the Minister of Finance and practitioners had expressed over surplus stripping. Harvey Perry, one of the Commissioners, described the surplus issue as probably the “most continuing and lively one” in Canadian taxation – “… the battle to release bottled up taxable surplus from corporations with the least painful results”. See J.H. Perry, “Anatomy of a Tax System and the Carter Report”, Toronto: CCH Canadian Limited, 1967 at 21. The House of Commons committee which studied the 1969 white paper reported that surplus stripping was a “prime motivating factor“in the establishment of the Commission (Eighteenth Report of the Standing Committee on Finance, Trade and Economic Affairs Respecting the White Paper on Tax Reform Ottawa: Queen’s Printer,1970 at p. 45), . Bird, however, may have overstated the case. The Commission was promised in the 1962 election campaign, in response to complaints from the business community that the tax system was too complex, that is over-taxed Canadian business and entrepreneurs and harmed economic growth. Surplus stripping was an issue “inside” the system, foreign to electoral politics. [↑](#footnote-ref-29)
29. Douglas Hartle, “Some Analytical, Political and Normative Lessons from Carter”, in Neil Brooks, ed., The Quest for Tax Reform, Toronto: Carswell, 1988, pp. 397-421 at p. 401 [↑](#footnote-ref-30)
30. Heward Stikeman,” Ability to Pay Revisited”, Report of the 1961 Conference, Canadian Tax Foundation, Toronto, 1962 at p. 23 [↑](#footnote-ref-31)
31. Goerge Tamaki,” Corporate Surplus Taxation – The Great Professional Dilemma”, Canadian Tax Journal 1962:6, pp. 434-442 [↑](#footnote-ref-32)
32. Ibid, p. 442 [↑](#footnote-ref-33)
33. The provision was, as the Report noted, “easily avoided” either by manipulating shareholdings, “introducing some element of business activity or exploiting weaknesses in the definition of control…” and by income characterization and significant reform was proposed in the 1961 budget but deferred when the Commission was established. See Report, chapter 19 at pp. 16-17. [↑](#footnote-ref-34)
34. *Stripping of Corporate Surplus,* supra, p. 4 [↑](#footnote-ref-35)
35. There had never been any principled attempt to justify the move to a classical system in 1926, which was effected in conjunction with a number of tax reductions which offset any immediate negative effect on shareholders. The “franchise” theory used to justify double taxation in the United States was never seriously advanced in Canada. [↑](#footnote-ref-36)
36. Dividends received from a foreign business corporation were deductible in computing taxable income under para. 28(1)(e). [↑](#footnote-ref-37)
37. To compensate Quebec for” opting-out” of a number of shared-cost programmes, such as health insurance. The anomalous position of Quebec was a product of the upsurge of separatist nationalism in the 1960s, the dominant political issue of the decade. [↑](#footnote-ref-38)
38. A federal-provincial Tax Structure Committee had been established to deal with conflicts in the tax area. Not long before the report was released, Sharp announced his intention to meet with the committee to discuss its implications. Changes in the federal tax base affected provincial tax revenues. See Debates, July 13, 1966, at p. 7634. [↑](#footnote-ref-39)
39. R.A. Musgrave, “The Carter Commission Report”, *Canadian Journal of Economics,* 1:1 (Supp.), 159-182 at 159 [↑](#footnote-ref-40)
40. Carter, Canadian Tax Reform at p. 233 [↑](#footnote-ref-41)
41. ” In failing to exact proportionate tribute from these people, Canada concedes vast amounts which would otherwise produce substantial general tax reductions.” Carter, Canadian Tax Reform at p. 235 [↑](#footnote-ref-42)
42. Carter also quoted with approval Simons’ statement that horizontal equity must” predominate over, if not wholly override” objectives such as economic growth in the tax system and rejected the use of tax expenditures than, for example, explicit subsidies. Carter, Canadian Tax Reform at pp. 237-8, quoting Henry Simons, *Federal Tax Reform 5* (1950). [↑](#footnote-ref-43)
43. Carter described the issue of shifting corporate tax to wage earners and consumers as” confused” and focussed on the” double taxation” of corporate income, which the Commission concluded, taxed shareholders at rates higher than their marginal tax rate. [↑](#footnote-ref-44)
44. Report, chapter 19 at pp. 4-5. Harvey Perry described the corporation income tax as “that most horrible of all tax monstrosities” but the Commission “could not see [its] way through the revenue loss. Perry, supra, note 11 at pp. 11, 22. [↑](#footnote-ref-45)
45. See *Report of the Royal Commission [on Dominion-Provincial Relations],* Ottawa: King’s Printer, 1940, volume 2, chapter VIII at p. 150 ff. The arguments were based on considerations of both efficiency and equity. The Commission viewed corporate taxes other than on income as undesirable costs on business. Their replacement by the federal corporate income tax would replace those costs with a tax solely on corporate income or surplus. This, however, “should only be preparatory to a more radical change which would shift the burden of those taxes to the personal income derived from business …” (at p 151), that is personal income and succession taxes. In the shorter term, the corporate income tax would be retained to tax non-residents and to prevent undue deferral. Double taxation of corporate income was also identified as undesirable, preventing neutrality of treatment among different forms of business organization. The solution briefly mentioned (and, of course, unnecessary for the Commission’s immediate task) was exemption of dividends from tax. The connection with tax rates was not pursued. The report also noted that abolition of corporate income tax would increase the value of shares and give shareholders disproportionate gains. It mentioned the “bold step” of taxing the resulting capital gains (at p. 53) but finished with the “offhand” view that gains were better addressed by succession taxes (at p. 55). [↑](#footnote-ref-46)
46. The Commission’s proposals were generally referred to in the debates that followed as “full integration”. [↑](#footnote-ref-47)
47. The Commission appears to have assumed that the provincial governments would either fall in line and adjust their rates accordingly or perhaps agree to vacate the field as discussed below. [↑](#footnote-ref-48)
48. The Commission reported that this was” not a necessary feature of the full integration system” but avoided the need to either calculate a separate gross-up rate for each dividend paid or to give a credit greater than the amount of tax paid. It also would force the corporation to reverse the effect of any preferences within the 2 ½ year period for accessing the credit. In the modern Act there is an implicit assumption that dividends are paid out of corporate surplus that has been taxed at the statutory rate. [↑](#footnote-ref-49)
49. That is, increased by the tax actually paid at the corporate level on the income needed to fund the dividend. [↑](#footnote-ref-50)
50. The Commission’s assumed that the majority of shareholders would be subject to marginal rates of tax less than 50% and that overall, shareholders would pay less tax. See Table 19-1 at p. 8 of chapter 19 of the Report for a simplified example of the operation of the proposal. [↑](#footnote-ref-51)
51. This method was substantially identical to a proposal submitted to the Commission by Donald Huggett, [a Toronto accountant] and considered briefly in the surplus stripping study (at p. 69). It was not one of the alternative proposals selected by the research staff for intensive study (which were included as appendices to the study). [↑](#footnote-ref-52)
52. Allocation would avoid the immediate creation of withholding obligations in respect of non-resident shareholders in a situation where there was no cash payment from which to withhold. [↑](#footnote-ref-53)
53. The complex associated corporation rules first introduced in 1949 were designed to prevent multiplication of the low rate through closely related corporations. [↑](#footnote-ref-54)
54. [↑](#footnote-ref-55)
55. Ibid, p. 28 [↑](#footnote-ref-56)
56. The estimated revenue loss from the full integration proposal was an amount equal to about 5% of federal tax revenue. See J. Bossons, “The Effect of Tax Rates on the Impact of Tax Reform”, *Report of the 22nd Tax Conference,* Canadian Tax Foundation, Toronto, 1969. [↑](#footnote-ref-57)
57. Though in the longer run, there would be, in Carter ‘s words, a” rough balance” between imposing capital gains tax on shares and eliminating double taxation of corporations. They” must be appraised together, separately they would fall”. Carter, Canadian Tax Reform at p. 234 [↑](#footnote-ref-58)
58. Report, vol. 4, p. 93 [↑](#footnote-ref-59)
59. Described in Appendix J to vol. 4. The transition tax would have applied to any distribution, whether of income or capital, at a time when the corporation had undistributed income on hand accumulated in the 5 year period preceding the transition date, excluding amounts on which the 15% s. 105 tax had been paid. The distribution would then be taxed at full personal rates in the hands of the shareholder without access to the dividend tax credit. The impact of the tax could be reduced by allowing the corporation to exclude 50% of any distribution by paying the 25% s. 105 tax. The example in Appendix J for a taxpayer at the 50% marginal rate shows total tax increasing from 50% to over 65% (assuming the s. 105 tax was paid). [↑](#footnote-ref-60)
60. Report, vol. 4, Ch. 26 at p. 506-7 [↑](#footnote-ref-61)
61. This presumably reflected the Commission’s review (and rejection) of the U.S. Subpart F regime. [↑](#footnote-ref-62)
62. Technically, the dividend would be grossed up by 100/70 to reflect the 30% tax paid and an additional credit given for the 20% tax. [↑](#footnote-ref-63)
63. The omission is curious because the rules were not consistent with the scheme proposed by the Commission. Amendments in 1959 had barred the creation of any new qualifying corporations; this may explain the lack of attention. [↑](#footnote-ref-64)
64. To achieve perfect integration with varying provincial tax rates would require multiple gross-up and dividend tax credit rates. The modern Act deals with this by assuming an average provincial tax rate. [↑](#footnote-ref-65)
65. See Report, vol. 6, p. 195 [↑](#footnote-ref-66)
66. Report, vol. 1 , pp. 105-111 [↑](#footnote-ref-67)
67. Ibid, pp. 51-103 [↑](#footnote-ref-68)
68. In December 1960, the Minister of Finance had appointed a special committee, drawn from the Canadian Bar Association and the Canadian Institute of Chartered Accountants to examine certain aspects of corporate taxation. The group, informally referred to as the Committee of Four, provided a sharp contrast to the Commission, pursuing a limited mandate with little or no staff. One suspects it reflected Donald Fleming’s approach to tax reform. By late 1962, when the Commission was appointed, Fleming had been relegated to the Justice ministry and was nearing the end of his political career. [↑](#footnote-ref-69)
69. See Report, vol. 4, at pp. 37-44. [↑](#footnote-ref-70)
70. Beauvais also claimed the Commission’s recommendations would favour surplus stripping because “all the surplus … would be distributable tax free”. The comment was either disingenuous or simply wrong. [↑](#footnote-ref-71)
71. R.B. Bryce, “Implementing the Report: Processes and Issues”, in W. Neil Brooks, ed., *The Quest for Tax Reform. op. ci.t fn. 29,*, pp. 37-42 at p. 38 [↑](#footnote-ref-72)
72. The Conservative government headed by John Diefenbaker was defeated in the April 8, 1963, election and a Liberal administration, headed by Lester Pearson, came to power, though without a parliamentary majority. An election in November 1965 produced another Liberal minority government. In its wake, Walter Gordon was replaced as Finance minister by Mitchell Sharp. [↑](#footnote-ref-73)
73. Mitchell Sharp, *Which Reminds Me … A Memoir,* Toronto: University Press, 1994 at p. 133 [↑](#footnote-ref-74)
74. Cabinet Conclusions, July 7, 1966, vol. 6321. The sheer volume of the Report was a significant factor. The legal publisher, CCH Canadian commissioned and published in 1967 a series of short books on different aspects of the Report, for example W.L. Wallace, *The Corporation and its Shareholders under the Carter Report* and J.K. Ralph, *Implications of the Carter Report for the Small Businessman,* apparently in response to demand for easier access to its recommendations. [↑](#footnote-ref-75)
75. Ibid, February 9, 1967, vol. 6323 [↑](#footnote-ref-76)
76. Ibid, February 24, 1967, vol. 6323 [↑](#footnote-ref-77)
77. Sharp, p.133. In the House, Sharp stated that the government intended to study the Report” for the next few months” before reaching any conclusions. Debates, February 24, 1967, p. 13479. [↑](#footnote-ref-78)
78. R.B. Bryce, “Implementing the Report: Processes and Issues”, in W. Neil Brooks, ed., *The Quest for Tax Reform. The Royal Commission on Taxation Twenty Years Later,* Toronto: Carswell, 1988, pp. 37-42 at p. 38 [↑](#footnote-ref-79)
79. Debates, June 1, 1967, p. 858 [↑](#footnote-ref-80)
80. Cabinet Conclusions, June 6, 1967, vol. 6323 [↑](#footnote-ref-81)
81. Ibid, September 21, 1967, vol. 6323 [↑](#footnote-ref-82)
82. Ibid, October 10, 1967, vol. 6323 [↑](#footnote-ref-83)
83. Ibid November 9, 1967, vol. 6323 [↑](#footnote-ref-84)
84. Debates, November30, 1967 , p. 4908 [↑](#footnote-ref-85)
85. Ibid, January 4, 1968, vol. 6338. Sharp confirmed this in the House on January 23, 1968. See Debates at p. 5837. [↑](#footnote-ref-86)
86. Debates, October 22, 1968, p. 1684-5 [↑](#footnote-ref-87)
87. Ibid, July 30, 1969, vol. 6340 [↑](#footnote-ref-88)
88. See ibid,. September 23, 1969, vol. 6340 [↑](#footnote-ref-89)
89. E.J. Benson (Minister of Finance), *Proposals for Tax Reform,* Ottawa: Queen’s Printer, 1969. [↑](#footnote-ref-90)
90. Bird and Bucovetsky described it as a “watered-down version” of the Report, supra at p 15. The proposals in the Report which were definitively rejected from the beginning – bringing gifts and inheritances into income and treating the family rather than the individual as the tax unit – may have been seen as the most troubling politically. [↑](#footnote-ref-91)
91. White Paper, paras. 2.39,2.40 [↑](#footnote-ref-92)
92. To be phased out over a period of 5 years. [↑](#footnote-ref-93)
93. The corporation could have only a single class of shares, all shareholders, individual or corporate, must be resident in Canada and corporate shareholders must share the same taxation year end as the electing corporation. [↑](#footnote-ref-94)
94. To avoid unpredictable effects on government revenue from the claiming of dividend tax credits, it adopted the Commission proposal that a dividend be paid within 30 months of the end of the taxation year in which the income was earned. [↑](#footnote-ref-95)
95. The gross up was to be based on tax actually paid; the White Paper did not specify the method for accomplishing this and did not refer to the” top-up” tax proposed by the Commission. As Brooks has pointed out, this” washed out” for the shareholder any tax incentive received by the corporation and potentially placed the shareholder in a worse position than that of a member of a partnership carrying on the same activity. See N Brooks,” Taxation of Closely-held Corporations: The Partnership Option and the Lower Rate of Tax”, in *Australia Tax Forum,* 4:3 (1986), pp. 381-509 at p. 433. [↑](#footnote-ref-96)
96. So that $100 of income earned in a widely-held corporation would, in the hands of an individual shareholder subject to the maximum persona rate, be subject to $62.50 in total tax, compared to $50 in the case of a closely-held corporation. Dividends in widely-help corporations would also have to be paid within 30 months. [↑](#footnote-ref-97)
97. The proposal also had the effect of equalizing the treatment of capital gains and dividends in the hands of high income taxpayers. For lower income taxpayers there was a bias in favour of dividend income which “probably coincides with their natural inclination to buy into well-established Canadian corporations.” See para. 4.41. Bird and Bucovetsky believed that this was the most significant divergence by the White Paper from the Report. See supra, note 11 at p. 19 [↑](#footnote-ref-98)
98. Surplus Stripping, at pp. 3-4 [↑](#footnote-ref-99)
99. Pubco 1 pays a $100 dividend to Pubco 2. Pubco 2 grosses it up to $150, pays tax at 33 1/3% or $50 and deducts the credit of $50. [↑](#footnote-ref-100)
100. See paras. 6.20 and 6.21 [↑](#footnote-ref-101)
101. Implementation was to be delayed until 1974 to allow for expansion of the treaty network. [↑](#footnote-ref-102)
102. White Paper, p. 80 [↑](#footnote-ref-103)
103. Ibid, p. 82 [↑](#footnote-ref-104)
104. Under the existing “tax on tax” system, federal tax was calculated, taking into account all credits and the province imposed its tax expressed as a percentage of the federal tax. Federal personal tax rates had been progressively reduced since 1947 to accommodate provincial tax. The ongoing proposal to move to a “tax on income” system did not come to fruition until much later and the 1971 tax reform proceeded on the basis of the tax on tax system. [↑](#footnote-ref-105)
105. See Ronald Robertson, “The House of Commons Committee and the Aftermath of the Royal Commission on Taxation”, in Brooks, *The Quest for Tax Reform, pp. 43-51* [↑](#footnote-ref-106)
106. *White Paper on Tax Reform,* Toronto: CCH Canadian Limited, 1970, summarizes 150 of the briefs heard by the Committee. Of 55 briefs addressing the proposed removal of the low rate for small businesses, only one (that of the Canadian Labour Congress) unreservedly expressed support. Most rejected it out of hand. [↑](#footnote-ref-107)
107. Briefs addressing integration were considerably fewer and ranged from outright opposition to lukewarm approval. The majority addressed the treatment of widely-held corporations, likely because of the less-favourable treatment proposed for them. [↑](#footnote-ref-108)
108. The Standing Senate Committee on Banking, Trade and Commerce, Report on the White Paper for Tax Reform, Ottawa: Queen’s Printer, 1970 [↑](#footnote-ref-109)
109. Bryce, at p. 39 [↑](#footnote-ref-110)
110. Cabinet Conclusions, June 11, 1970, vol. 6359 [↑](#footnote-ref-111)
111. Ibid, July 9, 1970, vol. 6359 [↑](#footnote-ref-112)
112. John Turner, the Minister of Justice, argued that Liberal members of the committee would require guidance on “all aspects” of the plan. The Prime Minister apparently resiled from his earlier position, stating that there was an “immediate need” to give guidance to Liberal members of the Committee. [↑](#footnote-ref-113)
113. Cabinet Conclusions, July 31, 1970, vol. 6359 [↑](#footnote-ref-114)
114. The Standing Senate Committee on Banking, Trade and Commerce, Report on the White Paper for Tax Reform, Ottawa: Queen’s Printer, 1970 [↑](#footnote-ref-115)
115. Cabinet Conclusions, March 18, 1971, vol. 6359 [↑](#footnote-ref-116)
116. Some tax reduction was needed to fulfil the promise that the overall effect of tax reform would be revenue neutral. See Cabinet Conclusions, May 11, 13 and 18, 1971, vol. 6381 [↑](#footnote-ref-117)
117. The “Raspberry Paper”, which described the provisions of the bill, described the corporate proposals as a “withholding regime”, perhaps to avoid the term” integration”, which had been the target of so much criticism. [↑](#footnote-ref-118)
118. Technically, the corporation was subject to the higher normal rate of tax but entitled to a tax credit which reduced the effective rate. Other corporations paid the normal rate on all income. [↑](#footnote-ref-119)
119. And at a 40% marginal rate for an individual shareholder. [↑](#footnote-ref-120)
120. Supra, at p. 33 [↑](#footnote-ref-121)
121. Where the income was a portfolio dividend from a Canadian corporation (not controlled by the recipient) corporation,) there was a separate refundable tax of [33 1/3%]. [↑](#footnote-ref-122)
122. An additional refundable tax was placed on portfolio dividends to prevent deferral and to prevent the use of otherwise tax-free intercorporate dividends to avoid the refundable tax. [↑](#footnote-ref-123)
123. The tax on ineligible investments was repealed in 1973 before having any effect as too complex and unworkable. [↑](#footnote-ref-124)
124. While some critics noted the apparent benefit to shareholders of full integration, there was a generalized suspicion of base broadening, on the fear that tax rates would be initially lowered but subsequently raised, but now on a broader base. [↑](#footnote-ref-125)
125. Sharp, at p. 134 [↑](#footnote-ref-126)
126. Ronald Robertson, “The House of Commons Committee and the Aftermath of the Royal Commission on Taxation”, in Brooks, *The Quest for Tax Reform,* supra, pp. 43-51 at p. 44 [↑](#footnote-ref-127)
127. The Ives Commission and the McDougall Commission. See Campbell and Raizenne, *History,* pp. 278-298. [↑](#footnote-ref-128)
128. Bryce, p. 42 [↑](#footnote-ref-129)
129. For example, the gross up mechanism for the dividend tax credit and many of the technical rules for capital gains taxation. [↑](#footnote-ref-130)
130. See, for example, Neil Brooks, *The Quest for Tax Reform, supra, fn.29;* Kim Brooks, (ed.), *The Quest for Tax Reform Continues: The Royal Commission Fifty Years Later,* Toronto: Carswell, 2013. Papers specifically addressing the corporate income tax include Kirk A. Collins and Tim Edgar, “The Carter Report’s Corporate Income Tax Proposals: Why They Were Rejected and an Assessment of the Current Canadian System as an Imperfect Alternative”, in Kim Brooks, ed., The Quest for Tax Reform Continues, pp. 115-53 and Jack M. Mintz, “Alternative Views of the Corporate Tax: A Reassessment of the Carter Report”, in Neil Brooks, ed., The Quest for Tax Reform, pp. 213-38. [↑](#footnote-ref-131)
131. It is not without significance that the Canadian government refused to have the Report printed – it was copied in typescript and bound in insubstantial paper covers. [↑](#footnote-ref-132)