Is Income Tax Supposed to Be Fair?

A Rejoinder to the Rejoinder and the Rejoinder's Rejoinder

[A comment (January 26, 2014) on the Open Forum Blog of the Canadian Tax Foundation on "Is Income Tax Supposed to be "Fair"? A Rejoinder" by Mr. H. Michael Dolson (November 13, 2013), available online at http://www.ctf.ca/CTFWEB/EN/Newsletters/The_Open_Forum_Blog/2013_Blogs/A_Rejoinder.aspx *]*

I read both the original post (11/08/2013) and the rejoinder (as well as the comments to both) with great interest. As Mr Jolie has identified some of the logical weaknesses in Mr. Dolson's rejoinder (acontextual reliance on Locke, example of strictly intended tax deduction – though not the mythical versions of society, whether in the state of nature or with stone-age mammoth hunters), I will attempt to add only to the question of morality and the law in taxation.

The moral content of law and the legal content of morality has been an area of intense debate. The two pillars of the debate are Lon L. Fuller (see "Positivism and Fidelity to Law - A reply to Professor Hart" (1958) 71 Harv L Rev 630) and H.L.A. Hart (see "Positivism and the Separation of Law and Morals" (1958) 71 Harv L Rev 593). The debate is ongoing and I will not venture into it as part of a Blog Comment.

However, I do believe that the common ground that exists between Hart and Fuller may be informative. Both agree that law and morality exist, though they disagree as to the state-action results of the breach or adherence to them. The same goes for our debate - both sides agree that morality and law both have roles to play - but in unlike Hart and Fuller there is no disagreement about the state-action results. Both agree that the state ought to do nothing where morality is breached, but they disagree about whether the person ought to feel guilty when an unintended benefit is conferred though the application of laws. It is in this difference between the legal effect of morality that I think the debate at hand is most fruitful. I will come back to this near the end of my comment.

If I may venture to surmise – and I do this at the peril of being wholly wrong – Messers. Jolie and Dolson appear to differ on only the propriety of a personal feeling of guilt. They both appear to agree (or at least do not disagree) that income (I assume pre-tax market income) is property, that tax laws are rule, that income taxation is confiscation of that property, that this confiscation is only property when done through democratically enacted laws, (as said above) that outside the law the state ought to take no action when morality is breached, and in their assignment and timing of a person's entitlement to market income. I too agree with all of the preceding points, save two: (1) that tax laws are rules; and (2) the assignment and timing of a person's entitlement to market income.

(1) that tax laws are rules

Tax laws, as we as tax professionals are aware, are made up of a series of guidelines that set

out the tax base, tax unit, tax rates, tax period, etc – the technical tax provisions that give shape to the area under taxation. Some of these guidelines are rules, while others are (as in many other areas of law) standards. Standards are intentionally nebulous guidelines that are meant to cover an area whose bounds are not known in advance, depend on changing circumstances, and are responsive to context. A common standard is the concept of "standard of care" in negligence torts – the aim of the standard is always clear but the content is responsive.

In the income tax arena, a number of guidelines are standards. This is evinced by the existence and wording of the GAAR. As this is a discussion as to what ought to be and not what it, I will allow myself to venture outside of court decisions (as decisions though binding for the time being can be ultimately wrong). Where tax guidelines are concepts, the correct outcome is not the one obtained by narrow application of the words, but one that is achieved through a broad and liberal interpretation that achieves the intended outcome. For example, the children's arts and fitness tax credits aims to give all persons who meet the pre-requisites a credit – it is a rule whose bounds are defined. However, let us assume (as I believe) that the Capital Dividend Account concept is a standard (not a rule) whose aim is to allow the tax free return to an individual investor of an amount equal to the tax free portion of any capital gains realised though a corporation. In applying this standard, any planning that results in more than the tax free portion of any capital gain realised being returned tax free contravenes the standard and would be wrong in law. This view of the matter takes the discussion beyond guilt to illegality. Morality's interaction with the law becomes the requirement to apply standards in good faith to achieve the intended outcome – making spurious strict interpretation and application of standards both wrong and illegal. Though we may disagree as to which tax guidelines are standards and which are rules, I believe the above analysis to be acceptable by all.

(2) The assignment and timing of a person's entitlement to market income

On my reading of the posts, the authors agree that a person's property entitlement is pre-tax market income, and that taxation is a taking of that income that must be otherwise justified. Though I agree that tax law, like all law, must be valid before it is applied, I disagree as to the relation of this justification to entitlement of Income. Mr. Dolson, in his able argument casually dismissed a vital element. He states that "notwithstanding that property rights are secured through the government, property cannot be seized from citizens […] without their consent [being though taking to] the extent authorised by a democratically elected legislature". It is the "notwithstanding" that I take issue with. I doubt that many would argue that a person's entitlement to anything (under the rule of law) arises until the application to that "thing" of all relevant laws. For example, a person's entitlement to real property in Canada is determined through the combined application of a variety of property granting laws, property dispersing laws, and property limiting laws. Though human emotion may mislead us, the reality is that a real property right is not violated by the application of expropriation statutes – a person's entitlement arises only after the consideration of all the statutes that define the bounds of a person's right.

The same goes for "income" as property. Pre-tax market income arises from the application of only some of the laws that delineate the bounds of a person's right – the property, contract, securities, corporate, etc rights created, granted, and enforced by government. There are a

whole set of other laws – tax laws for example – that also delineate the bounds of that person's right. No one can claim an entitlement until all relevant laws have been applied to the matter at hand, and therefore a person can only claim a right in, and therefore accuse the government of taking, after-tax income.

It is the combination of the two arguments above – the legal effect of standards and the entitlement only to after-tax income – that I believe informs the morality-legality debate of aggressive tax planning resulting in unintended benefits (I narrow the context to be in line with the other authors). If we accept that morality requires a good faith interpretation of standards, then where standards are used to tax plan in a manner that frustrates the aim of the standards, the action is immoral and illegal. I acknowledge that the area for debate as to what in the income tax law is a standard and what is a rule, and what the aim of the standards are, but this openness to debate doesn't counter the conclusion as to the legal and moral effect of standards in relation to tax planning.

[A great deal that could be expanded on was left for future argument, and foreseeable rejoinders have been left unanswered, due to nature of this encounter – the blogosphere]

Back To Top OR Home